| Ameren Illinois Company               | : |       |                           |                           |
| d/b/a Ameren Illinois                | : |       |                           |                           |
| Proposed general increase in natural gas | : |       |                           |                           |
| rates.                               | : |       |                           |                           |
| (tariffs filed February 18, 2011)    | : |       |                           |                           |

ORDER
DATED: January 10, 2012
# TABLE OF CONTENTS

I. PROCEDURAL BACKGROUND 1
II. NATURE OF AIC’S OPERATIONS 5
III. AIC’S PROPOSED TEST YEAR AND REVENUES 5
IV. RATE BASE 6
   A. Resolved Issues 6
      1. Federal Income Tax ADIT Correction 6
      2. State Income Tax ADIT - Bonus Depreciation 7
      3. ADIT - Manufactured Gas 7
      4. Budget Payment Plans 7
      5. Gas in Storage 7
      6. Merger Costs 8
      7. Previously Disallowed Incentive Compensation 8
   B. Contested Issues 8
      1. Capital Additions Adjustment 8
         a. Staff Position 8
         b. AIC Position 10
         c. IBEW Position 12
         d. Commission Conclusion 13
      2. Cash Working Capital 13
      3. Accrued OPEB Liability 14
         a. AIC Position 14
         b. Staff Position 16
         c. GCI Position 17
         d. Commission Conclusion 18
      4. Accumulated Provision for Injuries and Damages 19
         a. Staff Position 19
         b. AIC Position 20
         c. Commission Conclusion 22
      5. PSUP Awards 22
   V. OPERATING REVENUES AND EXPENSES 22
      A. Resolved Issues 22
         1. Investment Tax Credits 22
         2. Lobbying Costs 23
         3. Athletic Events Expense 23
         4. Company Use of Fuels 23
      B. Contested Issues 23
         1. Uncollectibles Expense 23
            a. Staff Position 23
            b. AIC Position 24
            c. Commission Conclusion 25
2. Charitable Contributions 26
   a. AIC Position 26
   b. Staff Position 27
   c. IIEC Position 28
   d. GCI Position 29
   e. Commission Conclusion 30
3. Injuries and Damages Expenses 31
   a. AIC Position 31
   b. Staff Position 32
   c. IIEC Position 33
   d. Commission Conclusion 33
4. Merger Costs 33
   a. AIC Position 33
   b. GCI Position 34
   c. Commission Conclusion 34
5. State Income Tax Expense - Regulatory Asset 35
   a. AIC Position 35
   b. Staff Position 35
   c. GCI Position 37
   d. IIEC Position 38
   e. Commission Conclusion 38
6. PSUP Awards 39
   a. AIC Position 39
   b. Staff Position 41
   c. GCI Position 43
   d. Commission Conclusion 43
7. Rate Case Expense 43

VI. COST OF CAPITAL/RATE OF RETURN 46
 A. Overview 46
 B. Resolved Issues and Immaterial Differences 47
 C. Common Equity Balance 47
    1. AIC Position 47
    2. Staff Position 51
    3. Commission Conclusion 53
 D. Cost of Short-Term Debt 54
    1. AIC Position 54
    2. Staff Position 55
    3. Commission Conclusion 55
 E. Credit Facility Commitment Fees 56
    1. AIC Position 56
    2. Staff Position 60
    3. Commission Conclusion 63
 F. Cost of Long-Term Debt 64
1. AIC Position  64
2. Staff Position       69
3. Commission Conclusion  75

G. Cost of Common Equity    77
1. AIC Position    77
   a. DCF       78
   b. CAPM       83
   c. Other ROE Models  85
   d. ROE Adjustments   86
   e. Flotation Costs  89
2. Staff Position        90
   a. DCF        91
   b. CAPM       95
   c. Adjustments to Calculated ROE  99
   d. Flotation Costs 103
3. IIEC Position 103
   a. DCF    106
   b. CAPM   110
   c. Other Models   112
   d. Adjustments to ROE       112
   e. Flotation Costs 112
4. GCI Position 113
   a. DCF     116
   b. CAPM    117
   c. Other Models    118
   d. Flotation Costs 118
5. IBEW Position 119
   a. DCF     119
   b. Adjustments to ROE      120
6. Commission Conclusion  120
   a. DCF     121
   b. CAPM    123
   c. Other    125
   d. Adjustments to ROE     125
   e. Flotation Costs 126
   f. Approved ROE 126

H. Authorized Rate of Return on Rate Base 128

VII. COST OF SERVICE       128
A. Resolved Issue - Allocation of Rider TBS Costs to Gas Customer Classes 129
B. Contested Issues       129
   1. Use of AIC’s Gas COSS 129
   a. AIC Position 130
   b. Staff Position 131
c. Kroger Position 133
d. IIEC Position 134
e. Commission Conclusion 134

VIII. REVENUE ALLOCATION 135

IX. RATE DESIGN 135
A. Resolved Issues 135
   1. Billing Units 135
   2. Increase for Charges (except GDS-1 and GDS-5) 135
   3. Single PGA/Rider PGA 136
   4. Conformity of GDS-2 Customer Charge - 600 Therms 138
   5. Conformity of GDS-4 Demand Charge - MDCQ 138
B. Contested Issues 139
   1. GDS-1 Customer Charge 139
      a. AIC Position 139
      b. GCI Position 141
      c. Commission Conclusion 144
   2. GDS-5 - Expansion of Rate Class Availability 144
      a. AIC Position 144
      b. GFA Position 146
      c. Staff Position 149
      d. Commission Conclusion 150

X. PROPOSED RIDERS/TARIFF CHANGES 152
A. Resolved Issues 152
   1. Pension Benefits Rider 152
   2. Uncollectibles Rider 152
B. Contested Issues 153
   1. Rider TBS - Transportation Banking Service 153
      a. AIC Position 153
      b. Staff Position 162
      c. IIEC Position 172
      d. Commission Conclusion 175
   2. Rider T – Cashout Provisions 176
      a. AIC Position 176
      b. Staff Position 180
      c. IIEC Position 183
      d. Commission Conclusion 184

XI. PROPOSED SMALL VOLUME TRANSPORTATION PROGRAM 185
A. AIC Position 185
B. Staff Position 187
C. CUB Position 188
D. RGS Position 189
E. ICEA Position 192
F. Commission Conclusion 193
XII. OTHER 195
A. Rate Zone Schedules in Future Rate Filings 195
B. Original Cost Determination 195
C. Depreciation Rate Study 196

XIII. FINDINGS AND ORDERING PARGRAPHS 197
STATE OF ILLINOIS

ILLENOIS COMMERCE COMMISSION

Ameren Illinois Company | d/b/a Ameren Illinois | Proposed general increase in natural gas | (tariffs filed February 18, 2011)
| | | | 11-0282

ORDER

By the Commission:

I. PROCEDURAL BACKGROUND

On February 18, 2011, Ameren Illinois Company d/b/a Ameren Illinois ("AIC") filed with the Illinois Commerce Commission ("Commission") new and/or revised tariff sheets for electric and gas service. AIC is a combination electric and gas public utility providing residential, commercial, and industrial electric and gas service throughout central and southern Illinois. AIC was formed on October 1, 2010 when Central Illinois Light Company d/b/a AmerenCILCO ("AmerenCILCO") and Illinois Power Company d/b/a AmerenIP ("AmerenIP") merged into Central Illinois Public Service Company d/b/a AmerenCIPS ("AmerenCIPS"). Concurrent with the merger, the newly formed company changed its name to "Ameren Illinois Company." AIC is a wholly owned subsidiary of Ameren Corporation ("Ameren"). The new and revised tariff sheets ("Proposed Tariffs") proposed changes in electric and gas rates and terms of service, to be effective April 4, 2011. On March 23, 2011, the Commission entered two Suspension Orders, one pertaining to the proposed electric tariffs and the other pertaining to the proposed gas tariffs. The Suspension Orders suspended the Proposed Tariffs to and including July 17, 2011 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 AIC. Upon suspension, AIC’s electric filing became identified as Docket No. 11-0279 and its gas filing became identified as Docket No. 11-0282. On July 7, 2011, the Commission entered Resuspension Orders renewing the suspension of the Proposed Tariffs to and including January 17, 2012.

AIC 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, AIC sent notice of the filing to its customers in bill inserts.
On February 23, 2011, the Administrative Law Judges sent AIC initial lists of 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"). These first deficiency letters concerned AIC’s failure to submit separate cost of service studies ("COSS") and associated schedules for each type of service for each of the three legacy utilities. On March 23, 2011, the Administrative Law Judges sent AIC a second pair of deficiency letters requiring it to submit various other missing information and provide explanations of certain portions of the rate filings. AIC responded to the first deficiency letters on March 24, 2011, when it submitted COSS information for Rate Zone 1 (which corresponds with the former AmerenCIPS), Rate Zone 2 (AmerenCILCO), and Rate 3 (AmerenIP). AIC provided information in response to the second pair of deficiency letters on April 21, 2011.


On August 30, 2011, the Commission hosted a sparsely attended public forum in Springfield for the purpose of receiving public comment on the general increase in electric and gas rates proposed by AIC. Only one public forum was held at the Commission’s Springfield office for budgetary reasons. A transcript of the public forum is available on the Commission’s e-Docket system.

The Administrative Law Judges consolidated Docket Nos. 11-0279 and 11-0282 on April 8, 2011. 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 April 18 and September 7, 2011. Thereafter, evidentiary hearings were held September 12 through September 16, 2011. Appearances were entered by counsel on behalf of AIC, Staff, the AG, the Commercial Group, CUB, AARP, GFA, IIEC, Kroger, and RGS.
At the evidentiary hearings, AIC called 19 witnesses to testify. The 19 witnesses include (1) Karen Althoff, AIC’s Supervisor of Rates and Analysis, (2) Krista Bauer, Manager of Compensation and Talent Acquisition for Ameren Services Company (“AMS”),[1] (3) Timothy Eggers, a Managing Executive of Gas Supply for AIC, (4) Michael Getz, AIC’s Controller, (5) David Heintz, a Vice President of the consulting firm Concentric Energy Advisors, Inc. (“Concentric”), (6) Robert Hevert, President of Concentric, (7) Leonard Jones, AIC’s Manager of Rates and Analysis, (8) Randall Lynn, a consultant with the consulting firm Towers Perrin, (9) Ryan Martin, Assistant Treasurer and Manager of Corporate Finance for AMS, (10) James Mazurek, a Partner in Accenture LLP’s Management Consulting practice area, (11) Brenda Menke, Income Tax Manager for AMS, (12) Craig Nelson, AIC’s Senior Vice President of Regulatory Affairs and Financial Services, (13) Stan Ogden, AIC’s Vice President of Customer Service and Public Relations, (14) Ronald Pate, AIC’s Vice President of Operations, (15) Gary Rygh, a Managing Director at Barclays Capital, Inc., (16) Ryan Schonhoff, a Regulatory Consultant within AIC, (17) Vonda Seckler, a Managing Executive of Gas Supply for AIC, (18) Ronald Stafford, AIC’s Manager of Regulatory Accounting, and (19) James Warren, a tax attorney with the law firm of Winston & Strawn LLP.

Nineteen witnesses testified on behalf of Staff. The Staff witnesses include (1) Scott Struck, a Supervisor in the Accounting Department of the Financial Analysis Division of the Commission’s Bureau of Public Utilities, (2) Mary Everson, (3) Dianna Hathhorn, (4) Burma Jones, (5) Bonita Pearce, and (6) Scott Tolsdorf, Accountants in the Accounting Department, (7) Janis Freetly and (8) Rochelle Phipps, Senior Financial Analysts in the Finance Department of the Financial Analysis Division, (9) Peter Lazare, a Senior Rate Analyst in the Rates Department of the Financial Analysis Division, (10) Philip Rukosuev, a Rate Analyst in the Rates Department, (11) Roy Buxton, Manager of the Engineering Department of the Energy Division of the Bureau of Public Utilities, (12) Greg Rockrohr, a Senior Electrical Engineer in the Engineering Department, (13) Yassir Rashid, an Electrical Engineer in the Engineering Department, (14) Eric Lounsberry, Supervisor of the Gas Section in the Engineering Department, (15) Mark Maple, a Senior Gas Engineer in the Engineering Department, (16) David Rearden, a Senior Economic Analyst in the Policy Department of the Energy Division, (17) David Brightwell and (18) David Sackett, Economic Analysts in the Policy Department, and (19) Torsten Clausen, Director of the Office of Retail Market Development (“ORMD”).

IIIEC offered three witnesses at the evidentiary hearings. IIIEC’s witnesses include Michael Gorman, Robert Stephens, and David Stowe from the consulting firm Brubaker & Associates, Inc. David Effron, a consultant specializing in utility regulation, Scott Rubin, a consultant and attorney specializing in public utility regulation, and Christopher Thomas, CUB’s Director of Policy, testified on behalf of the AG and CUB. James Crist, President of Lumen Group, Inc., a consulting firm focused on regulatory and market issues, offered testimony on behalf of RGS. 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. The Commercial Group called Steve Chriss, Senior Manager of
Energy Regulatory Analysis for Wal-Mart Stores, Inc., to testify.

AIC, Staff, IIEC, RGS, the Commercial Group, Kroger, and GFA each filed an Initial Brief and Reply Brief. The AG, CUB, and AARP jointly filed an Initial Brief and Reply Brief. The AG, CUB, and AARP are collectively identified as the Government and Consumer Intervenors (“GCI”). CUB also independently filed a separate Initial Brief on the issue of implementing a retail gas choice program in the AIC service area. IBEW filed an Initial Brief, but no Reply Brief. ICEA filed an Initial Brief and a statement indicating that it joined in the Reply Brief of RGS.

A Proposed Order was served on the parties on November 15, 2011. AIC, Staff, IIEC, and RGS each filed a Brief on Exceptions and Brief in Reply to Exceptions. The AG, CUB, and AARP jointly filed a Brief on Exceptions while only the AG and CUB joined together to file a Brief in Reply to Exceptions. CUB also independently filed a Brief on Exceptions and Brief in Reply to Exceptions on the issue of implementing a retail gas choice program. IBEW filed a Brief on Exceptions as well. GFA, Kroger, and the Commercial Group each filed a Brief in Reply to Exceptions. ICEA submitted a filing indicating that it joined in and adopted RGS’ Brief in Reply to Exceptions. The Briefs on Exceptions and Briefs in Reply to Exceptions have been considered in the preparation of this Order.

On December 30, 2011, the Governor signed into law Public Act ("P.A.") 97-0646, which modifies and amends certain provisions of P.A. 97-0616. Among the statutory revisions made by the Public Acts is the addition of a new Section 16-108.5 to the Act. Subsection (c) of Section 16-108.5 provides that a participating utility may elect to recover its electric delivery services costs through a formula rate tariff. As amended by P.A. 97-0646, Section 16-108.5(c) provides that in the event a participating utility filed electric delivery service tariffs with the Commission pursuant to Section 9-201 of the Act that are related to the recovery of its electric delivery services costs, and such tariffs are still pending on the effective date of P.A. 97-0646, the participating utility shall, at the time it files its performance-based formula rate tariff with the Commission, also file a notice of withdrawal with the Commission to withdraw such previously-filed tariffs. Upon receipt of such notice, the Commission is required to dismiss with prejudice any docket that had been initiated to investigate the electric delivery service tariffs, and such tariffs and the record related thereto shall not be the subject of any further hearing, investigation, or proceeding of any kind related to rates for electric delivery services.

On January 3, 2012, AIC filed with the Commission, pursuant to Section 16-108.5(c), proposed tariffs for the recovery of electric delivery service costs through a formula rate tariff. Concurrent with this filing, AIC filed a notice of withdrawal in Docket No. 11-0279, withdrawing the electric delivery services tariffs previously filed in that docket pursuant to Section 9-201 of the Act. On January 4, 2012, the Administrative Law Judges issued a ruling severing Docket Nos. 11-0279 and 11-0282. On January 5, 2012, the Commission entered an Order in Docket No. 11-0279 dismissing the proceeding with prejudice as
required by Section 16-108.5(c).

II. NATURE OF AIC’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 AIC covers roughly the lower two-thirds of Illinois. AIC currently serves approximately 1.2 million electric customers and 840,000 natural gas customers. All of AIC’s operations are within Illinois, although an affiliate of AIC (Ameren Missouri Company ("AMC") f/k/a Union Electric Company d/b/a AmerenUE) provides utility service in Missouri. At one time, AMC’s AIC’s predecessor company served the St. Louis Metro East area in Illinois. That area has since been subsumed within the service area of Rate Zone 1. Other affiliates of AIC provide unregulated services.

III. AIC’S PROPOSED TEST YEAR AND REVENUES

AIC proposes to use a future test year consisting of the 12 months ending December 31, 2012. No party objects to the use of this test year. The Commission concludes that the future test year AIC proposes is acceptable for purposes of this proceeding.

The Proposed Tariffs reflect a total increase in delivery service revenues of approximately $50.7 million for all AIC natural gas customers. AIC presented its original proposed natural gas revenue changes based on the combination of the three Rate Zones. AIC’s original proposed change in the delivery service operating revenue is as follows:[2]

<table>
<thead>
<tr>
<th>Revenue Change</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Combined Rate Zones</td>
<td>$50,694,000</td>
</tr>
<tr>
<td>as reflected in Proposed Tariffs</td>
<td></td>
</tr>
</tbody>
</table>

AIC determined the originally requested revenue using a return on equity for natural gas operations of 11.00%.

Over the course of this proceeding, however, AIC lowered its total requested gas delivery service revenue increase to approximately $49.6 million. In response to deficiencies identified by the Administrative Law Judges, AIC also provided its proposed revenue changes by each Rate Zone. The pending proposed changes in the delivery service operating revenues for each Rate Zone are as follows:

<table>
<thead>
<tr>
<th>Revenue Change</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>
AIC determined the revised requested revenues using a return on equity for natural gas operations of 10.75%.

AIC’s most recent electric and natural gas delivery service rate cases considered by the Commission were consolidated Docket Nos. 09-0306 through 09-0311 (Cons.). The Commission entered the Order in that matter on April 29, 2010. Shortly thereafter the Commission corrected calculation errors and entered on May 6, 2010 a Corrected Order authorizing a total aggregate revenue increase for AIC of approximately $14,727,000; substantially less than the approximately $130,000,000 that AIC sought at the close of the December 2009 evidentiary hearing in that proceeding. On November 4, 2010, the Commission entered an Order on Rehearing authorizing an additional $29,162,000, for a final total aggregate revenue increase of $43,889,000.

IV. RATE BASE

A. Resolved Issues

During the course of this proceeding, witnesses recommended various adjustments to AIC’s rate base. But upon receiving additional information from AIC, those recommending adjustments sometimes withdrew their suggestions and indicated that they accepted AIC’s explanation. For purposes of judicial economy, the Commission does not discuss here instances where a dispute is resolved without any adjustment to the rate base AIC proposed in its direct testimony. Such issues may be found in the parties’ briefs. Where the resolution of a dispute or correction of an error, however, resulted in an adjustment to rate base, a list of such adjustments follows.

1. Federal Income Tax ADIT Correction

Staff witness Hathhorn proposes adjustments to decrease AIC’s gas federal accumulated deferred income tax ("ADIT") amounts, thereby increasing rate base, to correct the error of unreasonable amounts identified in Ameren Ex. 16.2, Schedule 1. AIC explains that its ADIT schedules contain an error related to an incorrect sign on the deferred tax asset related to federal net operating loss, and correction of this error results in a net change to property related to ADIT. AIC accepts Staff’s adjustments and includes them in its rebuttal revenue requirements. The Commission finds the correction of this error appropriate and adopts it.
2. State Income Tax ADIT - Bonus Depreciation

Staff witness Hathhorn proposes adjustments to increase AIC’s gas state ADIT amounts, thereby decreasing rate base, because AIC’s proposed amounts did not reflect the effect of federal bonus depreciation on the state ADIT liability and were therefore unreasonable. AIC’s position was based on Illinois’ past practice of decoupling from federal tax provisions for bonus depreciation. AIC states in discovery, however, that the State of Illinois has not passed legislation to follow its past treatment of decoupling from the federal tax provisions of bonus depreciation. AIC accepts Staff’s adjustments and includes them in its rebuttal revenue requirements. AIC further states that the AG/CUB proposed adjustment for ADIT-Bonus Depreciation is very similar to Staff’s adjustment that it accepts. The Commission finds that the two adjustments proposed by Staff and the AG/CUB are nearly the same and will adopt Staff’s adjustment.

3. ADIT - Manufactured Gas

AG/CUB propose an adjustment to AIC’s gas rate base to eliminate the deferred tax debit balance related to “Manufactured Gas & Other Environmental Cleanup” in the total balance of ADIT. AIC accepts the adjustments proposed by AG/CUB for amortization of Investment Tax Credits and for ADIT-MGP. The Commission finds the adjustment reasonable and adopts it.

4. Budget Payment Plans

Staff witness Tolsdorf proposes an adjustment to reduce rate base by the average over-collection associated with the budget payment plan. According to AIC’s calculations, it has over-collected from customers on average from 2007 through 2010. Based on its own forecasts, AIC will over-collect from its customers during the test year as well. This over-collection represents a rate-payer funded source of capital and, as such, should be a reduction to rate base. AIC accepts Staff’s adjustment in its rebuttal testimony. The Commission finds the adjustment reasonable and adopts it.

5. Gas in Storage

Staff witness Maple proposes an adjustment to the amount of working capital for gas in storage to reflect current market prices. AIC’s originally projected working capital allowance for gas in storage for the test year was based on pricing information from June 2010. AIC provided updates to its requested working capital allowance for gas in storage based on more recent May 2011 pricing data for the test year. Staff’s adjustment related to gas pricing is based on May 2011 pricing information as well. On rebuttal, Staff also agreed
to use AIC’s original proposed volumes of gas in storage as stated in AIC’s Schedule F-9. The Commission finds the adjustment reasonable and adopts it.

6. Merger Costs

Staff witness Pearce proposed to reduce merger costs to remove the capital costs of the merger as identified in the Merger Integration and Process Optimization (“MIPO”) study from the test year revenue requirement. On rebuttal, AIC made a reduction to labor costs to correct for double counting of the amount of labor capitalized. AIC then adjusted the amount of capital investment related to the merger included in test year rate base related revenue requirements. Following these corrections, Ms. Pearce withdrew her adjustment to merger costs. The Commission finds the correction of the error appropriate and adopts it.

7. Previously Disallowed Incentive Compensation

Staff proposes to reduce rate base for capitalized incentive compensation amounts that had been previously disallowed by the Commission, as detailed on Staff Ex. 3.0, Schedule 3.05. AIC accepts Staff’s adjustment in rebuttal testimony. The Commission finds the adjustments reasonable and adopts them.

B. Contested Issues

1. Capital Additions Adjustment

a. Staff Position

Staff witness Rashid recommends that the Commission disallow $1,833,738 from AIC’s proposed rate base, which is the cost of 3 capital projects that support gas delivery service that AIC will not implement by the end of the test year, because these projects will not be used and useful by the end of test year as required by Sections 9-211 and 9-212 of the Act. Section 9-211 provides in full:

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.

Section 9-212 provides in pertinent part:

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. No generation or production facility shall be found used and useful until and unless it is capable of generation or production at significant operating levels on a consistent and sustainable basis.

In response to Staff’s proposed adjustment, AIC introduced Ameren Ex. 26.1, which included a list of 16 projects, the costs for 3 of which AIC initially included in its proposed gas rate base, but later decided to defer or cancel. The combined cost of these 3 projects included in its proposed gas rate base is $1,833,738. Ameren Ex. 26.1 also includes a list of 13 projects that AIC labeled as “projects not included in rate base added in 2011-2012.” Of these 13 projects, 4 projects will support gas delivery service. The combined cost for these 4 projects is $5,719,364. Staff understands that AIC did not update its schedules to reflect these changes because it did not identify any changes to the forecast “significantly and materially” affecting the revenue requirement. Although AIC did not propose adjustments to include these 4 projects in its rate base, AIC argues that the Commission should allow it to use the money it originally allotted to implement the delayed and cancelled projects for the implementation of the new projects that it identified in response to Mr. Rashid’s discovery of those delayed and cancelled projects. Staff insists that the Commission should not allow AIC to make these substitutions. According to Staff, it is AIC’s responsibility to provide the Commission with an accurate forecast of test year capital projects expense that may be reviewed to determine whether they are prudent and used and useful. Because AIC’s forecast for test year capital additions was not accurate, Staff urges the Commission to disallow $1,833,738 from AIC’s proposed rate base.

Contrary to AIC’s argument (See AIC Initial Brief at 14-15), Staff states that the used and useful inquiry does not raise an implication that utilities must provide a list of every capital addition planned for a future test year. Part 285 does not require a utility to list every single capital project it plans to implement between the rate case filing and the end of a future test year. Staff notes, however, that this does not preclude an investigation of the projects, included in the forecast, beyond those required to be disclosed under Part 285 if, during discovery, Staff determines that it is necessary. In this proceeding, Staff reviewed projects not included in AIC’s Schedule F-4.

Staff disagrees with AIC’s suggestion that the deferment or cancellation of certain projects should not affect rate base if a utility identifies additional projects of equal or greater cost that it states it will complete within a future test year. Staff maintains that the proper focus is not the overall forecast. Moreover, Staff finds misplaced AIC’s reliance on Schedules G-1 and G-8 as the basis for the Commission to consider the new projects as part of its overall forecast. Schedule G-1 compares forecast period data to actual data to demonstrate the reliability and accuracy of the utility’s forecast for each of the prior three years. Schedule G-8 provides a comparison by plant function of the original budget of capital additions and retirements to actual capital additions and retirements for each of the most recent three years. Although the purpose of these schedules is to provide some
historical context for the forecast, Staff insists that they do not provide support for allowing new projects to be substituted for the projects relied upon in the forecast. Staff avers that Schedules G-1 and G-8 do not compare the difference between capital projects that AIC wholly eliminated and a set of new projects that it intends to replace them with, but rather it presents a comparison between what the utility has budgeted in the past and the extent to which it has followed that budget. Staff insists that historical Schedules G-1 and G-8 are not relevant to and do not support using new projects to support the capital additions forecast. If AIC’s position is adopted, Staff observes that in rate cases with future test years, a utility could provide its forecast for capital additions with an overall capital spending level, which would remove the statutorily required “used and useful” analysis from the capital additions component of rate base.

Staff maintains that it is important that the Commission adopt its recommendation, not just for this AIC proceeding, but for all future rate cases where utilities decide to use a future test year. If the Commission accepts AIC’s last minute substitution of new, previously unidentified capital projects in place of the projects identified in the forecast, Staff fears that any used and useful analysis will become irrelevant. Staff states further that adoption of the “overall level of forecasted plant additions” would enable utilities with future test years to make whatever substitutions necessary to justify the level of their forecasted rate base additions in response to Staff’s proposed adjustments. Staff fears that the Commission would then lose its ability to hold the utilities to any meaningful rate base forecasting standards.

b. AIC Position

In response to Staff’s proposed adjustment, AIC argues that Staff’s adjustment exhibits a fundamental misunderstanding of ratemaking in a future test year. AIC states that a future test year, by definition, requires an evaluation of forecasted plant additions scheduled to be placed in service in the future. In any given year (whether a rate case is pending or not), AIC relates that projects budgeted for that year may not be completed. On the other hand, AIC continues, projects that were not budgeted may also need to be completed. Thus, in a future test year, AIC contends that the plant in service component of rate base is determined by examining the overall level of forecasted plant additions. AIC maintains that this is done not by looking at individual projects, but by examining the accuracy and reliability of the utility’s rate case forecast, measured in large part by looking at historical budget-to-actual information.

AIC contends that there are two problems with Staff’s argument that any project not completed during the test year does not meet the “used and useful” standard and therefore cannot be recovered in rates. First, AIC argues that Staff does not observe the standard it claims AIC should be held to. Noting Mr. Rashid’s claim that it is AIC’s duty to provide an accurate forecast of test year capital projects expense that may be reviewed to determine
whether they are prudent and used and useful, AIC asserts that this implies that utilities must provide a list of every capital addition planned for a future test year, with a corresponding duty on Staff to review this list and determine whether each project is or will be prudent and used and useful. But, AIC observes, Mr. Rashid agrees that the rules for future test years do not require utilities to list every single capital project they plan between the rate filing and the end of the test year. To the contrary, the instructions for Schedule F-4 require utilities to provide information only for certain major capital projects above a certain dollar threshold. (See Part 285.6100) If, as AIC understands Mr. Rashid to be saying, Staff has a duty to review all capital additions to ensure that they will be used and useful during the test year, AIC points out that that duty was not observed here. The second problem that AIC raises with regard to Staff’s position is that Staff ignores the overall capital additions forecast by AIC and the reliability of that forecast. In future test year cases, AIC asserts that determining the appropriate level of capital additions to be included in rate base must necessarily focus on the utility’s forecast. AIC argues that the overall level of forecasted capital expenditures is what counts, not whether individual projects are or are not completed during the test year.

AIC also takes issue with the distinction that Staff draws between actual operations and the review conducted in a rate case. AIC understands Staff to argue that a utility should not be allowed to respond to adjustments to its capital projects expense by expanding its list of test year capital projects. According to AIC, this is another way of suggesting that once a utility locks down its forecast and files a rate case using a future test year, the ratemaking process should suspend disbelief and assume every capital addition will be placed in service precisely as scheduled and exactly on budget. AIC asserts that this is not how the real world works.

AIC avers that forecasting which capital additions will be placed in service in the future is an exercise of judgment, not clairvoyance. AIC states that operating the system safely, reliably, and efficiently requires it to constantly review planned capital projects and re-prioritize when necessary. The fact that it must re-prioritize projects, AIC continues, does not establish that the level of overall capital additions forecasted for the test year is unreasonable or inaccurate. Furthermore, AIC contends that the Commission’s rules recognize that setting rates in a future test year requires a focus on the overall level of planned capital expenditures, not individual projects. Thus, AIC states that the plant in service component of its rate base is not based on when individual projects are expected to be placed into service. Plant in service is presented as a simple average of December 31, 2011 and December 31, 2012 plant balances. The plant additions and retirements forecasted during this period are based on the AIC board-approved 2012 budget. AIC states that the G Schedules submitted in this case provide information that can be used to evaluate the reasonableness and accuracy of AIC’s budget. Schedules G-1 and G-8, for example, require comparative data of budgeted versus actual capital expenditures and plant additions for the most recent three years. During the 2007-2009 period, AIC reports that overall gas capital expenditures were 102% of budget. AIC adds that gas gross plant additions were 2% over budget. AIC states that this information shows that it typically spends more on capital
projects than it has budgeted. AIC also states that Staff does not dispute that AIC’s overall forecasted plant additions are consistent with historical trends, or that AIC historically spends more on capital projects than it has budgeted.

Additionally, and contrary to recognizing any distinction between "rate cases" and "operations," AIC relates that Section 285.7015 of Part 285 specifically requires an explanation of whether the forecast for the test year uses the same assumptions and methodologies as forecasts prepared for management and other entities, such as the Securities and Exchange Commission ("SEC") and ratings agencies. Section 285.7020 requires a statement that the accounting treatment for anticipated events in the test year forecast is the same treatment that will be applied once the event has occurred. Not only is consideration of capital expenditures within a rate case not distinct from operations; AIC contends that the latter dictates the former. AIC urges the Commission to reject Staff’s distinction between "rate cases" and "operations."

AIC also argues that Staff’s "cost shifting" characterization is misguided. AIC indicates that the new projects listed in Ameren Ex. 26.1 were provided simply to illustrate that "shifting dollars" has no significant or material effect on the overall level of capital additions that should be included in rate base. AIC is not requesting recovery of the increase in capital expenditures. Moreover, AIC does not believe that Staff appreciates that under Section 287.30 of 83 Ill. Adm. Code 287, "Rate Case Test Year" ("Part 287"), a utility’s ability to update schedules and workpapers for a future test year is limited. If an update is even allowed, only one update may be filed, and only then according to a schedule established by the Administrative Law Judge. In this proceeding, AIC was afforded the opportunity to file an update with its rebuttal testimony. AIC did not do so because it did not identify any changes to the forecast "significantly and materially" affecting the revenue requirement, which is a condition for filing an update under Part 287.30(b)(1). If it had filed an update based on the changes in capital projects, AIC states that rate base would increase by approximately $3.9 million, as opposed to the $1.8 million decrease proposed by Staff. If the Commission is going to entertain an adjustment based on routine changes in project priorities, AIC insists that basic fairness and symmetry dictate that the adjustment include both deferred projects and additional projects. For the reasons discussed above, however, AIC contends that no such adjustment is necessary or appropriate.

c. IBEW Position

IBEW supports AIC’s overall test year level of capital additions. IBEW agrees with AIC witness Nelson that the overall level of forecasted capital additions should be considered when evaluating rate base, not individual projects. IBEW also agrees with AIC that netting the cancelled projects and the new projects confirms that the overall level of capital additions forecasted for the test year is reasonable, reliable, and accurate. Moreover, IBEW observes that the few individual projects being cancelled or deferred and the addition
of other projects has no material effect on forecasted capital additions.

IBEW also observes that AIC initially reduced its 2010 capital budget in June 2009 and further reduced its operating and capital budgets following the Commission’s Order in AIC’s last rate case. IBEW understands that many of these spending cuts were carried forward into the 2011 operating budget. But under such cuts, IBEW questions whether AIC can continue to provide adequate, safe, and reliable service. IBEW states that each project identified by AIC requires cost recovery so that it can continue to provide adequate, safe, and reliable service. Furthermore, to complete the projects, IBEW relates that AIC plans to hire the additional personnel that will be needed to perform the test year electric and gas projects.

d. Commission Conclusion

In any large organization, projects planned for completion even a few years into the future may not be completed while other projects not anticipated may be implemented. The Commission recognizes that regulated utilities are subject to this reality and respects their need to react to changing plant needs. At the same time, the Commission must also abide by the Act to ensure that a utility’s investments are prudently incurred and that plant in rate base is used and useful. Schedule F-4 assists the Commission in ensuring that only the costs for proper capital additions are included in rate base. Because trying to review all capital additions in the limited span of a rate case is not practical, Schedule F-4 calls for details on the most expensive projects. Staff and other parties are also free to inquire about other capital additions as well.

In this instance, Staff recommends disallowing approximately $1.8 million because by AIC’s own admission, the associated projects will not be completed by the end of the 2012 test year. Rather than accept the adjustment, AIC offers in rebuttal testimony additional plant additions not included in the test year rate base with total costs exceeding that which Staff seeks to disallow. When one considers Staff’s recommended disallowance with its newly planned capital additions, AIC contends that the overall forecasted budget is still essentially the same.

The problem with AIC’s position, however, is that the Act is not concerned with the overall plant investment of a utility. The Act is concerned with the prudence and used and usefulness of particular utility assets. The Commission has consistently applied this statutory requirement in the past. While AIC may find itself needing to add distribution plant that it did not anticipate when preparing its rate case, it chose not to update its future test year and should not be allowed to circumvent the process for reviewing its plant additions by focusing on its overall capital expenses.

Furthermore, the Commission shares Staff’s concern that if it accepts AIC’s
substitution of new, previously unidentified capital projects in place of projects disallowed from the future test year, the prudency and used and useful analyses will become irrelevant. Adoption of the "overall level of forecasted plant additions" standard would enable utilities with future test years to make whatever substitutions necessary to justify the level of their forecasted rate base additions in response to other party’s proposed adjustments. The Commission would then lose its ability to hold the utilities to any meaningful rate base forecasting standards. Accordingly, Mr. Rashid’s adjustment on this issue is accepted.

2. Cash Working Capital

There is a single issue with respect to the cash working capital ("CWC") methodology, relating to the lag days associated with Energy Assistance Charges ("EAC") that AIC collects from its customers and remits to the State of Illinois. AIC and Staff agree that the EAC funds are, on average, available to AIC on the 16th day of each month. AIC remits the EAC funds as of the 20th day of each month, and thus calculates that the funds are available to AIC for four days. Staff notes that the enabling legislation requires funds to be remitted by the 20th day of the following month (See 305 ILCS 20/13(f)), and thus calculates that AIC has the use of the funds for up to 35 days.

The question is whether the additional month that AIC could hold the funds should be imputed for CWC purposes. If AIC were to change its practices, it would mean that it would effectively remit no EAC charges to the State for one month. Hence, at the test year level of EAC charges, in the first year of the change, AIC would remit about $2.3 million less to the State than it would under its current practices. AIC states that this could impact the comprehensive low income energy programs administered by the Illinois Department of Commerce and Economic Opportunity with these funds. AIC requests that, in calculating the CWC requirement, the Commission recognize AIC’s past method of remitting this pass-through tax and avoid any negative impacts on the State, low-income customers, and AIC. Staff, on the hand, contends that ratepayers should not bear the cost of AIC’s unnecessary early payment and urges the Commission to base the CWC calculation on AIC’s access to these funds and not the date AIC chooses to remit them.

The Commission understands Staff’s position but is not inclined to adopt it. Given the circumstances surrounding the EAC, the Commission does not believe that the adjustment sought by Staff is warranted. The Commission will revisit this issue, however, if AIC alters its EAC remittance schedule.

3. Accrued OPEB Liability

a. AIC Position
In addition to a pension, AIC provides employees with other post-employment benefits ("OPEB"), which consist of such benefits as health care, life insurance, tuition assistance, and other post-retirement benefits outside of a pension plan. AIC’s OPEB expense, determined in accordance with Accounting Standards Codification ("ASC") 715-60, formerly Financial Accounting Standard No. 106, represents the accrued cost of providing these benefits. To the extent accruals are greater than cash contributions into the OPEB trust, an unfunded liability will exist. In previous rate cases, including recent AIC rate cases, the Commission has deducted the accrued OPEB liability from rate base. AIC understands that the basis for this adjustment has been that ratepayers have provided AIC with the OPEB dollars to fully fund the liability. It is further assumed that AIC has just not placed those dollars in the OPEB trust, resulting in money available to AIC at zero cost. AIC also understands that a deduction to rate base in the amount of the liability is considered appropriate because ratepayers have provided the utility with a cost-free source of capital and ratepayers should not have to pay a return on costs that they have already funded.

In this proceeding, AIC believes that it can avoid a deduction to rate base because it thinks it can demonstrate that the OPEB liability does not represent ratepayer-supplied funds withheld from the trust. Ameren Ex. 2.4 purports to identify with reasonable certainty the portion of the existing OPEB liability that has been recovered from ratepayers. According to AIC's analysis, ratepayers have provided only half of the dollars required to fully fund the existing OPEB liability. AIC claims further to have made cash contributions to the OPEB trust to fund expenses accrued in excess of ratepayer-supplied OPEB funds. AIC insists that it is not appropriate to deduct the remaining liability from rate base when ratepayers have not funded those dollars. AIC states that it is the ASC 715-60 accruals that it recovers as an annualized expense through rates. AIC indicates that it lacks a mechanism that automatically adjusts OPEB expense in rates to match annual ASC 715-60 accruals. Thus, AIC records an amount of OPEB expense for any given period that will likely, if not always, vary from the amount recovered in rates.

If the utility has not recovered enough OPEB dollars to fully fund the liability, AIC contends that the entire liability cannot represent “cost-free" funds. If, for example, a utility’s ASC 715-60 expense is $4 million, it collects $2 million in rates, and it pays only $1 million into the trust, the utility’s accrued liability may be $3 million, but only $2 million of that liability represents funds from ratepayers. In the past, utilities have argued in the abstract that the fundamental premise for the adjustment is flawed if the utility recovers less OPEB dollars in rates than what it accrues, regardless of the cash placed in the trust. Some portion of the liability in theory must represent dollars not collected, they have argued. AIC notes that the Commission has dismissed such arguments. But AIC maintains that it is inappropriate to believe that the excess liability is solely attributable to the utility.

AIC believes that this is the first case in which any utility has submitted evidence analyzing ratepayer OPEB dollars since implementation of ASC 715-60. In preparing
Ameren Ex. 2.4, AIC conducted an analysis of OPEB dollars accrued to expenses, included in AIC rates, and placed in the OPEB trust, since the adoption of ASC 715-60. The purpose was to determine whether ratepayers have fully funded the existing liability. Ameren Ex. 2.4 shows generally that, although ratepayer-supplied funds may have exceeded cash contributions for AmerenCIPS since the adoption of ASC 715-60, for both AmerenCILCO and AmerenIP ratepayer-supplied OPEB funds were inadequate to fully fund the liability. Specifically, AIC reports that as of September 30, 2010, the balance of AIC’s OPEB liability was approximately $120,515,000 ($35,528,000 allocable to gas operations). But a review of prior rate orders, exhibits, and workpapers since the adoption of ASC 715-60 shows that only $60,253,000 ($17,763,000 allocable to gas operations) of that liability has been recovered in rates. AIC concludes that it is impossible for it to have collected enough OPEB dollars from ratepayers to justify the reduction of the entire amount of the liability from rate base. Furthermore, in preparing its filing, AIC pledged to contribute additional funds to the trust to cover the ratepayer portion and reflected that expected contribution in the latest actuarial forecast. Since the initiation of this proceeding, AIC has fulfilled that pledge and now contends that the entire remaining liability on its books for the test year is the non-ratepayer-supplied portion. AIC states that it is not seeking to recover the accrued OPEB dollars allegedly not recovered in rates. Nor is AIC seeking recovery of, or a return on, dollars placed in the OPEB trust in excess of the ratepayer-supplied portion. AIC states that it is simply asking the Commission not to make a deduction to test year rate base to reflect dollars that it alleges it never received.

AIC suggests that GCI ignores its evidence when they argue for a rate base deduction reflecting OPEB liability. AIC notes that AG/CUB witness Effron does not contend that the liability is ratepayer funded, but instead simply argues that the test year balances of accrued OPEB liabilities should be deducted from rate base, consistent with the Commission’s treatment in AIC’s prior rate cases. AIC contends that his argument that the Commission should deduct the balance now just because it did so before should be rejected. AIC argues that it is not consistent with the Commission’s prior cases to deduct the amount of liability from rate base if AIC has demonstrated that those dollars have never been collected.

AIC rejects Staff’s numerous reasons for why an adjustment should still be made. First, AIC denies that the corresponding employee benefits costs reflected in the revenue requirement have been enough to fully fund the existing liability. Second, in response to Staff’s claim that it is not possible to disaggregate prior base rates by line item in order to determine how much has been recovered for each element of the revenue requirement, AIC contends that Ameren Ex. 2.4 shows that not to be true. Third, Staff contends that after rates are established, they are presumed adequate to allow a utility to recover its costs, including a return on rate base. When rates are no longer adequate to do this, a utility may request a general increase in rates. Staff points to Mr. Effron’s testimony and argues that this liability represents expenses accrued in excess of actual payments; therefore, it is a proper reduction of rate base. But AIC reiterates that the fact that the liability exists or the
Commission has deducted the liability from rate base in prior rate cases is not a justification for making the same deduction in this case based on the record evidence AIC presented.

b. Staff Position

Staff urges the Commission to accept its proposed adjustment to reduce rate base for the projected average OPEB liability for the test year ending December 31, 2012. Staff maintains that the OPEB liability represents a cost-free source of capital that was provided by ratepayers. As such, Staff contends that ratepayers should not have to pay a return on it. Staff identifies numerous cases in which the Commission has concluded that OPEB liability should be treated as a reduction of rate base. Staff specifically notes the following rate cases: Peoples Gas Light and Coke Company ("Peoples")/North Shore Gas Company ("North Shore"), Docket Nos. 07-0241 and 07-0242 (Cons.); Peoples/North Shore, Docket Nos. 09-0166 and 09-0167 (Cons.); Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor"), Docket No. 04-0779; and the previous rate cases for AIC’s legacy utilities, Docket Nos. 06-0070 through 06-0072 (Cons.).

Staff is not persuaded by AIC’s analysis depicted in Ameren Ex. 2.4. Staff asserts that this analysis is nothing more than an exercise in single-issue ratemaking; it assumes a single component of the revenue requirement remains the same and is not offset by changes in other components of the revenue requirement in between each rate case. Staff contends that AIC’s analysis is flawed because each revenue requirement that formed the basis of prior rates must be regarded as a whole and it is neither possible nor proper to go back in time and disaggregate prior base rates by line item to determine how much has been recovered for each element of the revenue requirement. In other words, Staff believes that after rates are established, they are presumed adequate to allow a utility an opportunity to recover its costs, including a return on rate base. When rates are no longer adequate to do this, Staff points out that a utility may request a general increase in rates. Staff also observes that during the time those rates are effective, some expenses likely increase, while others may decline. Therefore, Staff concludes that it is not possible to state with certainty exactly how much of any particular expense was recovered through base rates. Rather, if the expense was reflected in the revenue requirement in previous rate cases, Staff asserts that it is presumed that recovery was adequate to cover costs until new rates were approved.

Staff also fears that AIC’s efforts to revisit past revenue requirements because they were allegedly insufficient could open the door for any utility to present an “analysis” of a given cost, claiming that it had not been fully recovered over some period of time, including multiple decades, and seeking to recover such amounts now and in the future. At the end of a rate case, Staff states that the record is marked “Heard and Taken” and no further evidence may be presented. Staff avers that the evidentiary record has been long closed for the cases cited and the period of time preceding the instant rate case proceeding. Staff
asserts that the treatment of the OPEB liability sought by AIC runs counter not only to well-established principles of ratemaking, but also to well-established principles of law.

Finally, Staff witness Pearce notes that her adjustment reduces rate base for the projected average 2012 accrued OPEB liability that remains after the 2011 AIC contribution of $100 million, described by AIC witnesses and reflected in AIC’s response to AG-DJE 3.19 Attach, line 4, column (c). As Ms. Pearce explains, this response demonstrates that even after the additional 2011 contribution from AIC, AIC projects an OPEB liability will remain for the 2012 test year. Staff states that this liability represents expenses accrued in excess of actual payments; therefore, it is a proper reduction of rate base.

c. GCI Position

GCI argues that test year balances of accrued OPEB liabilities should be deducted from plant in service in the calculation of AIC’s rate bases in the present cases. GCI agrees with Staff’s view that 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. GCI asserts that the OPEB issue in this case, particularly regarding AIC’s control of ratepayer supplied OPEB funds, is similar to the accrued OPEB issue in other cases, where the Commission has definitively addressed the matter. GCI directs the Commission’s attention to Docket No. 95-0129, Docket Nos. 09-0166 and 09-0167 (Cons.), Docket Nos. 06-0070 et al. (Cons.), and Docket Nos. 07-0585 through 07-0590. (Cons.). GCI states further that AIC has offered no valid reason in this case to explain why the Commission should deviate from prior treatment of OPEB. GCI therefore concludes that the Commission should adopt the adjustments for the accrued liability proposed by AG/CUB witness Effron and supported by Staff. The adjustment to rate base as proposed by AG/CUB witness Effron and Staff witness Pearce reduces AIC’s rate base by $6,850,000 and $3,062,000 for electric and gas, respectively. These adjustments to rate base are stated net of ADIT.

d. Commission Conclusion

When the Commission enters an order establishing rates, those rates are presumed adequate to allow a utility an opportunity to recover its costs, including a return on rate base. A utility’s OPEB expenses are reflected in those rates. Because ratepayers have provided the utility with "OPEB dollars" through the presumptively adequate rates, it is also presumed that the utility will apply those ratepayer supplied "OPEB dollars" to its OPEB accruals. Historically, if a utility’s OPEB fund is deficient, because the approved rates were designed to avoid any OPEB deficiency, the Commission recognizes that the utility’s failure to apply collected "OPEB dollars" means that the utility has the use of those dollars as a cost-free source of capital. Because ratepayers should not have to pay a return on costs that they
have already funded, the Commission deducts from rate base the amount of the OPEB liability.

AIC now insists that through Ameren Ex. 2.4, it has demonstrated that ratepayers have not paid what they owed toward OPEB expenses. AIC contends that only approximately $60 million ($18 million allocable to gas) of the $120 million liability ($36 million allocable to gas operations) has been recovered in rates. After contributing $100 million toward OPEB expenses during the course of these proceedings, AIC argues that the remaining balance of the liability represents funds not yet collected through rates. AIC wants the Commission to take note of this alleged ratepayer deficiency and decline Staff and GCI’s recommendation that nearly $3 million representing OPEB liability be deducted from rate base.

Although the Commission finds AIC’s position a novel approach, it does not find it appropriate. AIC professes to somehow have parsed from past Commission-approved rates that amount attributable to OPEB expenses for each of the legacy utilities. Because its current OPEB accruals exceed that which it believes it was entitled to under prior and existing rates, AIC seems to suggest that past and existing rates clearly have not sufficiently collected "OPEB dollars." The Commission questions the validity of such an analysis and wonders how AIC was able to isolate that specific element of the legacy utilities’ rates over nearly 20 years for two of the companies and nearly eight years for the third and account for the myriad of variables affecting its revenues and expenses over those years. Moreover, AIC’s analysis would seem to amount to single-issue retroactive ratemaking. The Commission finds it wholly inappropriate to attempt to reconcile one component within decades worth of approved rates with what a utility believes that one component should have produced in revenue.

Had AIC found its revenues to be insufficient to meet its obligations and provide reliable and safe gas and electric service, it was within its ability to seek additional revenue through electric delivery services rate filings and natural gas rate filings. The record reflects that AIC in fact availed itself of these opportunities. Moreover, Section 16-111(d) of the Act provided for rate relief during the mandatory transition period if certain hardships existed for AIC. For AIC to now claim that it was unable to address what it now perceives as a past rate deficiency is disingenuous.

In conclusion, the Commission agrees with the arguments of Staff and GCI. Consistent with past practice, AIC’s accrued OPEB liability shall be deducted from rate base. AIC’s analysis and the improper precedent it would establish are rejected.

4. Accumulated Provision for Injuries and Damages

a. Staff Position
Staff recommends an adjustment to reduce rate base by the amount of Accumulated Provision for Injuries and Damages (“APID”) as shown in Staff Ex. 22.0R2, Schedule 22.02. Staff relates that the APID represents previously expensed costs (expense accruals) recovered from ratepayers that have accumulated over time on the balance sheet. These funds, Staff asserts, represent a source of cost free capital for AIC which entitles ratepayers to the benefit of a rate base deduction. The point of contention between Staff and AIC is whether or not the dollars which fund the APID have in fact been recovered from ratepayers. Staff’s position is that the injuries and damages (“I&D”) expense, regardless of how the amount is determined, is recovered from ratepayers. A portion of that expense funds the APID and the ratepayers are entitled to the benefit of a rate base deduction for these accumulated funds.

AIC argues that ratepayers have not funded the APID because in this and prior rate cases AIC normalized the test year I&D expense using an average of payouts rather than the more volatile and fluctuating expense accruals. Staff states that AIC would have the Commission believe that by normalizing this expense, the ratepayers are no longer paying the I&D expense. According to Staff, what AIC fails to acknowledge is that the normalization adjustment is made to set the appropriate amount to collect from ratepayers for I&D expense. The normalization adjustment more accurately calculates how much will be collected from ratepayers for I&D expense on a recurring basis, but does not eliminate recovery of the expense itself.

Staff notes that AIC witness Stafford calculates the five year average of cash claims paid adjusted for inflation to be $1.87 million and the 2012 reserve accruals to be $3.40 million. If the Commission accepts AIC’s argument, Staff continues, it would mean that if one removes from the revenue requirement the expense accruals that fund the APID ($3.40 million) and add in its place the cash claims paid ($1.87 million), then somehow the ratepayers are no longer funding the APID. Staff finds this argument to be without merit and urges its rejection. Staff insists that a portion of the amount collected for I&D expense, regardless of how the amount of that expense is determined, funds the APID. Staff maintains that ratepayers are entitled to a rate base reduction for the amount of these accumulated funds.

Furthermore, Staff contends that application of AIC’s argument to the facts demonstrates that ratepayers have funded a balance greater than the APID. Staff reports that Mr. Stafford testifies that the normalization adjustment has occurred in each rate case dating back to Docket Nos. 06-0070 et al. (Cons.). In each of the last two cases, however, Staff notes that the overall adjustment increased the I&D expense rather than decreasing it. Thus, Staff finds that AIC’s adjustments have allowed it to recover more, not less, than the expense accruals necessary to fund the APID. This leads Staff to conclude that AIC’s argument is erroneous and should be dismissed by the Commission.

b. AIC Position
In AIC’s last three rate cases, the Commission has not made a deduction to rate base to reflect the amount of the accumulated reserve for I&D. Staff, however, proposes such a reduction to rate base in this proceeding. AIC reports that the Commission rejected this same adjustment the last time it was proposed in an AIC rate case, Docket Nos. 07-0585 et al. (Cons.). AIC states further that pro forma adjustments have eliminated Account 925 expense accruals and added in its place a normalized level of cash claims. AIC relates that this was the approach recommended by the AG and CUB and adopted by the Commission in Docket Nos. 06-0070 et al. (Cons.). AIC adds that it was the approach subsequently approved by the Commission in Docket Nos. 07-0585 et al. (Cons.) and Docket Nos. 09-0306 et al. (Cons.). In preparing this rate filing, AIC states that it again adjusted test year I&D expense to remove the test year accrual for claims to be paid. The accrual has been replaced with a historical average of actual claims paid for the five year period 2006-2010.

AIC contends that no argument or evidence has been presented in the record to cause the Commission to change its view. AIC explains that the use of a cash claims basis to adjust the amount of I&D expense to recover in rates eliminates the existence of the reserve balance for ratemaking. AIC has been recovering a normalized level of actual cash claims paid. Like other normalized expenses, such as storm costs, AIC states that the level of expense included in rates is based on actual costs incurred by AIC, not on accrued estimates of AIC’s future claims expense.

AIC asserts that the distinction between cash and accrual accounting is critical. Under accrual accounting, AIC indicates that a liability for future claims exists for financial reporting. Under cash accounting, however, no liability exists. AIC states that the use of actual cash claims paid rather than expense accruals for ratemaking means that customers are not funding the accrued I&D liability. AIC thus reasons that no liability exists for ratemaking. In other words, AIC contends that if accruals have been eliminated in setting I&D expense, they are not in the revenue requirement and are not being funded by ratepayers. Moreover, AIC states that Staff cannot identify any I&D expense accruals that have been included in rates since Docket Nos. 06-0070 et al. (Cons.). Nor, AIC continues, can Staff reconcile its adjustment with the fact that no adjustment to reduce rate base for the reserve has occurred in AIC’s last three rate cases.

Despite the fact that no accruals have been funded by AIC’s ratepayers, Staff contends that the normalized level of cash claims paid is a proxy for what the expense accruals should be. In response, AIC argues that one cannot serve as the proxy for another. AIC explains that one is based on actual cash outlays while the other is based on estimates of future claims to be paid. Accrued expense, AIC argues, will not equal cash outlays at any point in time or for any averaging period. But more importantly, AIC argues that cash outlays did not create the accumulated provision that Staff seeks to deduct from rate base. Indeed, if cash accounting was used for reporting this expense, AIC maintains that there would be no accumulated provisions for I&D. For instance, if it kept accounting for OPEB costs on a cash “pay as you go” basis for ratemaking purposes after the adoption of ASC 715-60, AIC
asserts that ratepayers would not have funded any portion of accrued OPEB liability recorded for financial reporting purposes. That a normalized level of actual cash claims is used as a substitute for ratemaking purposes for accrued expense does not, AIC insists, demonstrate that ratepayers have provided AIC with funds for future liabilities that AIC has not yet paid.

Staff cites a number of dockets for other utilities where the Commission has deducted the I&D reserve from rate base. AIC observes that in none of the cases was the adjustment contested. But more importantly, AIC points out, Staff fails to identify a single docket where an adjustment to rate base has occurred where the accruals have been eliminated from the revenue requirement and replaced with actual claims paid. For instance, AIC agrees that the Commission reduced rate base in the amount of the I&D reserve in the past two rate cases for North Shore and Peoples, Docket Nos. 07-0241 and 07-0242 (Cons.) and Docket Nos. 09-0166 and 09-0167 (Cons.). The distinction that AIC wishes to make, however, is that I&D expense in those proceedings was set based on expense accruals, not cash claims. In fact, AIC continues, in the only prior case where this proposed adjustment has been contested, the Commission rejected the adjustment because expense for ratemaking was set based on a cash accounting basis. Specifically, in AIC’s 2007 rate case, the AG and CUB recommended that the I&D reserve should be deducted from rate base, arguing, as Staff does here, that the reserve represented ratepayer-supplied funds. The Commission rejected the proposed adjustment as unwarranted. AIC reports that the Commission found that while a reserve balance still existed on AIC’s balance sheet, it was only for reporting, not ratemaking purposes. AIC states that the Commission accepted its argument then that the use of a cash basis eliminates the need for an adjustment to deduct the reserve. AIC urges the Commission to reject Staff’s proposed adjustment in this proceeding for the same reasons, as long as Account 925 accruals are eliminated from the revenue requirement and replaced with an average of actual cash claims paid.

c. Commission Conclusion

The Commission previously addressed this issue in an earlier proceeding concerning AIC’s legacy utilities, Docket Nos. 07-0585 et al. (Cons.). In that proceeding, the AG raised arguments very similar to what Staff raises now. In resolving the issue, the Commission found in favor of the legacy utilities and concluded that use of a cash basis eliminates the existence of a reserve balance for ratemaking. The Commission also concluded in that Order that while a reserve balance still exists on the utilities’ balance sheets, it is only for reporting, not ratemaking, purposes. Docket Nos. 07-0585 et al. (Cons.), Order (September 24, 2008) at 8-9. The Commission sees nothing in Staff’s arguments that would lead it to deviate from its past treatment of this issue. Accordingly, the Commission rejects Staff’s position on this issue and adopts AIC’s position.

5. PSUP Awards
Under the discussion of operating revenues and expenses, Staff recommends disallowance of 100% of the costs for AIC’s Performance Share Unit Program (“PSUP”). Acceptance of Staff’s adjustment would necessitate the removal of the capitalized costs of this incentive stock award program. In light of the Commission’s conclusion on this operating expense issue, the Commission also directs that the capitalized costs of the PSUP be removed as Staff recommends. The rationale for the disallowance of the PSUP as an operating expense appears below.

V. OPERATING REVENUES AND EXPENSES

A. Resolved Issues

During the course of this proceeding, witnesses recommended various adjustments to AIC’s operating revenues and expenses. But upon receiving additional information from AIC, those recommending adjustments sometimes withdrew their suggestions and indicated that they accepted AIC’s explanation. For purposes of judicial economy, the Commission does not discuss here instances where a dispute is resolved without any adjustment to the operating revenues and expenses AIC proposed in its direct testimony. Such issues may be found in the parties’ briefs. Where the resolution of a dispute or correction of an error, however, resulted in an adjustment to operating revenues and expenses, a list of such adjustments follows.

1. Investment Tax Credits

Investment tax credits are credits against taxes payable related to qualifying plant additions. The credits are generally based on a percentage of the qualifying plant. Regulated public utilities do not treat the decrease to taxes payable as an immediate reduction to income tax expense but treat the tax savings as a deferred credit and amortize the tax savings into income over the life of the plant giving rise to the credits. In its direct filing, AIC did not include the amortization of investment tax credits in its determination of pro forma test year operating income under present rates. On rebuttal, AIC calculated the AG and CUB’s adjustment to reduce federal income tax expense for amortization of Investment Tax Credits for each gas Rate Zone. Therefore, no adjustment to AIC’s rebuttal position is necessary to incorporate the amortization of investment tax credits into the calculation of pro forma income tax expense. The Commission finds AIC’s rebuttal calculations on this issue appropriate and adopts them.

2. Lobbying Costs

Staff witness Tolsdorf proposes an adjustment to remove from AIC’s revenue
requirement certain lobbying expenses specifically disallowed by Section 9-224 of the Act. AIC accepts Staff’s adjustment. The Commission finds this adjustment reasonable and adopts it.

3. Athletic Events Expense

Staff witness Tolsdorf proposes an adjustment to remove from AIC’s revenue requirement certain expenditures for athletic events, including the cost of tickets to professional baseball and hockey games. AIC accepts Staff’s adjustment. The Commission finds this adjustment reasonable and adopts it.

4. Company Use of Fuels

Staff witness Jones proposes an adjustment to decrease the cost of fuels used by AIC for its own purposes. The adjustment reflects the updated test year cost of gas as provided by AIC. AIC accepts Staff’s adjustment. The Commission finds this adjustment reasonable and adopts it.

B. Contested Issues

1. Uncollectibles Expense

a. Staff Position

Pursuant to Section 19-145 of the Act, the Commission may, in a proceeding to review a general rate case, order AIC to prospectively switch from using the uncollectible amount set forth in Account 904 to using net write-offs in the determination of the amount to recover through its Rider GUA-Gas Uncollectible Adjustment, provided that net write-offs are also used to determine the utility’s uncollectible amount in rates. The Act provides further that in the event the Commission requires such a change, it shall be made effective at the beginning of the first full calendar year after the new rates approved in such proceeding are first placed in effect.

Staff witness Pearce recommends that the Commission order AIC to prospectively switch from using the uncollectible amount in Account 904 to using net write-offs as a percentage of revenues. She is willing to accept AIC’s proposal to use a three-year average based on calendar years 2008 through 2010. Staff’s rationale is that the balance of Account 904, uncollectibles expense, fluctuates with changes to the allowance for doubtful accounts. The allowance for doubtful accounts is based on estimates of uncollectible accounts. Staff
 contends that a switch to the net write-off method would ensure that the calculation of incremental uncollectible expense recoverable through Rider GUA is based on actual accounts written-off and unrecovered instead of estimated amounts. Staff believes that actual information is preferable to estimates since it is more accurate and should be used whenever available. Staff further asserts that Section 19-145 of the Act support its proposal. Staff also cites the Commission’s Order in Docket No. 10-0517 (Proposal 1, Order at 3) in support of its position that rates should be determined by individual gas Rate Zone.

Ms. Pearce also proposes a change to the Gross Revenue Conversion Factor (“GRCF”) to reflect the uncollectibles percentage for each gas Rate Zone based on a six-year average of net write-offs as a percentage of revenues. She testifies that it is necessary to change the GRCF because the adjustment to uncollectibles expense only adjusts the uncollectible expense associated with revenues at present rates. There will also be an impact on uncollectible costs associated with the change in revenues that result from this docket. Ms. Pearce relates that the GRCF adjusts uncollectible expense for the change in revenues at present rates. Therefore, Staff reflects the GRCF based on the percentage of uncollectible revenues for each gas Rate Zone, as presented in Staff’s revenue requirement. Staff notes further that the final uncollectibles percentages approved by the Commission in the instant proceeding should be used to update the uncollectibles adjustment in Rider S for Purchased Gas Adjustment (“PGA”) supply, and all other tariffs in which the Commission-approved uncollectibles rate is a factor.

b. AIC Position

For purposes of calculating its uncollectibles expense, AIC proposes using the average of actual Account 904 uncollectible expense for the years 2008, 2009, and 2010. AIC contends that this approach is comparable to the amortization periods set in AIC’s prior rate cases, Docket Nos. 09-0306 et al. (Cons.) and Docket Nos. 07-0585 et al. (Cons.). AIC understands that no party objects to the use of the annual average of the years 2008 through 2010 to set uncollectible expense. The parties only dispute whether the Commission should order a switch to net write-offs when calculating uncollectible expense, rather than rely on AIC’s preferred use of Account 904 uncollectible expense.

AIC asserts that its proposed treatment of uncollectible expense for purposes of determining both the base rate amount and the amounts recovered through Rider GUA is reasonable. AIC states that it is recovering its actual uncollectible costs; no more and no less. AIC acknowledges that the Commission may require a switch to net write offs, but notes that it is not required to. In this instance, AIC asserts that there is no sound reason for making the switch. AIC characterizes Staff’s recommendation as a solution in search of a problem.

In support of its position, AIC states that the purpose of establishing rates using a test
year is to match revenues with expenses, and to ensure that ratepayers are being charged the cost the utility incurs to provide them service. By switching to the net write-off method, AIC contends that there is a mismatch between the revenues and the uncollectible expense being recorded. According to AIC witness Nelson, under Staff’s proposal, the uncollectible expense would be based on the write-offs of receivables for sales and service related to prior periods, not the current period. Although timing differences may occur with riders or other costs trackers, AIC claims that the use of net write-offs causes even more lag between the ultimate reconciliation of expense to the related revenue that caused the expense. During years of volatile gas and electric prices, AIC states that customers could end up paying for high write-offs related to years when they were not AIC customers.

In evaluating this issue, AIC maintains that the important determination is not whether actual experience trumps estimations, but how to establish a representative amount of an expense for the test period so that ratepayers are paying the costs to provide them service. If Account 904 provides a better picture of AIC’s uncollectible expense during the time rates are in effect, then AIC believes that it is appropriate to use Account 904 expense to set rates. AIC states further that no witness has testified that use of Account 904 would produce inaccurate results, nor has any witness testified that there would be a mismatch between the revenues and the uncollectible expense being recorded.

With regard to Ms. Pearce’s understanding that the Order in Docket No. 10-0517 requires uncollectible rates to be determined by individual Rate Zone, AIC contends that the Order only requires that Account 904 expense be allocated to each Rate Zone for purposes of Rider GUA. Specifically, AIC understands the Order to only require the following language to be added to Rider GUA:

For the 2010 reporting year, and subsequent reporting years, the annual Account 904 expense amounts shall be allocated to each Rate Zone based on the relative weighting of Account 904 expense by corresponding legacy utility for the period January through September 2010. Order (March 15, 2011) at 3.

Thus, AIC concludes, the Order in Docket No. 10-0517 does not support Staff’s position. In contrast, AIC maintains that a single electric and single gas uncollectible rate should be used as recommended by AIC witness Stafford.

c. Commission Conclusion

The Commission understands that there are two issues regarding the determination of uncollectibles in this proceeding: (1) whether the Commission should order a switch to the net write-off method for the calculation of uncollectibles expense and (2) whether a single uncollectibles rate should be utilized. As expressed on many prior occasions, the Commission favors the use of accurate, cost-based rates when appropriate in light of rate
impact mitigation concerns. While the use of the balance reflected in Account 904 is not inappropriate, because it is based in part on estimates of uncollectible accounts, the Commission finds that use of net write-offs is more appropriate because the latter method employs actual amounts in its calculation. Consistent with this conclusion, the Commission also finds that Staff’s recommendation to calculate separate uncollectible amounts for each Rate Zone is more appropriate. Determining a distinct uncollectible rate for gas service for each Rate Zone is more consistent with the use of cost-based rates and the Order in Docket No. 10-0517. Accordingly, Staff’s position on these issues is adopted.

2. Charitable Contributions

AIC proposes to include $775,000 in charitable donations in its gas revenue requirement. Section 9-227 of the Act addresses charitable contributions and provides in full:

It shall be proper for the Commission to consider as an operating expense, for the purpose of determining whether a rate or other charge or classification is sufficient, donations made by a public utility for the public welfare or for charitable scientific, religious or educational purposes, provided that such donations are reasonable in amount. In determining the reasonableness of such donations, the Commission may not establish, by rule, a presumption that any particular portion of an otherwise reasonable amount may not be considered as an operating expense. The Commission shall be prohibited from disallowing by rule, as an operating expense, any portion of a reasonable donation for public welfare or charitable purposes.

Whether the charitable contributions AIC seeks to include in its revenue requirements for the test year are reasonable is contested among the parties.

a. AIC Position

AIC seeks to recover from ratepayers the full amount of the charitable contributions that it anticipates making in the test year. As for their reasonableness, AIC contends that this 2012 budgeted amount is roughly proportional to the $6.1 million that the Commission recently approved for ComEd, which only provides electric service. AIC acknowledges that its 2011 budget for charitable contributions is less, but claims that the lower amount was simply due to economic and budget conditions. Moreover, as a large business with a presence in many communities across the State, AIC argues that many charitable organizations expect and depend upon companies like AIC to support them. AIC also maintains that the effect of its contributions on customers is not significant.

AIC urges the Commission to reject IIEC’s recommendation that all charitable
contributions be removed from the test year revenue requirements. AIC suggests that IIEC’s position contradicts Section 9-227 of the Act. Similarly, AIC opposes Staff’s recommendation that the amount of charitable contributions included in the test year revenue requirements be limited to the 2011 amount, plus a 2% increase. AIC contends that Staff is essentially proposing to deny funds to charitable organizations in AIC’s territory, while reducing a residential customer’s bill by pennies per month.

b. Staff Position

In Docket Nos. 09-0306 et al. (Cons.), to which AIC refers, Staff accepted and the Commission approved AIC’s rebuttal proposal of approximately $406,000 for charitable contributions in the 2008 test year. AIC’s charitable contributions budget for 2011 is approximately $1.2 million ($464,000 allocable to gas). AIC’s charitable contribution budget for the 2012 test year is approximately $2 million ($766,000 allocable to gas). In comparison to its 2011 charitable contributions budget, Staff points out that AIC is proposing a 65% increase in its 2012 charitable contributions budget. Staff finds this increase unreasonable and recommends that the Commission limit recovery to 2% above AIC’s projected budget for 2011.

Staff understands that AIC considers its 2012 budget reasonable because it has every intention of spending that amount. But in Staff’s opinion, AIC’s intention to spend money is not justification in and of itself for ratepayer recovery. Furthermore, Staff is not challenging any specific proposed contribution but rather the aggregate amount of contributions which the ratepayers are required to support. Staff notes that in Business and Professional People for the Public Interest v. Illinois Commerce Commission, 146 Ill. 2d 175 (1991) (“BPI II”), the Illinois Supreme Court said:

... we believe that the Commission must determine the reasonableness of the amount of contributions based on the total contributions rather than on an individualized basis. There are numerous charitable organizations worthy of Edison’s support. If Edison were to make a reasonable donation to each of these organizations, the aggregate total of the donations could very easily exceed a reasonable amount. 146 Ill.2d at 255.

Staff maintains that charitable contributions are a discretionary expense and AIC has provided no justification for such a significant percentage increase from its 2011 budget or from the amount authorized by the Commission in the most recent rate case.

With regard to AIC’s claim of minimal impact on ratepayers from its charitable contributions, Staff avers that AIC fails to consider that rates are based on a multitude of factors and many different expenses. Any one individual expense when allocated across millions of customers may not result in much more than pennies a month. Staff points out,
however, that that fact alone does not render a 65% increase in that item reasonable.

Staff observes that ratepayers face difficult economic hardships today. Under AIC’s position, Staff notes that ratepayers have no choice whether to contribute to charities or which organizations will receive that benefit. With historically high unemployment, stagnant wages, high and rising energy, healthcare, and education costs, Staff finds it unreasonable to further burden the ratepayer with an increase to the costs of a public utility’s charitable contributions, no matter how small. Staff contends that this is especially true when including the greater amount in rates is the very thing that would alleviate the utility’s own “economic and budgetary conditions” that precluded it from donating at the higher levels in 2011.

c. IIEC Position

In IIEC’s view, AIC’s contributions to charity should not be included in its cost of service. In the current economic environment, IIEC argues that no involuntary, compulsory contribution to charities selected by the utility is reasonable. Additionally, according to IIEC, there are other circumstances that impel the Commission to find that AIC’s proposed contributions are unreasonable and should not be included in AIC’s cost of service. Accordingly, IIEC recommends that the Commission eliminate the entire proposed amount from the electric and gas revenue requirements to be recovered from customers.

First, IIEC makes the observation that the contributions to charity that AIC seeks to recover in this case were originally booked to a below the line account, Federal Energy Regulatory Commission (“FERC”) Account 426. IIEC notes that under that circumstance, such expenditures would actually be charitable contributions, since they would come from Ameren shareholders, not recovered through monopoly service rates from others. IIEC contends that this initial below the line treatment is a clear indication that AIC did not view the expense as appropriate for ratemaking consideration. Through a series of accounting entries, IIEC reports that AIC brought the below the line charitable expense totals back into regulated accounts -- then included them in its revenue requirement request for this rate case. Even under the terms of Section 9-227, however, IIEC urges the Commission to find that the budgeted amount is neither a reasonable amount in the current economy, nor appropriate for recovery in just and reasonable rates.

Second, IIEC agrees with Staff that charitable contributions are discretionary expenses, which can be reduced without affecting the utility’s ability to provide safe, reliable, and adequate service. Moreover, IIEC observes that just as the elimination of AIC’s charitable contributions does not negatively affect service, ratepayer funding of the utility’s charitable contributions does not provide enhanced utility service or other benefits to ratepayers. IIEC points out that in contrast to AIC, AIC’s customers do not have the same flexibility to reduce their compulsory contributions to charity in AIC’s name, enforced through utility bill payments, and (unlike AIC) the core functions of customers’ lives are affected by
changes in the amount of compelled contributions to AIC’s selection of charities.

Third, IIEC contends that the current economic environment for AIC’s ratepayers is so challenging that any amount of compulsory “charity” on behalf of a utility is unreasonable. IIEC avers that reasonableness is not an assessment that can be made in a vacuum. Charitable contribution amounts found reasonable in other circumstances need not be accepted as such under all conditions. Though AIC expresses concern about the level of rates it must charge its customers as a result of this rate case, IIEC notes that AIC seeks to recover its charitable donations from its ratepayers, many of whom today may be compelled to rely on charity. Especially during these difficult economic times, IIEC suggests that such discretionary expenses (in any amount) are not reasonably imposed on ratepayers.

IIEC acknowledges that the Commission has not followed its recommended course in the past. IIEC points out, however, that the Commission’s determinations of reasonableness in prior cases are, as a matter of law, not binding in this case. Mississippi River Fuel Corp. v. Illinois Commerce Comm., 1 Ill. 2d 509 (1953) at 513. The Commission’s findings of fact must be based on this record alone. IIEC contends that the record in this case is significantly different from prior records. The record in this case, IIEC maintains, reflects the realities of an economic environment that is unique in recent times. IIEC does not deny that its recommendations would be a departure from past Commission decisions but claims that it is equally undeniable that the economic conditions faced by AIC’s customers are also a departure from anything the Commission has reviewed under the current statute.

Furthermore, IIEC asserts that AIC’s arguments in testimony closely track the language of Section 9-227 in most respects. According to IIEC, however, Ameren Ex. 28.1 lists only the recipients of planned contributions and categories of activities with which those recipients are associated. The exhibit does not contain information from which the Commission can verify that the contributions are made “for the public welfare” or another permissible purpose. Pursuant to Section 9-201(c) of the Act, IIEC states that such information is part of the utility’s burden of proof, it is not a responsibility of any other party to show the contrary. The gist of Section 9-227, IIEC argues, is to require an examination of proposed expenses, as opposed to categorical distinctions between allowed and disallowed contributions. Yet, IIEC continues, AIC approaches this issue as though the utility is entitled to recover expenses that are reasonable according to a categorical comparison to what another utility was able to recover.

d. GCI Position

GCI supports Staff’s adjustment to AIC’s proposed charitable contributions for the test year. GCI concurs that a forecasted 65% increase in the test year over 2011 contributions is unreasonable. Charitable contributions are a discretionary expense not necessary for the provision of safe and reliable service. GCI agrees with Staff that during these challenging
economic times, AIC’s obligation is to provide safe and reliable service at the most reasonable rate possible. GCI observes that AIC claims that the 65% increase is warranted because it desires to increase contributions, but in 2011 was under economic and budget constraints that did not allow it to contribute at the level it wanted. But at present, GCI notes that AIC’s customers are under similar constraints, and are without the same flexibility when it comes to paying their utility bills.

GCI agrees with IIEC that including charitable contributions in cost of service makes ratepayers involuntary contributors to charitable organizations chosen by the utility. This is especially difficult, GCI adds, during these difficult economic times. But GCI notes that IIEC’s position of disallowing 100% of charitable contributions is a departure from past Commission practice. At a minimum, GCI urges the Commission to adopt Staff’s adjustment and limit recovery of charitable contributions to 2% above 2011 levels.

e. Commission Conclusion

The Commission observes that during the 2012 test year, AIC anticipates making contributions of approximately $2,000,000 ($775,000 allocable to gas) to schools and universities, disease research organizations, multiple chambers of commerce, hospitals, a county fair, the Illinois State Fair, a hockey team, the United Way, and multiple other entities. See Ameren Ex. 28.1. Whether such contributions are appropriate, particularly in the current economic climate, is of some dispute. Section 9-227 provides that,

> It shall be proper for the Commission to consider as an operating expense, for the purpose of determining whether a rate or other charge or classification is sufficient, donations made by a public utility for the public welfare or for charitable scientific, religious or educational purposes, provided that such donations are reasonable in amount.

The provisions of Section 9-227 make clear that charitable contributions are a recoverable expense. The Commission understands that it must also "determine the reasonableness of the amount of contributions based on the total contributions rather than on an individualized basis." BPI II, 146 Ill.2d at 255.

In making a determination of reasonableness, the Commission agrees with IIEC that reasonableness is not an assessment that can be made in a vacuum. Charitable contribution amounts found reasonable in some circumstances need not be accepted as such under different circumstances. Weighing on such a determination is the fact that charitable contributions are discretionary expenses, which can be reduced without affecting the utility’s ability to provide safe, reliable, and adequate service.

The IIEC proposes to eliminate all charitable contributions from AIC’s revenue
requirement. The IIEC argues that “the current economic environment for Ameren’s ratepayers is so challenging that any amount of compulsory “charity” on behalf of a utility is unreasonable.” IIEC Init. Br. at 9. Not only is IIEC’s position a departure from the Commission’s past treatment of charitable contributions, it fails to take into account that in times of economic hardship there is an even greater need for charitable help. Charitable contributions are important societal engines that provide welfare to communities. As such, the Commission rejects IIEC’s position on this issue.

The Commission is cognizant of the difficult economic hardships ratepayers are facing. As Staff notes, ratepayers are experiencing historically high unemployment, stagnant wages, high and rising monthly bills, and rising healthcare and education costs among other factors. Under the current economic climate, the Commission is concerned that AIC has not justified its full $775,000 in anticipated charitable contributions in 2012. First, the Commission notes that by its own admission AIC reduced its charitable contributions in the past when its financial resources were constrained. AIC now apparently foresees a sufficiently improved financial situation to significantly increase discretionary donations (and gain the associated goodwill and positive publicity) with the expectation that ratepayers will provide the entire amount of the donations. The Commission is concerned that AIC’s proposal would seem to reverse its decision to decrease charitable contributions when the full cost could not be effectively passed along to its ratepayers. For AIC to now expect others, some who may be in financial distress, to fund its donations in the name of charity is troubling to the Commission. To quote AIC when discussing its own financial concerns, “[e]very dollar will make a difference.” AIC Init. Br. at 1.

To be perfectly clear, the Commission by no means intends to suggest that AIC cannot or should not make any of the donations that it proposes. AIC and Ameren are free to make any such donations. But because of the overall economic climate, the Commission cannot conclude that the full amount should be passed through to ratepayers. The Commission recognizes that the individual impact on ratepayers is small, but as the Commission has held before, it is not the reasonableness of individual elements of bills that concern ratepayers, it is the total amount. A 65% increase in recoverable charitable contributions from ratepayers during the current economic climate is untenable. As such, the Commission finds that Staff’s proposal to limit recovery of charitable contributions at the Company’s 2011 budget plus a 2% increase is more reasonable. Accordingly, the Commission adopts Staff’s position on this issue.

### 3. Injuries and Damages Expenses

Staff, AG/CUB, and AIC agree that test year I&D expense should be adjusted to remove the test year accrual for claims to be paid. They also agree that the accrual should be replaced with a historical average of actual claims paid for the five year period 2006-
2010. This is consistent with the approach approved by the Commission in AIC’s last three rate cases. Where the position of AG/CUB and AIC deviates from that of Staff is whether the non-accrual portions of I&D expense should be normalized.

a. AIC Position

In arguing against normalizing the non-accrual portion of I&D expense, AIC points out that the Commission has not done so in any of the past three AIC rate cases. Nor, AIC argues, has Staff demonstrated that the non-accrual portion is an expense that should be normalized. AIC recommends that Staff’s adjustment to normalize the entire amount of the expense in Account 925 should be rejected. AIC suggests that the Commission use the amount of I&D expense agreed to by AG/CUB and reflected in AIC’s schedules as presented on rebuttal.

In recent Commission orders setting electric and gas rates for AIC dating back to at least the Order in Docket Nos. 06-0070 et al. (Cons.), AIC notes that the Commission has normalized only the cash claims portion of I&D expense after elimination of the Account 925 expense accruals. AIC claims that both it and Staff recognized in the 2006 rate case that because cash payments can fluctuate greatly from year to year, it is appropriate to use a normal level of annual claims paid as the substitute for the expense accrual. Both the reserve accruals and the corresponding cash claims paid, AIC contends, have continued to fluctuate dramatically in the past five years. In contrast, AIC continues, the second largest component of I&D expense (liability and workers compensation insurance expense) historically is not a volatile expense. Without evidence of volatility for a particular expense item, AIC argues that there is no basis to normalize. AIC and AG/CUB’s approach replaces the expense accruals with a normalized level of cash claims paid to develop the overall level of I&D expense recorded to Account 925. Staff’s approach, on the other hand, normalizes the entire account and changes the test year expense for the entire account to a historical average. Although there is a basis (and agreement amongst the parties) to normalize the accrual portion of Account 925 based on the volatility of cash claims paid, AIC asserts that there is no such basis to normalize all expense booked to this account.

In response to Staff’s suggestion that AIC has not justified the increase in projected test year I&D expense less the expense accruals, AIC contends that Staff has not pointed to any evidence other than the percentage change for projected non-accrual expense for Account 925 in support of its normalization proposal. More importantly, AIC insists, Staff’s calculation of the electric percentage increase and gas percentage decrease for non-accrual Account 925 expense does not take into account the corrections AIC made to the allocation of I&D expense to gas and electric operations made in supplemental testimony. Rather, AIC observes that Staff’s calculation used the original test year forecast for electric I&D expense (which was overstated) and the original test year forecast for gas I&D expense (which was understated). Thus, AIC states that there is not even any record evidence of the actual
percentage change in projected non-accrual Account 925 expense.

b. Staff Position

Staff urges the Commission to accept its adjustment to normalize I&D for the entire expense rather than just a portion of the expense. While AIC proposes to normalize only the expense accruals portion of the I&D expense, Staff points out that the remaining portion of the I&D expense has fluctuated greatly over the time period from 2006 through 2010 and appears to be just as “highly volatile” as the expense accruals over the same time period. The main goal of normalizing any expense for ratemaking purposes is to include in the revenue requirement the most representative amount of expense for the test year. According to Staff, AIC has provided no evidence which would explain why its projected test year I&D expense would be significantly higher than the inflation adjusted five year average. Staff acknowledges AIC’s supplemental testimony indicating that AIC had incorrectly allocated some I&D expenses for the forecasted test year between gas and electric. Staff contends that a review of AIC witness Stafford’s rebuttal revenue requirement schedules, however, indicates that the adjustments mentioned in the supplemental testimony are not reflected in the revenue requirement schedules. Staff maintains that the uncertainty introduced from AIC’s accounting errors and failure to reflect the corrections in its proposed revenue requirement are a further reason Staff’s position of normalizing the entire amount of I&D should be accepted.

c. IIEC Position

IIEC found AIC’s proposed expense level excessive. Based on the testimony of IIEC and other intervenors, IIEC relates that AIC corrected and revised its test year I&D expense proposal in its rebuttal testimony. AIC’s revised amount reflects a reduction of approximately $2.3 million. While IIEC acknowledges that other issues raised by Staff remain unresolved, the revision proposed by AIC resolves the issues raised by IIEC on this issue.

d. Commission Conclusion

Having reviewed the arguments, the Commission is not persuaded that the record supports a change from past practice on this issue. If Staff wishes to renew its arguments with additional evidence in future rate proceedings, the Commission will consider such arguments then. But for purposes of this proceeding, the Commission adopts AIC’s position.

4. Merger Costs
a. AIC Position

AIC has included in the test year revenue requirement approximately $2 million of operations and maintenance ("O&M") savings and $728,000 of O&M costs related to the merger of the legacy utilities on October 1, 2010, as determined through a comprehensive and detailed study of merger costs and benefits, the MIPO study. In addition, AIC has included in test year rate base approximately $704,000 of capital cost savings and $235,000 of capital costs related to the MIPO study, which are not contested. AIC urges the Commission to approve recovery of all of these amounts.

AIC explains that its rate-making treatment reflects the amortization over a four-year period for the merger costs, in the amount of $728,000 per year, which recognizes that savings from these initiatives will continue to accrue to ratepayers in future rates. AIC has reflected estimated test year savings from 2011 and 2012 merger initiatives in the 2012 test year forecast and proposes that future savings from merger initiatives would accrue to ratepayers in subsequent rate cases, net of related costs incurred to realize such savings. These amounts also reflect a correction to remove from the merger costs certain internal labor amounts, made by AIC on rebuttal.

AG/CUB witness Effron proposes an adjustment in the amount of approximately $500,000 to remove merger O&M costs from the test year. The basis for his adjustment, as AIC understands it, is that the merger costs are entirely estimates of costs that AIC expects to incur in 2011 and 2012, and so it is not appropriate to reflect the amortization of the costs in the revenue requirement before those costs are actually known. AIC contends that Mr. Effron’s position appears to ignore AIC’s use of a future test year, and so should be rejected. Because it is utilizing a future test year, AIC argues that its costs are based on a projection or forecast of the future period. Thus, AIC contends that the use of projected savings for merger costs and benefits is appropriate. Further, AIC states that the MIPO represents a detailed study of projected merger costs and benefits that support the projected future costs and benefits of the merger. Given this study supporting the merger costs, AIC asserts that Mr. Effron’s position should be disregarded. Finally, even if the Commission were to agree with Mr. Effron, AIC claims that Mr. Effron’s adjustment has ignored the savings side of the equation. If costs and savings are unknown, AIC suggests that the appropriate remedy would be to remove from the revenue requirement both the test year merger costs ($500,000, as proposed by Mr. Effron) and the test year merger savings of $2 million (as also too indefinite under his analysis). AIC states that this would result in an increase to AIC’s revenue requirement of approximately $1.5 million.

b. GCI Position

Until the actual amount of costs to be recovered is known and until it can be established that expected savings from the merger are actually being realized, GCI argues
that there should be no recovery of merger costs. GCI states that the merger costs proposed by AIC are estimates of the costs AIC expects to incur in 2011 and 2012. GCI notes that AIC claims to have experienced $1.27 million dollars of savings related to the merger, which it has included in test year O&M expense and supposedly reflected in Account 903, Customer Record and Collection Expenses. Mr. Effron found that it was not clear that AIC’s 2012 forecast for that account actually incorporated the savings claimed by AIC. On rebuttal, AIC eliminated the deferral and amortization of internal labor costs related to the merger from its request. GCI reports that Mr. Effron therefore reduced his adjustment accordingly, which resulted in an adjustment of $503,000 for gas.

c. Commission Conclusion

Given its use of a future test year and the record on this issue, the Commission is satisfied that AIC has accurately reflected its merger costs and savings in its test year operating expenses. GCI’s arguments do not persuade the Commission to conclude otherwise. Accordingly, the Commission adopts AIC’s position on this issue.

5. State Income Tax Expense - Regulatory Asset

a. AIC Position

Effective January 1, 2011, the State of Illinois increased the state corporate income tax rate by 2.2%. AIC proposes to reflect the increase prospectively in utility rates set in this proceeding, and to recover the effect of the tax rate increase experienced before new utility rates go into effect (essentially, the increased 2011 liability) by amortizing that amount over the expected life of the new rates. Specifically, AIC seeks to recognize a regulatory asset, which would be amortized over a two-year period beginning January 1, 2012. While Staff agrees that the state tax rate increase should be recovered prospectively, it opposes AIC’s request to recover the impact of the tax hike experienced before new utility rates go into effect.

AIC argues that Staff’s position is inconsistent with what the Commission has done when income tax rates decrease. Pursuant to the Tax Reform Act of 1986 ("TRA"), the federal corporate income tax rate decreased from 46% to 34%. AIC reports that the Commission quickly required utilities to either file new tariffs reducing base rates, file TRA rate riders that would collect rates subject to refund to reflect the reduced tax rate, or face rate reduction proceedings. All utilities complied with the Commission’s directive in one form or another. AIC states that one of its predecessor companies, Central Illinois Public Service Company, ultimately refunded tens of millions of dollars to customers pursuant to its electric and gas TRA riders.
AIC now seeks regulatory treatment that is symmetrical with the Commission’s early action regarding a change in tax rates. One of the Commission’s important roles, AIC states, is to assure that rates fairly reflect the interests of utilities and customers alike. AIC argues that a policy that always favors customers is not symmetrical, fair, or reasonable, and is unlikely to be viewed favorably by investors, upon whom the utility companies (and by extension, their customers) rely. Accordingly, AIC believes that it should be permitted to set up and recover a regulatory asset over a two-year period beginning January 1, 2012.

b. Staff Position

Staff proposes adjustments to reduce AIC’s gas operating expenses for the deferred state income tax expense from 2011. Staff argues that the regulatory asset represents deferred expenses incurred outside of the test year and is therefore unreasonable to include in the 2012 test year. Because AIC’s proposal involves a single cost from outside of the test year, Staff contends that the proposal raises the specter of single issue ratemaking since it involves including non-test year expenses in the revenue requirement in a case with a future test year. Staff asserts that the Commission “must examine all elements of the revenue requirement formula to determine the interaction and overall impact any change will have on the utility’s revenue requirement.” Citizens Utility Board v. Illinois Commerce Comm’n, 166 Ill. 2d 111, 138 (1995). Clearly, Staff avers, deferral of operating expenses for later recovery would violate the Commission’s test year rules as established in BPI II by allowing recovery of these operating expenses outside of the test year.

In support of its position, Staff points out that in Docket No. 98-0895, the Commission denied an application by Citizens Utilities Company of Illinois to defer and amortize costs associated with remediation of Y2K issues. The Commission determined that the Y2K costs were operating expenses. The Commission found:

If this deferral is allowed, the Applicant may offset revenue in a future rate filing against these expenses. Under general rate making principles, only expenses incurred during the test year can be used to offset revenue accrued during that year.

Although, the expenses appear to be reasonable and made in the public interest, they are not sufficiently large, or sufficiently unique, to justify special accounting treatment. The requested deferral would improperly match expenses from a non-test year with revenues from a test year. The requested deferral is contrary to the ratemaking principle requiring that expenses be recognized in the year in which they are incurred.

Docket No. 98-0895 Order (March 15, 2000), Section IV.
In that Order, Staff observes that the Commission cited BPI II, which found that recovery of operating expenses outside of the test year violates test year principles. See BPI II 146 Ill.2d at 240-241. Staff states further that the Commission’s Order in Docket No. 98-0895 also cited Docket No. 93-0408, a rulemaking proceeding regarding the deferral of costs:

The Commission has previously recognized the applicability of BPI II to the question of deferral of operating expenses in ratemaking in Docket 93-0408. That recognition is dispositive of the issue in this proceeding. Docket No. 98-0895 Order March 15, 2000), Section IV.

In Docket No. 93-0408, Staff relates that the Commission accepted the utilities’ definition of deferred costs as “items of expense or savings that would ordinarily be recognized as such in a given period, but which would be recognized at a future time.” Docket No. 93-0408 Order (October 19, 1994) at 2.

Staff also argues that the fact that this increased expense was caused by a change in the state income tax rate does not alter the fact that it is an out-of-test year period increase, no different than if AIC’s wages were higher in 2011 than in its last rate case. Staff states further that there is no provision in the state income tax legislation directing the Commission to make utility companies whole or make utility ratepayers pay for all increased tax liability in between rate cases. On the contrary, Staff observes, the income tax rate for corporations was simply raised from 4.8% to 7.0% without discussion of the impact on Illinois utilities nor any change in Commission authority regarding such additional tax. See 35 ILCS 5/201 (b)(8) and (10). Moreover, Staff asserts that other expenses may be decreasing enough to offset the magnitude of the tax increase, which is why operating expenses are analyzed as a whole and why allowed rate recovery is generally based upon a test year examining all changes in a company’s financial position, not just isolated increases. Staff adds that deferring and amortizing an operating expense causes revenue and expenses to be improperly matched as one year’s expenses would be netted against a different year’s revenue.

In response to AIC’s suggestion that it had no opportunity to alter utility rates before the change in tax rate went into effect, Staff notes that if AIC had selected a 2010 historical test year, the 2010 state income tax expense would have been restated based upon the increased state income tax rate as a known and measurable change incurred within the test year period as defined in Section 287.40 of Part 287. No deferral or regulatory asset would have been created since the test year would already include the 2011 increased tax at issue here. Because the court rulings and Commission orders on the subject of rate recoverability of deferred operating expenses are not new, Staff contends that AIC should have been aware of the consequences of the rate recoverability of its increased 2011 state income tax expense.

Additionally, Staff contends that AIC misrepresents the Commission’s past practice with regard to the TRA in 1986. Staff states that the TRA orders pertaining to AIC’s former
operating utilities show that the Commission required a revenue requirement analysis for each utility prior to any ratemaking change taking place. Staff explains that there was no simple, standard Commission practice as AIC’s testimony implies. Staff also notes that not all utilities changed their rates due to the tax decrease, including the former Central Illinois Light Company and Central Illinois Public Service Company gas operations.

Staff also denies that its adjustments always favor customers. As an example of an adjustment benefitting AIC, Staff points to a correction it suggested to AIC’s ADIT that increased AIC’s rate base and, therefore, was a benefit to AIC, not ratepayers. Staff maintains that its position on AIC’s request to recover a deferred operating expense outside of the test year is not based upon the result of the proposal, but rather the controlling guidance of the test year rules and the aforementioned court rulings.

c. GCI Position

GCI objects to AIC’s proposal to establish a regulatory asset pertaining to the increase in the state income tax rate. To do so, they contend, would selectively and unfairly recognize a change that increases AIC’s revenue requirement without concomitant recognition of changes that decrease its revenue requirement. All other things equal, GCI recognizes that an increase in state income tax rate would increase AIC’s revenue requirement. But all other things are not equal, GCI observes, because in 2011, bonus tax depreciation equal to 100% of qualifying plant additions is available to AIC. This bonus depreciation, GCI explains, reduces AIC’s cost of service in 2011 through ADIT, and the revenue requirement effect of the bonus depreciation is substantially greater than the revenue requirement effect of the state income tax rate increase. GCI also rejects AIC’s argument that symmetry calls for recovery of the non-test year tax expense. GCI states that AIC chose a 2012 test year, and it cannot pick and choose certain expenses from other years to include. GCI insists that AIC should be required to follow the rules of the test year it chose, both the freedoms and constraints, on an equal basis.

d. IIEC Position

IIEC calculates that the effect of adopting AIC’s position on this issue would be to increase test year costs by $494,000 for gas operations. IIEC recommends that the Commission reject AIC’s proposal and raises arguments echoing those of Staff and GCI. IIEC points out that AIC’s 2011 tax expense could have been offset by other expense decreases and contends that the effect on AIC is not so significant as to warrant special treatment. Nor, IIEC continues, does the fact that the tax expense increase was beyond AIC’s control change the fact that it is simply another out-of-test year expense increase, no different from an increase in wages in a year the utility did not propose as its test year. Ultimately, IIEC views AIC’s proposal as yet another instance of a utility choosing an
advantageous test year, then reaping the benefits of that choice while trying to avoid its consequences. AIC had an opportunity to select a test year that would have legitimately included the 2011 tax expense increase. IIEC states that AIC chose a different course, however, and now asks the Commission to pretend it did not and to transfer the financial consequences of its decision to its ratepayers. IIEC concludes that the requested inclusion of the out of test year expenses in AIC’s test year revenue requirement is unlawful and cannot be allowed.

e. Commission Conclusion

AIC recommends that the Commission allow it to include in its 2012 test year the increase in its 2011 Illinois income tax. All parties recognize that doing so is generally inconsistent with the test year rules. AIC, however, contends that it is only right to do so because in 1986, when the relevant federal income tax rate fell by 12%, the Commission required utilities to reflect the tax reduction in rates.

The Commission has considered AIC’s request for special treatment relating to income taxes and has concluded that it does not share AIC’s view. With regard to the 1986 federal tax reduction, the Commission required a revenue requirement analysis for each utility prior to any ratemaking change taking place. Therefore, the process in 1986 was not as simple as AIC suggests. In fact, only one of the three legacy utilities actually reduced its electric and gas rates as a result of the income tax rate reduction.

In addition, AIC does not appear to have taken into account any decreases in expenses during 2011 that may have offset the state income tax rate increase. GCI insists that such an offset in fact exists and references bonus tax depreciation. Looking at only one expense out of many in any given year is inappropriate and amounts to single-issue ratemaking. As noted above, this is specifically what the Commission did not do in association with the 1986 income tax rate reduction. Contrary to AIC’s suggestion, an increase in 2011 state income tax rates is no different than any other expense incurred by AIC.

Moreover, not recognizing a 12% decrease in the federal income tax rate would have amounted to a windfall to utilities. The increase in the state income tax rate is much smaller, having only increased from 4.8% to 7.0%, for a change of 2.2%. It appears that the overall impact on AIC is not significant. In fact, if this change had a greater impact on AIC, it could have chosen a different test year. Accordingly, the Commission will uphold the test year rules and rejects AIC’s position.

6. PSUP Awards
AIC requests recovery of 50% of the test year cost of its PSUP. The requested amount is $483,000 in operating expenses and $197,000 in utility plant. AIC characterizes the PSUP as an integral component of its executive compensation, and awards certain executives the right to receive a share of Ameren common stock, a “Performance Share Unit.” PSUP awards are based on achievement of performance criteria relating to Ameren’s total shareholder return (“TSR”) relative to a utility peer group and AIC’s earnings per share (“EPS”) over a set number of years. The stock amount, however, does not vest for three years, and will not vest at all in the event of termination for cause. Whether AIC should be allowed to pass along to ratepayers the cost of the PSUP is in dispute.

a. AIC Position

According to AIC witness Bauer, the primary objective of the PSUP is to encourage AIC’s executives to remain with AIC and focus their efforts on its long-term success. Moreover, she contends that the multi-year time frame and stock award distinguish the PSUP from AIC’s annual, short-term, cash incentive compensation plan. AIC claims that the PSUP benefits Illinois ratepayers in several ways. First, by encouraging executives to remain, such experienced executives benefit customers through their knowledge of the industry in general and of AIC specifically. AIC also claims that they promote efficiency and effectiveness in their respective lines of work. Thus, by encouraging longevity, AIC contends that the PSUP promotes competency.

In addition to promoting executives’ longevity with AIC, Ms. Bauer testifies that the PSUP improves AIC’s ability to recruit capable employees. She indicates that long-term stock award programs are common among AIC’s utility peers and are accepted in the industry as an important tool in acquiring top executive talent. Without a plan with the design of the PSUP, she fears that executive positions within AIC would be less attractive to candidates. Because the PSUP benefits AIC, she suggests that it also benefits customers.

To achieve long-term success, AIC also argues that executives under the PSUP must support cost management and cost control measures. AIC believes that it and its ratepayers benefit from such objectives as well. In AIC’s last rate case, Docket Nos. 09-0306 et al. (Cons.), the Commission instructed AIC to consider the benefits to both ratepayers and shareholders resulting from cost management and cost control measures with respect to AIC’s short-term incentive compensation plan. With this mind and because the PSUP benefits both AIC and its customers and necessarily encourages consideration of cost management and cost control measures, AIC proposes partial recovery—50%—of its PSUP cost. In other words, given the PSUP benefits both ratepayers and shareholders, AIC suggests that both share equally the cost of the program.

While conceding that the PSUP provides some level of benefit to ratepayers, AIC notes that Staff opposes AIC’s 50/50 sharing proposal on the grounds that the program
aligns employee interests with those of shareholders and allegedly provides no “direct ratepayer benefit”—the standard applicable to recovery of short-term incentive compensation plan expense. AIC disagrees with Staff’s recommendation that shareholders cover all of the cost of the PSUP. AIC’s first counterpoint to Staff’s position is simply that the PSUP is not a short-term incentive compensation plan. As such, AIC argues that the “direct ratepayer benefit” standard (applicable to short-term incentive compensation plans) that Staff witness Pearce refers to is not the appropriate standard under which to consider the PSUP. Rather, Ms. Bauer suggests, apart from the most apparent distinction—awards are made in stock, and not in cash—the PSUP differs from short-term incentive compensation plans. Unlike short-term incentive compensation plans, she reiterates that the primary objective of the PSUP is to attract, motivate, and retain AIC leaders by providing a competitive total compensation package that serves as a counterbalance to short-term incentive compensation. Further, unlike short-term incentive compensation plans, under which cash compensation is distributed annually, Ms. Bauer states that the PSUP entails a three-year vesting period which encourages AIC executives to remain with AIC. Moreover, she believes that it is noteworthy that the 2008 PSUP incorporates an additional two-year holding period—Performance Share Units are awarded five years before the award of any common stock. As a result of these differences, AIC contends that the "direct ratepayer benefit" standard is not applicable. But even if the same standard applies to the PSUP, AIC asserts that it is appropriate to include in rates a portion of the PSUP.

AIC acknowledges the similarities of this issue with one addressed by the Commission in ComEd’s rate Order in Docket 05-0597. In that Order, the Commission disallowed recovery of the expense of the portion of ComEd’s incentive compensation plan related to an EPS metric. See Docket No. 05-0597 Order (July 26, 2006) at 96. AIC believes that the ComEd Order is distinguishable. Not only was ComEd’s plan in Docket No. 05-0597 a short-term incentive (cash) compensation plan, AIC notes that the ComEd Order did not concern a 50/50 sharing proposal like AIC is suggesting here. Rather, ComEd sought complete recovery of its incentive compensation plan, including the EPS funding metric, through rates. AIC is not seeking recovery of the portion of its incentive compensation plan tied to an EPS metric.

b. Staff Position

Based on AIC’s description of the PSUP, Staff concludes that the PSUP basically rewards AIC’s executives for AIC’s financial performance and aligns the interests of executives with shareholders. Because AIC has not demonstrated that this incentive program provides any direct benefit to AIC ratepayers, beyond the incentive for employees to stay with AIC that is created by the relatively longer vesting period, Staff considers it inappropriate to pass any of the PSUP costs on to ratepayers.

In support of its position, Staff explains that the PSUP is based on financial targets.
like EPS. According to the PSUP program concept described in AIC’s response to Staff DR BAP-15.01, Attach 3, p. 3 of 8, 2008 PSUP Design Specifications:

The actual number of share units earned will vary from 0% to 200% of target, based on Ameren’s 2008-2010 [TSR] relative to a utility peer group and on continued employment during 2008-2010.

If Ameren’s EPS covers its current dividend of $2.54 during each of 2008, 2009 and 2010, a minimum of 30% of a target award will be earned, regardless of TSR performance versus the peer group. If EPS falls below the dividend as measured at the beginning of the cycle but TSR performance is above the 30th percentile, the program will pay out according to the scale. If TSR is negative over 2008-2010, the plan is capped at 100% of target of relative performance.

Once earned, share units continue to rise and fall in value with Ameren stock price during 2011 and 2012, at which point they are paid out in Ameren stock. Participants cannot vote share units or transfer them until they are paid out. Final payment of earned and vested share units is made even if the participant has left Ameren unless there has been a termination for Cause.

Staff contends that financial incentives like net income and EPS goals create a circular incentive in which rate increases help achieve the financial goals of the incentive program, thereby driving costs higher while providing little or no benefit to ratepayers.

Staff relates that the Commission has a well-established standard for assessing recovery of incentive compensation costs. In Docket Nos. 09-0306 et al. (Cons.) the Commission reiterated the standard as follows:

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. Docket No. 09-0306 et. al. (Cons.) Order (April 29, 2010) at 83.

Staff observes that costs associated with the PSUP are not necessary for the provision of utility service, and given AIC’s failure to demonstrate direct ratepayer benefits, Staff asserts
that these costs should be disallowed in their entirety.

Staff is not persuaded by AIC witness Bauer’s argument that the retention of more experienced executives represents sufficient direct benefit to ratepayers to warrant ratepayers contributing to the cost of the PSUP. Although the PSUP may provide some tangential ratepayer benefits as described by Ms. Bauer, Staff asserts that this plan is designed primarily to benefit shareholders, which is why the AIC executives are compensated with shares of Ameren stock instead of cash. Because shareholders are the primary beneficiaries of the PSUP, Staff contends that they should bear the entire cost. In support of this position, Staff cites Docket No. 05-0597 in which the Commission found that the portion of ComEd’s incentive compensation plan that was based on an EPS metric should not be recovered through rates because the primary beneficiaries of increased EPS are shareholders, not ratepayers. Docket No. 05-0597 Order (July 26, 2006) at 96. The Commission noted that in spite of ComEd’s assertion that the entire plan funding was dependent on “customer satisfaction,” as measured by some customer survey benchmark, the Commission was not convinced that the link between performance was strong enough to warrant recovery of incentive payments for meeting financial goals.

On appeal, Staff reports that the Appellate Court noted that the Commission ruled that ComEd did not demonstrate a sufficient nexus between the EPS portion of the incentive compensation plan and a benefit to ratepayers. The Appellate Court noted that ComEd’s compensation expert witness had testified that incentive plans benefit everyone, including customers, because as “productivity rises, more attention is paid to cost control and more focus is given to customer service.” ComEd also asserted, AIC observes, that a financially healthy utility can obtain needed financing at a lower cost, which would lower customer costs. At oral argument, the Order notes that ComEd suggested the incentive plan benefited ratepayers by attracting good employees that raised the level of service customers receive. Staff relates that the Appellate Court concluded that such a benefit is too remote. Docket No. 05-0597 Order (September 17, 2009) at 12–13. Staff points out that the types of tangential customer benefits described in Docket No. 05-0597 above are similar to those described by Ms. Bauer in her arguments for the PSUP. Accordingly, Staff maintains the position that all costs related to the PSUP should be removed from the revenue requirement in the instant proceeding.

c. GCI Position

GCI supports Staff’s adjustment to disallow 100% of the expense associated with the PSUP. GCI observes that incentive compensation costs are recoverable in rates only if the plan confers upon ratepayers specific dollar savings or other tangible ratepayer benefits. If simply attracting and retaining qualified executives, which AIC identifies as the primary purpose of the PSUP, was enough to be determined a “customer benefit,” as required by the Commission, then according to GCI any and all incentive compensation plans could
arguably be recoverable. GCI asserts that retaining qualified employees has no specific dollar savings, nor does it provide ratepayers a tangible benefit. Instead, GCI contends that the PSUP rewards executives for AIC’s financial performance, thereby aligning the interests of executives with shareholders. GCI also points out that the PSUP can reward employees when AIC is allowed rate increases by the Commission, which is strictly a shareholder benefit. GCI further observes that the program is based on financial targets similar to the EPS metric disallowed by the Commission in Docket No. 05-0597.

d. Commission Conclusion

The Commission has reviewed the record on the PSUP and is reluctant to allow even partial recovery from ratepayers of the associated costs. Primarily, the Commission does not perceive any benefit to ratepayers from PSUP awards, which are based on the achievement of performance criteria relating to Ameren’s TSR and AIC’s EPS. All else equal, having experienced, trained executives benefits AIC and rewarding them if the Company’s value increases is logical. But it appears to the Commission that the primary trigger (if not the only trigger) leading to an award of Ameren common stock is tied to the Company’s financial bottom line rather than enhanced service to ratepayers, not unlike the situation in Docket No. 05-0597. The fact that ComEd sought 100% recovery from ratepayers for its incentive compensation plan does not render it irrelevant to the current circumstances. Whether it is 1% or 100% proposed recovery of a financial performance based award, the Commission cannot justify passing on to ratepayers expenses for an incentive compensation plan that does not provide an overall benefit to them. If the loosely connected customer benefits were considered sufficient, then as GCI suggests, any and all incentive compensation plans could arguably be recoverable. Nothing in this conclusion prohibits AIC from continuing the PSUP, but given the lack of perceptible benefits for customers, the Commission cannot require customers to pay for the program. Accordingly, the Commission adopts Staff’s position on this issue.

7. Rate Case Expense

The expenses that a utility incurs in preparation and litigation of a rate case are addressed in Section 9-229 of the Act and Section 285.3085 Schedule C-10 of Part 285. Section 9-229 provides in full:

Consideration of attorney and expert compensation as an expense. The Commission shall specifically assess the justness and reasonableness of any amount expended by a public utility to compensate attorneys or technical experts to prepare and litigate a general rate case filing. This issue shall be expressly addressed in the Commission’s final order.
Section 9-229 became effective on July 10, 2009. Section 285.3085 provides in full:

a) Provide detail of the total projected expenses associated with the instant rate case as to those expenses that the utility is seeking to recover in its proposed rates. The detail shall include the expenses of the instant rate case and the amount included in test year jurisdictional operating expense at proposed rates on Schedule C-1 for the following categories:
   1) Outside consultants or witnesses;
   2) Outside legal services;
   3) Paid overtime;
   4) Other expenses; and
   5) Total expense.

b) The information provided for each outside consultant or witness and each outside legal service shall include:
   1) Name;
   2) Estimated fee;
   3) Basis of charge;
   4) Travel expenses;
   5) Other expenses;
   6) Projected total expenses of instant rate case;
   7) Type of service rendered;
   8) Specific service rendered; and
   9) Amount included in test year jurisdictional operating expense at proposed rates on Schedule C-1.

c) Provide by footnote:
   1) A description of the costs associated with the category, other expenses; and
   2) An explanation of the calculation of the costs associated with the category, paid overtime.

d) If amortization of previous rate case expenses are included within test year jurisdictional operating expense at proposed rates on Schedule C-1, provide the amount of amortization expense associated with each rate case by docket number.

AIC requests recovery in rates of $3,341,759 for outside legal and technical experts. AIC proposes to amortize this amount over two years. AIC presented information in support of this requested level of rate case expense in Ameren Ex. 40.13. In response to an Administrative Law Judges data request, AIC reports that it paid $546,463.31 to attorney and technical experts that it employs for work they performed to prepare and litigate both the gas and dismissed electric rate proceedings. Ameren Ex. 54.0 consists of AIC’s response to the Administrative Law Judges’ data request.

AIC and Staff both recommend that the Commission expressly find that the amounts that AIC proposed, as adjusted by Staff, to be expended to compensate attorneys and
technical experts to prepare and litigate this proceeding are just and reasonable pursuant to Section 9-229 of the Act. Staff recommends that the Commission make the following finding in its order:

The Commission finds that the amounts of compensation for attorneys and technical experts to prepare and litigate this proceeding, as adjusted by Staff, are just and reasonable pursuant to Section 9-229 of the Public Utilities Act (220 ILCS 5/9-229).

The Commission notes that, in light of the relatively recent enactment of Section 9-229 and the related issues raised in recent rate cases, the Commission is taking a closer look at rate case expense. On November 2, 2011, the Commission initiated a rulemaking in Docket No. 11-0711 to allow all interested parties to participate in formulation of rules regarding the issue of rate case expense. The rulemaking will establish clear criteria, procedural and evidentiary standards to justify attorneys’ and expert compensation under Section 9-229 of the Act. The Commission’s intention for initiating the rulemaking in Docket 11-0711 is succinctly stated in its initiating Order, which provides in pertinent part:

A rulemaking is an appropriate vehicle for this, as the Commission’s intent is that this will establish a general policy for the Commission, as opposed to a pronouncement in a rate case that will only affect a single utility.

Given the timing of the rulemaking proceeding that has begun and the case herein, the Commission is without the benefit of those new standards. Nevertheless, the Commission is cognizant that a thorough analysis of these costs is required in order to approve such costs under Section 9-229 as well as the recent Court opinion. The Commission observes that the instant record shows the issue of rate case expense was a resolved issue by all parties, uncontroverted and undisputed in the record until the Briefs on Exceptions. During discovery, rebuttal and surrebuttal testimony, AIC presented extensive information in support of its requested level of rate case expense, including information regarding amounts expended to compensate attorneys and technical experts. Notably, AIC provided information regarding its projected level of rate case expense in compliance with Rule 285.2085, 83 Ill. Adm. 285.2085, which included billing rates for outside consultants and attorneys and the associated breakdown of time spent by those individuals necessitated by the rate case, monthly updates of rate case expense incurred, and narrative responses addressing the reasonableness of each rate case expense component. The information provided in Ameren Ex. 40.13 shows the amount of rate case expense actually incurred by the Company as of June 2011.

Furthermore, in response to the Administrative Law Judges’ data request regarding compensation to technical experts and attorneys employed by AIC or its affiliates, AIC provided even more information in Ameren Ex. 54.0 regarding rate case expense by listing the in-house attorneys and technical experts and the estimated compensation paid to each
of those employees.

As mentioned above, the Commission is aware of a recent Appellate Court decision wherein the Appellate Court remanded the issue of rate case expense finding that the Commission analysis should be reflective of its in depth review concerning attorney and expert compensation, related to the rate case expense, in order to meet the new statutory requirements contained in Section 9-229 of the Act. People of the State of Ill. v. Ill.C.C., et al; Illinois-American Water Co. V. Ill.C.C., et al., 2011 Ill App (1st) 101776, Opinion of December 9, 2011, Ill.C.C. Docket No. 09-0319. In the underlying case, Docket No. 09-0319, some parties argued that the rate case expense was too large in cumulative terms. This matter is clearly distinguishable as those allegations are not part of the record in the instant docket. Rate case expense, as adjusted by Staff, was not disputed on the grounds that the expense was too large. Moreover, in this proceeding the Commission has undertaken the type of diligent analysis of the supporting evidence for rate case expense as proscribed by the Court in its recent decision.

The Commission notes that the amount of rate case expense was not an issue raised by any party to this proceeding. We reviewed the evidence provided in the record by AIC and conclude that the Company provided ample and credible information to enable us to make a finding that the rate case expense is just and reasonable. Having reviewed the record, the Commission finds AIC’s requested recovery of rate case expense, as adjusted by Staff, is just and reasonable pursuant to Section 9-229 of the Act and should be approved. The Commission also adopts AIC’s proposal to amortize rate case expense over two years to be reasonable and that proposal is adopted.

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. Resolved Issues and Immaterial Differences

Staff witness Ms. Phipps proposes to adjust the capital structure to remove the remaining Construction Work in Progress (“CWIP”) accruing an allowance for funds used during construction. For the purposes of this docket, AIC does not object to the results of the proposed adjustment.

AIC and Staff agree there is no material difference between the average 2012 preferred stock balance of $59,158,692 that Staff recommends and AIC’s proposed balance of $59,194,837.

Staff and AIC agree that AIC’s average 2012 short-term debt balance equals $6,473,198.

Staff and AIC agree there is no material difference between the average 2012 long-term debt balance of $1,591,564,788 that Staff recommends and AIC’s proposed balance of $1,591,759,083.

Staff and AIC agree that the average 2012 embedded cost of preferred stock equals 4.98%.

C. Common Equity Balance

1. AIC Position

AIC states that when Ameren acquired AmerenIP, generally accepted accounting
principles ("GAAP") as then in effect required Ameren to “push down” certain items to AmerenIP’s books. So that a mere change in control did not change Illinois Power’s balance sheet for ratemaking purposes, the Commission required, as a condition of approving the change in control, that those “push down” effects be reversed for ratemaking purposes in Docket No. 04-0294. AIC says the Commission required that rates be set as if the accounting “push down” had never occurred.

AIC indicates that it and Staff disagree as to the proper adjustments required to effectuate the Commission’s requirement in Docket No. 04-0294. AIC believes that it proposes to remove all effects of the accounting entries related to purchase accounting consistent with the Commission’s Final Order in Docket No. 04-0294. AIC says Staff proposes only to remove the entire goodwill balance, while leaving other purchase accounting entries in place that are directly related to the AmerenIP acquisition. In AIC’s view, the heart of the issue pertains to the proper means of excluding the purchase accounting on AmerenIP’s books.

AIC argues that contrary to Staff’s position, all effects of purchase accounting should be adjusted out of the capital structure, including eliminating the effects of amortizations created by virtue of fair market value purchase accounting entries made at the time Ameren acquired AmerenIP. AIC insists it is unfair to cherry-pick adjustments going one way and ignore off-setting adjustments going the other way, as Staff has done with regard to the purchase accounting effects on AIC’s capital structure.

AIC maintains that when Ameren acquired AmerenIP, financial accounting standards required that Ameren “push-down” its investment to the newly acquired subsidiary’s books and re-examine the book value of assets and liabilities and reset those book values based upon the fair market value of the acquired assets, including the effect of the premium that Ameren paid, which was reflected as goodwill. AIC says the resulting accounting entries are referred to generally as “push-down accounting” or “purchase accounting,” one significant effect of which was to alter AmerenIP’s capital structure by changing the balance of common equity. AIC states that in Docket No. 04-0294, Staff recommended, and Ameren and the Commission agreed, that the effects of the purchase accounting should be reversed for ratemaking purposes. According to AIC, this was necessary and appropriate because the Commission sets rates based upon a rate base that is valued at book. AIC claims it would not be appropriate to change rates to reflect a change in the cost of service that occurred simply because AmerenIP had a new corporate owner. AIC asserts that reversing all the push down adjustments means the push down accounting under GAAP has a neutral effect on the cost of service.

AIC claims that since Docket No. 04-0294, the Commission has followed through and consistently followed the principle of neutrality reflected in its approval conditions in Docket No. 04-0294. AIC says that thereafter, the Commission approved capital structures in the last three AIC rate cases that reflected reversal of all push down accounting adjustments.
In AIC’s view, what Staff wants to do now is reverse just one of the push down adjustments and leave the others in place, meaning that push down accounting would not have a neutral effect on cost of service, as was intended, but in fact would serve to lower the cost of service. AIC insists there is no justification for this result. AIC contends that the items that Staff wants to leave in place came about only because Ameren paid the premium that produced the goodwill. AIC maintains that Staff wants to exclude the goodwill, but leave the off-setting effects in place.

AIC asserts that Staff’s position in this proceeding is inconsistent with the Order in Docket No. 04-0294, sound ratemaking principles, and is without evidentiary support. AIC argues that in this case, Staff appears to at times accept the concept of reversing purchase accounting entries, but at other times disagrees that purchase accounting adjustments should be made. According to AIC, Ms. Phipps recognizes that multiple accounting entries are made as related to “purchase accounting” but also disagrees with reversing any entry other than the cumulative total of goodwill as recorded in Uniform System of Accounts (“USOA”) No. 114 (“Account 114”). AIC contends there are accounting entries intertwined with the balance relied upon by Ms. Phipps as a result of purchase accounting.

AIC also claims that Ms. Phipps, who is not a certified public accountant, was not familiar with either the financial accounting standard referenced in Docket No. 04-0294, or the account entries filed by AmerenIP in compliance with the Final Order issued in that docket. AIC also claims that Ms. Phipps recommends accounting treatment at odds with the manner in which AIC is directed to comply with its annual reporting requirements (“Form 21 ILCC”).

AIC indicates that Staff also relies upon the direction in the Final Order in Docket No. 04-0294, indicating the impact of the purchase accounting should be collapsed into Account 114 for regulatory purposes. AIC alleges that Account 114 contains the $411 million goodwill balance that Ms. Phipps removes. AIC complains that she does not “collapse” the other purchase accounting entries into that account balance, as AIC claims it does in its Form 21 ILCC, or otherwise net them against goodwill. In AIC’s view, Staff misses the point that AIC is collapsing all adjustments into that account entry for regulatory purposes by netting all purchase accounting adjustments against that entry and reporting the same to the Commission annually. AIC contends this is precisely how it complies with the Final Order issued in Docket No. 04-0294. AIC insists reduction of goodwill is a single collapsed adjustment made in lieu of adjusting other accounts in piecemeal fashion to fully reverse the purchase accounting entries. AIC argues that this treatment is consistent with what the Commission approved in Docket No. 04-0294 with regard to both ratemaking and Form 21 ILCC reporting.

AIC states that subsequent to the Final Order in Docket No. 04-0294, Financial Accounting Standards changed as of 2006 pertaining to how certain purchase account entries are made, and the recordation process for those entries had to be adjusted,
specifically regarding Account 219. AIC asserts that it cannot be said that AIC’s present accounting entries justify a departure from the Commission’s decision in Docket No. 04-0294.

AIC believes Staff does not justify why the Commission should asymmetrically reverse the goodwill entry, yet leave other purchase accounting entries in place for the purpose of developing a capital structure. AIC maintains that proper treatment is accomplished by reversing all of the purchase accounting entries to accounts resulting from the AmerenIP acquisition as they impact test year accounts. AIC says it has done so for the past three rate cases by netting the purchase accounting amortized entries against the goodwill asset.

It is AIC’s position that the Commission should affirm its regulatory treatment of the purchase accounting related to the AmerenIP acquisition in this case and accept AIC’s proposed accounting thereof for the purpose of establishing AIC’s capital structure.

In its Reply Brief, AIC alleges that the majority of Staff’s arguments concerning goodwill and purchase accounting consists of entirely novel assertions that were simply not presented in the direct or rebuttal testimony of Ms. Phipps, the sole Staff witness addressing the issue. AIC states that the first page of the section does paraphrase the testimony of Ms. Phipps, but claims the remainder of the argument is the presentation of a new theory. According to AIC, Staff now claims it could not “verify” the accounting, and this claim is somehow supported by a series of obscure criticisms concerning the nature of dividends and when they should be made.

AIC asserts that because Staff waited to raise these issues in its Initial Brief, AIC has been deprived of any meaningful opportunity to respond. AIC alleges that Staff essentially presents new expert analysis in its Initial Brief. AIC says it cannot now enlist an accountant to review and rebut the information on the record; it cannot now propound discovery to understand the basis for the generalized criticisms, and cannot conduct any cross examination of the expert whose work product is presented on pages 51-52 of Staff’s Initial Brief. AIC argues that from a legal standpoint the tactic unduly prejudices AIC; sustaining an approximately $2 million dollar revenue requirement adjustment based upon evidence the AIC has not been given an opportunity to rebut cannot be achieved without violating AIC’s due process rights.

AIC contends that while Staff does provide some citations to the record, specifically the transcript, a quick review reveals that the admissions attributed to Mr. Stafford either did not occur or were highly conditional and without certainty. Of concern to AIC, Staff alleges “. . . the common equity balance that AIC presents to its investors excludes goodwill instead of purchase accounting adjustments,” and Staff follows with a citation to Mr. Stafford’s cross examination. AIC Reply Brief at 29, citing Staff Initial Brief at 51. AIC asserts that the attribution does not accurately depict the subject matter of the questioning, which made no
mention of a concept of goodwill “instead” of purchase accounting. AIC believes this is important because Mr. Stafford agrees that goodwill should be removed from the common equity balance, but only to the extent the removal is net of other purchase accounting adjustments. AIC also asserts that, Mr. Stafford did not even make an admission as Staff’s citation would infer. AIC states that when asked if AIC excluded “goodwill” from presentations to investors, referring to a report, Mr. Stafford indicated that he “. . . did not know with certainty whether it would or wouldn’t.” (d. at 29-30, citing Tr. at 235. AIC alleges that Mr. Stafford did accept a representation by counsel “subject to check,” but the purpose of such acceptance is not an unequivocal admission, as Staff’s citation would suggest. AIC claims a “subject to check” question is customarily asked for the purpose of laying some context for further questioning in order to move the hearing along, not some legal trickery by which a witness is forced to admit something to which they have questionable familiarity or recollection. AIC claims Staff has abused the custom in this instance.

AIC also states that Mr. Stafford indicated he could not authenticate the documents counsel was asking him about. With regard to Staff Cross Ex. No. 9, AIC says Mr. Stafford said he did not remember seeing the exhibit. AIC adds that he later corrected that he did recall being asked to review a single slide in the broader presentation but counsel did not ask him about that slide. With regard to Staff Cross Ex. 10, counsel asked Mr. Stafford about a document held out to be a single undated page taken out of what he was told was a 2007 rate case 285 schedule. AIC indicates it is not to suggesting the document was a fake, but says Mr. Stafford could not confirm its authenticity. AIC states that Staff did not seek admission of its Cross Exhibits 9 and 10, and they are not part of the record. AIC complains that Staff cites specific values from those exhibits in its Initial Brief.

According to AIC, the fact is that Staff fails to explain why it should depart from the accounting approved in Docket No. 04-0294, AIC’s annual reporting in Form 21 ILCC, and the capital structure approved in the past three rate cases. AIC maintains that Staff does not “collapse” other purchase accounting adjustments against goodwill or otherwise reverse the totality of the purchase accounting that resulted from the acquisition of AmerenIP.

2. **Staff Position**

AIC’s average 2012 common equity balance excludes approximately $344 million of purchase accounting adjustments reflected in Account 114 as of September 30, 2010. Staff avers AIC’s proposed purchase accounting adjustments reflect bookkeeping entries to Account 114 that do not affect AIC’s common equity balance; therefore, Staff proposes to remove the goodwill balance in lieu of AIC’s purchase accounting adjustment balance to avoid including in rates any purchase accounting adjustments that are not appropriate for ratemaking purposes.

Staff recommends that the Commission reject AIC’s proposed purchase accounting
adjustments because they could not be verified. Staff asserts that those purchase accounting adjustments reflect unrelated amortization of Account 219, Accumulated Other Comprehensive Income. Staff also argues that push down accounting entries must be finalized within one year of the closing date of reorganization. Staff says that once finalized, purchase accounting adjustments should decrease ratably until the end of the applicable amortization period. Staff complains that AIC expects the purchase accounting adjustment to increase from 2010 to 2011, then decrease from 2011 to 2012. In contrast, Staff says AIC expects its goodwill balance will remain constant in 2011 and 2012. Staff also claims that the common equity balance that AIC presents to its investors excludes goodwill instead of purchase accounting adjustments.

Staff asserts that without explanation, AIC dropped $63 million in income-related purchase accounting adjustments from its current rate case. Staff claims that in the 2007 AmerenIP rate cases, AIC made two purchase accounting-related adjustments to AmerenIP’s balance of common equity: the first adjustment subtracted $155 million of “goodwill net of purchase accounting adjustments;” the second adjustment subtracted $63 million of “income generated from … purchase accounting.” Staff Initial Brief at 21, citing Tr. at 238-242. Staff finds this troubling given the difference between AIC’s $344 million purchase accounting adjustment and $411 million goodwill balance equals approximately $63 million, suggesting to Staff that a similar retained earnings adjustment in the instant case would have resulted in purchase accounting adjustments that approximate AIC’s goodwill balance.

According to Staff, AIC’s explanation is that the $63 million would have been an adjustment made after the AmerenIP acquisition by Ameren to reflect the absence of paying out common dividends for the retained earnings associated specifically with the purchase accounting impact on the income statement and that the $63 million was specifically related to retained earnings from income generated from push down accounting or purchase accounting. Staff says AIC also contends that until such time as the retained earnings have been fully paid out in common dividends, the Company will make that adjustment.

Staff states that while purchase accounting is required for financial reporting purposes, and AIC must reverse the effects of purchase accounting for regulatory purposes, dividends do not represent a reversal of purchase accounting adjustments to net income, as AIC claims. Staff argues that instead, companies declare dividends out of earnings as a whole, rather than a particular type of earnings; the USOA defines retained earnings as the accumulated net income of the utility less distribution to stockholders and transfers to other capital accounts. Staff also contends that the USOA provides no instruction for tracing dividends to a particular source of utility income. According to Staff, AIC admits that it is almost impossible to pinpoint exactly how cash is used. Staff also says that in Docket No. 04-0294, the Commission lifted pre-existing restrictions on AmerenIP’s common dividend payments. Given AmerenIP was not prohibited from paying dividends following the acquisition by Ameren, Staff argues it is not clear why any “unpaid” common dividend would
still remain when AmerenIP filed its 2007 rate case almost three years following its acquisition by Ameren. Staff finds AIC’s explanation for its exclusion of the 2007 rate case adjustment to retained earnings from the current rate cases should be insufficient because it is contrary to the Commission’s rules and its Order in Docket No. 04-0294 allowing AmerenIP to recommence dividend payments.

Staff maintains that it cannot verify AIC’s proposed purchase accounting adjustments, which may result in an overstatement of the common equity balance for ratemaking purposes. Staff asserts that Ms. Phipps’ adjustment would avoid including in rates any purchase accounting adjustments that are not appropriate for ratemaking purposes. Staff believes the Commission should adopt Staff’s proposed common equity balance for AIC, which excludes $411 million goodwill.

In its Reply Brief, Staff claims that AIC mischaracterizes Staff’s position when it argues that Staff’s proposal contradicts the Commission’s directive in Docket No. 04-0294. Although Staff does not oppose the accounting treatment authorized in Docket No. 04-0294, Staff recommends against adopting AIC’s proposed purchase accounting adjustments for setting rates in this proceeding because AIC’s proposed purchase accounting adjustments are not verifiable. Specifically, Staff witness Phipps argued that to the extent purchase accounting adjustments affect Account 219, the balance should decrease ratably until the end of the applicable amortization period. Moreover, Staff maintains that it identified a $63 million retained earnings adjustment that appeared in AIC’s 2007 rate case, but which does not appear in the instant case.

It is Staff’s position that contrary to AIC’s assertion, AIC’s proposed adjustments in the instant case are not consistent with AIC’s proposed adjustments in the last three rate cases because the instant case does not include a $63 million adjustment to retained earnings that AIC made in the 2007 rate case. According to Staff, absent the adjustment to retained earnings, AIC could be inflating its common equity balance by approximately $63 million, which would contradict the Commission’s Order in Docket No. 04-0294, which AIC argues required reversing purchase accounting adjustments in order to ensure Ameren’s acquisition of AmerenIP would have a neutral effect on the cost of service.

3. Commission Conclusion

Staff recommends removing from the common equity balance the balance of goodwill on AIC’s books. AIC argues that Staff’s proposal reduces the common equity balance by too much because a portion of the goodwill balance on its books is offset by purchase accounting transactions.

As an initial matter, the Commission observes that this issue involves rather technical accounting issues that are neither easily explained nor understood. While the Commission
does not fault either AIC or Staff for their efforts on a difficult issue, it seems to the Commission that thorough communication could have resulted in a mutual understanding between the parties. Unfortunately, this did not happen and the Commission is forced to resolve this difficult issue.

In direct testimony, Ms. Phipps proposed removing $411 million of goodwill from AIC’s common equity balance. She notes that AIC proposed to use the September 30, 2009, balance of the purchase accounting adjustments reflected in Account 114 Plant Acquisition Adjustments. She asserts that that balance reflects bookkeeping entries to Account 114 that do not affect AIC’s common equity balance.

In rebuttal testimony, Mr. Stafford states that the netting of purchase accounting adjustments against Account 114 goodwill is required to be reported annually on AIC’s Form 21 ILCC as a difference between AIC’s Form 1 and Form 21 ILCC balance sheets. He claims that AIC’s purchase accounting adjustments are verified by an accounting officer in the filing of Form 21 ILCC, and verified separately by an accounting officer at the time of rate case filings. Mr. Stafford also asserts that the purchase accounting adjustments are intertwined with goodwill. The Commission also notes that in Docket No. 04-0294, the Commission found that:

The Commission also adopts the recommendation of Staff witness Ms. Pearce that the impact of push down accounting should be collapsed into account 114, plant acquisition adjustments, for all Illinois regulatory purposes, such as reporting in Form 21 ILCC. Order at 33-34.

In rebuttal testimony, Ms. Phipps states that goodwill is a direct result of purchase accounting. She does not, however, directly respond to Mr. Stafford’s arguments about Account 114 nor attempt to refute his arguments about the intertwining of purchase accounting and goodwill.

As previously discussed, the Commission understands purchase accounting to be technical and complex. It appears to the Commission that while easy to understand, Staff’s recommendation on this issue is overly simplistic. The Commission concludes that the record supports AIC’s position that purchase accounting and goodwill are intertwined. It is clear to the Commission that Staff’s recommendation does not reflect this fact. The record supports AIC’s position that the common equity balance should be reduced by $350,833,351. This adjustment reflects a netting of accounting adjustments against the goodwill balance which is supported by the record of this proceeding. Substituting this value into Staff Ex. 24.0, Schedule 24.03 in place of the value used by Staff, $411,000,000, produces an average common equity balance of $1,889,251,000, which the Commission believes should be used for purposes of setting rates in this proceeding.

D. Cost of Short-Term Debt
1. **AIC Position**

AIC argues that Staff’s adjustment to the 2012 cost of short-term debt, as well as the 2012 planned long-term debt issuance, is premised upon the use of historically low interest rates present immediately preceding its direct testimony. AIC says that in contrast, Mr. Martin utilized Blue Chip Financial Forecasts dated December 1, 2010, to develop a forecast of interest rates applicable. AIC indicates that Ms. Phipps opposes AIC’s position citing her belief that current interest rates are appropriate for use in 2012. AIC believes that in a future test year, it is appropriate for a utility to use recognized financial industry forecasts to test year interest rates as Mr. Martin did in this docket. AIC recommends that the Commission approve Mr. Martin’s proposal as set forth in his direct testimony.

2. **Staff Position**

Staff states that AIC’s projected short-term debt balances comprise 100% bank loans, which are made on a 30 day basis, in which case the interest rate on those bank loans will equal a 30-day London Interbank Offered Rate ("LIBOR"), plus a 2.05% margin that is based on AIC’s senior unsecured credit ratings of Baa3/BBB- from Moody’s Investors Services ("Moody’s") and Standard and Poors ("S&P"). As such, Staff recommends a 2.24% cost of short-term debt for AIC that equals the current 0.19% one-month LIBOR rate, plus a 2.05% margin. Staff Ex. 7.0 at 8-9.

Staff finds AIC’s proposed short-term debt rate problematic for two reasons. Staff complains that AIC used the projected 3-month LIBOR rate to estimate the cost of 30-day bank loans, which Staff believes will overstate AIC’s actual cost of short-term debt because interest rates typically rise as the time horizon for the investment lengthens. Second, Staff says AIC’s proposed short-term debt rate is based on a forecasted interest rate instead of a current, observable interest rate. Staff indicates that AIC argues that it is reasonable to rely on interest rate forecasts, which are based on expert analysis, for forward test year purposes. In Staff’s view, accurately forecasting interest rates is problematic. Staff also asserts that the accuracy of a forecast diminishes as the time horizon lengthens. According to Staff, a comparison of the March 2007 Blue Chip Economic Indicators projections for the annual average for 10-year U.S. Treasury bonds for years 2009 and 2010 over-estimated the actual annual average 10-year U.S. Treasury bond yield by 1.9 percentage points. Staff recommends that the Commission adopt Staff’s proposed short-term debt rate, which is based on current, observable interest rates for the same time horizon as the expected short-term bank loans.

3. **Commission Conclusion**

There are two contested issues affecting the cost of short-term debt, the cost rate for
bank loans and the treatment of credit facility commitment fees. The Commission understands that Mr. Martin and Ms. Phipps agree that AIC’s cost for short-term bank loans is based on the sum of the then current 30-day LIBOR rate and a margin of 2.05%. The basis for AIC’s proxy for the LIBOR rate in the formula is the projected three-month LIBOR rate. In contrast, Staff recommends using the current one-month LIBOR rate.

The question is whether to use AIC’s projected three-month LIBOR rate or Staff’s current one-month LIBOR rate in estimating the cost rate for bank loans. On the one hand, AIC complains that Staff’s proposal relies on historically low interest rates. On the other hand, Staff argues that forecasting future interest rates is problematic. Staff also argues that because interest rates typically rise as the time horizon for the investment lengthens, AIC’s three-month method overstates the interest rate.

It is impossible to know what the LIBOR rate will be when rates established in this proceeding will be in affect. The Commission concludes that by basing its estimate of the 30-day LIBOR rate on projected three-month LIBOR rates, AIC has overstated the interest rate. Of the two proposals offered, the Commission finds Staff’s to be better and it is hereby adopted for purposes of this proceeding.

E. Credit Facility Commitment Fees

1. AIC Position

AIC indicates that it requires liquidity provided by short-term debt in order to ensure a source of cash is available if needed to support operations. In order to establish the facilities and lines of credit with participating banks, AIC says it is required to pay an upfront fee. For the purposes of ratemaking, AIC says the fee is expressed as a basis point equivalent value, and then blended within the overall cost of capital in proper proportion to the approved capital structure. AIC indicates that it and Staff disagree on the amount of fees recoverable in rates, while no other parties have taken a position on the issue. AIC says the disagreement stems from Staff witness Ms. Phipps’s proposal to adjust credit facility commitment fees based upon what it views as a misapplication of Section 9-230 of the Act. Staff recommends recovery only to the extent of fees equivalent to 25 basis points. AIC proposes recovery of the actual fees paid equal to 66.5 basis points. AIC claims Ms. Phipps has not adequately supported the reasonableness of the resulting fees she proposes to be recoverable in rates. AIC believes Staff’s adjustment should not be approved and, accordingly, a full 10 basis points should be added to overall weighted average cost of capital.

In support of its position, AIC invokes an argument that, as a matter of constitutional law, utilities are entitled to ask for a fair return upon the value it employs in providing public
service. AIC also invokes the argument that Illinois utilities are entitled, as a matter of state law, to fully recover the costs of providing distribution service. AIC repeats its belief that Staff’s adjustment is premised upon an errant application of Section 9-230 of the Act.

AIC thinks the statute is clear; for the purpose of setting rates, the Commission should not allow any incremental risk or cost of capital to be passed onto customers to the extent such risk or cost is the result of affiliation with non-regulated or unregulated affiliate businesses. AIC suggests the question for the Commission is two-fold: has AIC established a record to support its entitlement to a full recovery of credit facility fees; and does a reasonable application of Section 9-230 warrant an adjustment in this case?

AIC believes it provided substantial evidence in support of the bank facility fees it paid and the allocable portion thereof that it requests recovery of in this proceeding. AIC says Mr. Martin developed a facility for AIC separate and distinct from the affiliate facilities developed for AmerenUE and AIC’s unregulated generation affiliates. AIC claims it provided proof of the three distinct facilities by providing the three distinct Arrangers Fee Letters attached to Mr. Martin’s rebuttal testimony. AIC says it also provided a copy of the invoice showing that each facility was billed as a separate itemized amount.

AIC argues that Mr. Martin developed a facility that included lower cost modest commitments as well as commitments from larger, more stable lenders capable of making more meaningful commitments, and that he provided a breakdown demonstrating the diversity of commitments made to AIC by participating lenders and the associated fees. AIC says it also provided an exhibit showing comparable fees paid during 2010 by other utilities with similar credit ratings. AIC asserts that both the Peoples as well as Commonwealth Edison Company (“ComEd”) paid fees comparable to AIC. AIC says it paid a fee equivalent of 66.5 basis points, whereas ComEd paid 60.5 and Peoples, together with its affiliates, paid an approximate range of 65-70 basis points. AIC also says it voluntarily reduced the fees for the portion of the total credit commitment available under the facility that could be called upon by Ameren.

AIC believes Staff misapplies Section 9-230 and proposes an "unsustainable" adjustment in three important ways. AIC says that first, Staff inappropriately suggests that the facilities be pooled into a hypothetical single facility and further assumes escalating fees as a result of a hypothesized single line of credit. Second, AIC says Staff improperly includes in its combined analysis the fees associated with a regulated utility, AmerenUE. AIC contends that affiliations with regulated utilities by definition cannot give rise to a Section 9-230 adjustment. Finally, AIC claims Staff failed to establish in the record any basis in fact or expert opinion that AIC could realistically obtain a reliable credit facility for a fee as low as 25 basis points.

Staff argues that the Commission should consider all three Ameren facilities, including the facilities arranged for AmerenUE, AIC’s generating affiliate, and AIC, under one
A single progressive fee structure, and quotes from a response to a Staff data request in support of this theory. AIC contends that Staff takes the explanation provided in Mr. Martin’s response entirely out of context, failing to note that Staff specifically requested a comparison of affiliate bank facilities. AIC says Ms. Phipps attached the quoted data request responses and another related request to her testimony as Attachment 1 and 2. According to AIC, those requests asked Mr. Martin to provide a comparison of the three separate facilities. AIC says it was Ms. Phipps that requested the information be provided on a unified basis.

AIC maintains that the facilities were separate and distinct from one another, and AIC has only requested recovery of the specific fees associated with the AIC facility according to the invoice received. AIC believes that if anything is demonstrable by virtue of the analysis Mr. Martin provided in the responses contained in Attachment 1 and 2, it is that no preferential treatment was given or subsidy afforded to any AIC affiliate in the development of the three separate credit facilities. AIC argues that the data request responses actually support a finding that there was no adverse impact on AIC’s costs that would be excluded from rates under Section 9-230.

According to AIC, Staff did not offer any opinion or provide any market-based analysis in support of the availability of a facility of comparable composition and quality to AIC for the fee equivalent to the 25 basis points recommended by Ms. Phipps. AIC says Mr. Martin could not line up key lenders for such a fee. It is AIC’s position that it would be impossible to procure a stable, reliable facility of the size required by AIC by offering all lenders a commitment fee of 25 basis points. AIC says Ms. Phipps admitted she had no opinion to offer as to the availability of an $800 Million dollar facility to AIC for 25 basis points, and further admitted that she did no market research to test the validity of such a fee.

In its Reply Brief, AIC contends that Staff misses the point of the matter, Ameren negotiated three separate facilities for each business line, fully segregating the respective aggregate credit commitments to Ameren Illinois, AmerenUE, and Ameren Energy Generating Company (“Genco”). AIC says the basis for Staff’s aggregated fee theory derives largely from excerpts taken from data requests Staff sent to AIC specifically asking for a side by side comparison of the three facilities. AIC also asserts that Staff indirectly takes aim at the manner in which Ameren negotiated the facilities for each business line, essentially arguing that the contemporaneous approach to setting up the three facilities somehow caused AIC and its affiliates to pay more overall despite having separate facilities, thus inflating the share attributable to AIC. AIC believes Staff has not explained or even suggested how it would be possible for the AIC to reduce its facility fees through some alternative negotiation process, whereby somehow AIC could convince banks to accept a lower fee for the same amount of credit commitment. AIC also believes it is incorrect when Staff alleges AIC holds out that the facilities were negotiated at different times. AIC claims Mr. Martin has been transparent about how the facilities were syndicated.
In AIC’s view, this is a classic straw man argument where Staff chooses to continue to interpret “separately negotiated” in a cynical manner in order to make it appear that AIC somehow is trying to obscure what is truly an in-broad-daylight approach to credit facility syndication. AIC says Mr. Martin used the word “negotiated” trying to explain the issuance of three separate lending facilities to different legal entities, in the same vein as someone saying that they negotiated three separate checks, meaning the person wrote three checks as opposed to one, not that they sat a table and entered into adverse negotiations on three different occasions. AIC claims the notion of a person to person negotiation is a misrepresentation of the nature of the syndication process, which AIC asserts is more of a multi-bank bidding process.

AIC contends that contrary to Staff’s interpretation, Section 9-230 is not a discrete alternative to the application of reason or reasonableness. AIC says it has not asked the Commission to ignore Section 9-230 by virtue of some substitute reasonableness standard. AIC suggests the Commission may review the positions of the parties for their reasonableness in application of the facts to the legal principles at issue, Section 9-230 applicability notwithstanding.

AIC asserts that in the case Staff relies upon, Illinois Bell Telephone Co. v. Illinois Commerce Comm’n, the appellate court was simply indicating the Commission erred in addressing “reasonableness” generally for the basis of its decision to reject CUB’s proposed Section 9-230 adjustment in the Order under review. AIC Reply Brief at 33-34, citing Staff Initial Brief at 55, 283 Ill. App. 3d 188, 207 (2nd Dist. 1996). AIC says the appellate court correctly concluded that reasonableness alone is not sufficient to sustain a ruling upon a Section 9-230 determination and the Commission must specifically address whether incremental risk or additional costs were caused due to an unregulated affiliate. AIC states that the complete holding of the appellate court goes on to identify the case establishing the appropriate standard to which the Commission is held. Id. citing Central Illinois Public Service Co. vs. Illinois Commerce Comm’n, 243 Ill.App.3d 421, 443 (4th Dist. 1993). According to AIC, in Central Illinois, the court affirmed the Commission when it made an express finding the utility was unaffected by its unregulated parent. AIC believes it is pertinent to this case that Central Illinois made it clear in upholding the Commission’s decision argument that “. . . [t]he credibility of expert witnesses and the weight to be given to their testimony are matters for the Commission to decide as finder of fact.” (d., citing 243 Ill.App.3d at 443.

According to AIC, the problem with the legal sustainability of Staff’s adjustment in this case is that it fails to establish the condition Section 9-230 specifically prohibits. AIC insists there must be some showing or measure of incremental or additional risk or cost of capital attributable to the affiliate’s influence on the cost of capital. To demonstrate incremental or additional cost, AIC claims it is necessary to establish some kind of baseline that would provide a reasonable basis for what would have been paid in fees without the alleged influence of the unregulated affiliate or affiliates. AIC asserts that Staff provided no market
analysis to support what AIC would have paid, nor did Staff offer any opinion that the AIC could have obtained a comparably reliable and stable facility for a mere 25 basis points or otherwise attempt to defend this number.

AIC contends that Staff has still not explained, in testimony or its Initial Brief, why it is appropriate to pool and inequitably divide AmerenUE and AIC costs as part of its analysis. AIC says it does not dispute that it cannot recover AmerenUE costs – most certainly it cannot, but AIC believes a proper interpretation of Section 9-230 would hold that the law pertains to unregulated, non-utility affiliates (i.e. Merchant generation, marketing affiliates, and the like). In AIC’s view, if Staff feels a jurisdictional cost allocation issue is present, it is free to raise it, but insists Section 9-230 is the wrong statute to rely upon. AIC believes that to support Staff’s analysis, the statute would have used language to the effect of “... affiliates other than a public utility,” as opposed to the very specific descriptors “non-utility” and “unregulated.” AIC also claims it does not appear from Staff’s Initial Brief that Staff is directly arguing AIC paid AmerenUE costs, but rather total costs were inflated due to the manner of negotiation.

Regardless of the legal basis for the adjustment, AIC insists the issue with regard to AmerenUE is also one of fairness. In AIC’s view if the Commission pools two separate lines of credit into one and assigns the smallest, least cost commitments to AIC, Ameren certainly cannot expect to proportionally recover the larger higher cost commitments from its Missouri customers. AIC believes it should be permitted to recover the costs it incurs on a facility entered into to support AIC operations. AIC thinks the better solution here is to leave the commitments separate and associated with their own fee, as AIC proposes to do in this case.

2. **Staff Position**

Staff states that Ameren established three credit facilities in September 2010: the $800 million Ameren Illinois credit facility (the “Illinois Facility,” which covers AIC and Ameren), the $800 million Ameren Missouri credit facility, and the $500 million Genco credit facility. Ms. Phipps calculated one-time arrangement and upfront fees for AIC to maintain its bank lines of credit and annualized the amount over the three-year period for which the credit facility will be effective, as well as annual fees, to arrive at her recommendation to add 8 basis points to AIC’s overall cost of capital for bank commitment fees.

Staff says the contested issue regarding bank commitment fees relates to the amount of upfront fees. Staff notes that Section 9-230 of the Act prohibits including in a utility’s allowed ROR any increased cost of capital which is the direct or indirect result of the public utility’s affiliation with unregulated or non-utility companies. Staff says bank commitment fees vary from 0.25% to 0.875% of the amount of each lender’s aggregated commitments to the three credit facilities. Staff adds that AIC’s response to Staff data request RMP 1.04
states, “[u]pfront fees were paid as a percentage of each bank’s credit commitment . . . banks that committed less than $75 million received 25 basis points.” Staff claims the highest commitment by a single lender to the Illinois Facility was $47.62 million. Staff claims the fee schedule indicates that each lender would have charged AIC 25 basis points if the upfront fee had been assessed against the commitment to the Illinois Facility alone. Ms. Phipps calculated upfront fees of $2,000,000 (i.e., 0.0025 x $800 million). Staff also contends that Ameren’s ability to borrow up to $300 million under the Illinois Facility effectively reduces the AIC sub-limit to $500 million (or 62.5% of the $800 million facility). Ms. Phipps calculated $1,250,000 of upfront fees she believes is recoverable for ratemaking purposes pursuant to Section 9-230 of the Act.

AIC alleges that Ms. Phipps misinterpreted data it provided regarding upfront fees. Further, AIC alleges that it separately negotiated the upfront fees for the Illinois Facility. Staff believes the facts show otherwise. According to Staff, the invoice setting forth the closing fees covers all three credit facilities. Staff also asserts that the Illinois, Missouri, and Genco upfront fees are identical percentages of the total commitment to those facilities (i.e., 0.665%). Staff claims that excepting the names of the companies listed, the Arrangers Fee Letters are identical for the three facilities. Staff also contends that the individual bank commitments to the Illinois and Missouri facilities are identical and each bank’s commitment to Genco is exactly 62.5% of that bank’s commitment to the Illinois and Missouri facilities.

Next Staff asserts that since the Commitment Fee Rates are all multiples of 0.5 basis points and each bank commitment is a multiple of $5 million, each bank received a commitment fee that is a multiple of $250 (i.e., 0.005% x $5 million). Staff says, nonetheless, the upfront fees to the three facilities are all calculated to the nearest penny (i.e., $3,325,892.86 to the Genco credit facility and $5,321,428.57 to both Illinois and Missouri credit facilities). Staff argues that calculating upfront fees totaling millions of dollars, down to the penny, in amounts exactly proportionate to three facilities entered at that time, is consistent with allocating upfront fees negotiated jointly rather than separately negotiating upfront fees for the Illinois facility. If the three facilities had been negotiated independently, Staff insists some variation in these fee amounts and individual bank commitment amounts per total commitment should exist, but there is none.

Staff notes that AIC claims that its affiliation with Genco does not result in any increases in Illinois facility commitment fees. The Company also claims that banks are willing to accept a lower commitment fee rate for a larger combined transaction and that economies of scale would have resulted in lower bank commitment fees. Staff argues that to the contrary, under the terms of the Illinois facility, the upfront fee rates increase as commitment amounts increase. Staff asserts that as such, aggregating commitments under the Illinois, Missouri and Genco credit facilities results in higher upfront fees than would result from calculating upfront fees based on the commitments under each individual credit facility. Staff also believes there are no economies of scale associated with a larger credit facility given that, under the terms of the Illinois facility, upfront fee rates increase as
commitment amounts increase.

Staff says AIC argues it concluded the Illinois facility fees were reasonable and prudent because its commitment fee rate was consistent with rates paid by other utilities during 2010. Staff believes AIC’s argument should be disregarded on two levels. On the factual level, Staff claims the argument implies the data for credit facilities provided in Ameren Ex. 24.5 are similar to the Illinois facility. Staff asserts that Ameren Ex. 24.5 does not reveal the fee rate for bank commitments of similar magnitude to those in the Illinois facility (i.e., $50 million or lower). Staff also contends that AIC’s argument misses the legal issue. Staff insists the adjustment to the upfront fees is not a matter of reasonableness or prudence. Staff believes the issue falls under Section 9-230 of the Act because the commitment fee rate is progressive (i.e., escalating) and determined on the basis of aggregate bank commitments under the Illinois, Missouri and Genco facilities. Staff maintains that the fee rate AIC pays is a direct function of its affiliation with non-utility and unregulated companies. Staff says the greater the commitment to the Missouri and Genco facilities, the higher upfront fee rate AIC pays.

According to Staff, Illinois courts have specifically addressed this issue regarding the interpretation of Section 9-230 of the Act. Staff believes all discretion for the Commission has been removed. Staff insists Section 9-230 does not allow the Commission to consider what portion of a utility’s increased risk or cost of capital caused by affiliation is “reasonable” and therefore should be borne by the utility’s ratepayers; the legislature has determined that any increase whatsoever must be excluded from the ROR determination. Staff believes it is impermissible for the Commission to substitute its reasonableness standard for the legislature’s absolute standard. Staff says the Court determined it is not permissible for the Commission to substitute its reasonableness standard for the legislature’s absolute standard. In Staff’s view, AIC’s arguments that the Illinois facility fees were reasonable and prudent is irrelevant to its recovery of these fees. Staff insists that as a matter of law, the Commission must adopt Staff’s recommendation that AIC’s cost of capital for bank commitment fees equals 8 basis points rather than the 10 basis point adder AIC seeks.

In its Reply Brief, Staff says AIC alleges further that Staff’s proposal misapplies Section 9-230 of the Act. AIC argues that Staff: (1) assumes escalating fees as a result of a hypothesized single line of credit; (2) includes in its combined analysis the fees associated with a regulated utility, AmerenUE. AIC contends that affiliations with regulated utilities by definition cannot give rise to a Section 9-230 adjustment; and (3) Staff failed to establish any basis in fact or expert opinion that AIC could realistically obtain a reliable credit facility for the fee equivalent as low as 25 basis points.

Staff argues that the pooling of the three Ameren facilities (i.e., Illinois facility, Missouri facility and Genco facility) into a “single line of credit” was an actual occurrence, not a hypothetical one, at least from the standpoint of applying upfront fees to each bank’s aggregate commitment to the three facilities. In contrast, Staff claims it calculated the
upfront fee as if the Illinois facility had been negotiated separately and that the upfront fee rates had been applied to the actual bank commitments to the Illinois facility. Staff says AIC insists that its customers compensate it for the higher fee rate that was assessed against the aggregate bank commitments to the three facilities. According to Staff, the escalating upfront fee scale for credit facilities of Ameren and its subsidiaries is nothing new. Staff says it made the same adjustment in the last AIC rate case, which the Commission adopted, despite similar arguments by AIC regarding the reasonableness of the bank commitment fees. (Staff Reply Brief at 34, citing Docket Nos. 09-0306 et al. (Cons.), Order at 155)

AIC asserts that Staff improperly includes in its combined analysis the fees associated with a regulated utility (AmerenUE) and argues that affiliations with regulated utilities by definition cannot give rise to a Section 9-230 adjustment. Staff contends that to the contrary, Section 3-105(a) of the Act limits its definition of public utility to companies that operate within Illinois. In Staff’s view, a Missouri utility is not a “public utility” under the Act, which means, for the purpose of applying Section 9-230 of the Act, AmerenUE is a non-utility affiliate of AIC.

Staff maintains that whether the fee is reasonable in comparison to the fees other companies pay to obtain a credit facility is irrelevant. Staff insists that Section 9-230 adjustments are not reasonableness adjustments. Nevertheless, Staff says AIC points to upfront fees for ComEd and Peoples to show the AIC fees are reasonable. Staff suggests that fee rates could have declined over the five to six months that elapsed between the February 2010 and March 2010 effective dates of the ComEd and Peoples facilities on the one hand and the August 2010 effective date of the AIC facility on the other. Staff also contends there is no evidence in the record regarding whether there are escalating upfront fees associated with the Peoples credit facility and whether the fee rates Peoples paid were assessed against bank commitments to Peoples’ facility in isolation or against aggregate bank commitments to all three Integrys Energy facilities (i.e., Integrys Energy, Peoples and Wisconsin Public Service). Staff believes that in any event, the reasonableness of those fees is irrelevant because whether costs are reasonable is beyond the scope of Section 9-230 of the Act. That is, Staff maintains that Section 9-230 prohibits incremental costs resulting from non-utility affiliates, regardless of whether a “market-based analysis” suggests those costs are reasonable.

3. Commission Conclusion

With regard to the credit facility commitment fees, Ameren Ex. 24.3 shows that on July 29, 2010, three credit facilities were executed. The Illinois credit facility is an $800 million facility for AIC and Ameren. The Missouri credit facility is also an $800 million facility for AmerenUE (now AMC) and Ameren. What is known as the Genco facility is a $500 million facility that includes Genco and Ameren.
Staff contends that if the Illinois credit facility had been established on its own separate from the Missouri and Genco credit facilities, the fees would have been lower. AIC maintains that the facilities were separate and distinct from one other, and it has only requested recovery of the specific fees associated with the AIC facility according to the invoice received. AIC insists that Ameren Ex. 24.1 shows the actual and appropriate fees associated with the Illinois credit facility. Staff disagrees because AIC’s response to a Staff data request, which is part of the record as Staff Ex. 24.0, Attachment 1, shows a fee schedule that differs from what is shown on Ameren Ex. 24.1. Specifically, Staff’s exhibit indicates that banks that commit less than $75 million are to receive a 25 basis point commitment fee rate. Staff points out that Ameren Ex. 24.1 shows that no bank committed more that $75 million to the Illinois credit facility.

AIC argues, essentially, that Staff misinterpreted the information shown in Staff Ex. 24.0, Attachment 1, because it presented fee rates based upon the aggregate amount borrowed under the three credit facilities. The Commission believes that, at least to some extent, this undermines AIC’s assertion that the Illinois credit facility was negotiated entirely independently from the other two credit facilities. In the Commission’s view, this issue involves the question of whether the fee rate schedule shown on Ameren Ex. 24.1, page 1, would have been exactly the same if the Illinois credit facility had been negotiated totally independently from the other two credit facilities. While the Commission believes that it is possible, AIC has failed to adequately demonstrate that this is certain, or even likely. The Commission finds Staff’s reliance on AIC’s response to a data request to be reasonable and, therefore, adopts Staff’s recommendation with respect to the calculation of the Illinois credit facility fees.

F. Cost of Long-Term Debt

Staff recommends a 7.44% embedded cost of long-term debt for AIC. As discussed below, AIC disagrees with Staff’s adjustments to (1) the coupon rate for AIC’s expected October 2012 bond issuance; (2) reduce the principal amount of the $400 million 9.75% bonds that AmerenIP issued in October 2008 by $50 million; and, (3) reduce the interest rate for the 8.875% bonds that AmerenCILCO issued in December 2008 to 6.76%.

1. AIC Position

With regard to the coupon rate for AIC’s expected October 2012 bond issuance, AIC indicates that the same argument concerning the use of forecasted versus present interest rates controls the outcome of this contested issue.

In 2008, AmerenIP issued $400 million of debt with a coupon rate of 9.75%. AIC states that in its last rate case, the Commission approved Staff adjustments to the cost of
capital associated with this debt issuance. In the present docket, AIC says Staff proposes a new adjustment to replace $50 million worth of the 9.75% debt issuance with debt having a hypothetical coupon rate equal to the overall weighted cost of capital. AIC cannot accept Staff’s proposed adjustment to AmerenIP’s debt issuance, claiming it is unfair and lacks empirical analysis or other support.

AIC believes Staff’s position as advanced in this case is not legally tenable. AIC insists it is entitled to recovery of its prudently incurred costs in providing service. In determining whether a management decision was imprudent, AIC says the Commission has held that hindsight review is impermissible and a finding of imprudence cannot be sustained by substituting one person’s judgment for that of another.

According to AIC, Mr. Martin had personal knowledge of the undertaking of the 2008 debt issuance, and testified that it was prudently undertaken based on careful consideration of relevant and observable facts and circumstances during a period of near global financial catastrophe. AIC says Ms. Phipps claims that the debt was issued in an amount more than it required, but stated that Staff was not alleging imprudence. AIC says she also clarified her adjustment was not based upon any Section 9-230 analysis. Referring to the collapse of Lehman Brothers, AIC says Ms. Phipps even acknowledged the validity of Mr. Martin’s stated position that at the time of the issuance financial markets were distressed.

In AIC’s view, Staff has failed to articulate any facts or expert analysis that would support its proposed adjustment pursuant to an applicable legal standard. AIC argues that if Staff alleges no imprudence in the actions of management in this case or other legally sustainable basis for a disallowance, then Staff is simply substituting its judgment for that of the AIC’s management in hindsight fashion. AIC maintains a disallowance cannot be sustained upon such testimony.

AIC states that in its Initial Brief, Staff has quoted a specific portion of the most recent AIC rate case Order in favor of the adjustment proposed by Ms. Phipps in the present docket. According to AIC, the cited portion of the order essentially explains that the Commission agreed with Staff; $50 million out of a $400 million long-term debt issuance by AmerenIP for 9.75% should be excluded from Ameren IP’s long-term debt given that AmerenCIPS was contemporaneously enjoying a loan for the same amount contributed in part by AmerenIP through the intercompany money pool. AIC states that the finding reflects a concern related to cross-subsidization among separate Illinois utility affiliates. AIC’s questions why this section would be cited by Staff in the present docket, considering AIC now has a single unified capital structure. AIC contends that the cross-subsidy concern is no longer relevant. AIC asserts that the debt capital associated with the AmerenIP issuance is now embedded within a unified capital structure inclusive of all pre-existing long-term debt, including both AmerenCIPS and AmerenIP issued debt.

AIC says it respectfully disagreed with Staff’s adjustment, fully realizing a similar
adjustment was previously approved over its objections. AIC says the legal basis for the disallowance is unclear. AIC also indicate it does not understand Staff’s “perverse result” argument. In AIC’s view, the rationale almost reads to mean that the company is being penalized for some misdeed, which is not management imprudence. Hypothetically speaking, AIC suggests that if a utility somehow did elevate the debt level errantly in a manner that reduced equity relative to debt, the result would be a neutral or beneficial impact on the capital structure and weighted overall cost of capital from a ratepayer perspective. AIC believes that if such circumstance were in fact the case, then it would follow that no adjustment is warranted.

AIC notes that Staff proposes an adjustment to AIC’s 2008 debt issuance by AmerenCILCO bearing a coupon rate of 8.875%. Staff believes that reducing the coupon rate is necessary in order to comply with Section 9-230 of the Act, alleging that AIC’s cost of capital is higher due to AmerenCILCO’s affiliation with Ameren Energy Resources Generating (“AERG”) in 2008. AIC indicates a similar adjustment was proposed by Staff in Docket Nos. 09-0306 et al. (Cons.) and was ultimately approved by the Commission in that docket. AIC says Staff proposes a similar adjustment in this proceeding, with Ms. Phipps revising her adjusted coupon rate higher to 6.76% from 6.24%.

AIC believes no adjustment is warranted and it fundamentally disagrees with the methodology used to support it. AIC claims new facts have emerged since the last rate case, casting doubt on Staff’s methodology. AIC claims Staff’s analysis, even as revised in this case, is deficient, and the cost of the debt should be valued at its issued coupon rate of 8.875%.

AIC contends that AERG did not give rise to increased risk, or additional interest cost paid by AmerenCILCO, due to its then existing affiliation with AERG, or parent holding company, CILCORP. AIC says that in Docket Nos. 09-0306 et al. (Cons.), Staff proposed a disallowance based upon a methodology designed to replicate how credit ratings agencies would have perceived AmerenCILCO as a stand alone utility. Ms. Phipps employs the same methodology in support of her adjustment in the present case. She continues to believe such an adjustment is warranted by relying upon a hypothetical Moody’s analysis that would surmise had AmerenCILCO been a stand alone utility, it would have been the highest rated utility in the United States by Moody’s.

AIC contends that the hypothetical conditions that Ms. Phipps attempted to model in support of a stand-alone analysis have come to fruition. AIC states that in 2010, AmerenCILCO divested itself of AERG after the Order was issued in Docket Nos. 09-0306 et al. (Cons.) and prior to the closing of the merger creating AIC. AIC also says Fitch Ratings (“Fitch”) issued a report downgrading AmerenCILCO’s credit rating on May 20, 2010, citing expressly the transfer of AERG from AmerenCILCO and the loss of the associated margins as rationale supporting the downgrade. AIC indicates that Fitch is a credit ratings agency and it is recognized by the financial industry alongside S&P and Moody’s.
In AIC’s view the fact that Fitch would explicitly cite the divestiture of AERG as a reason supporting a downgrade would bode contrary to Ms. Phipps underlying premise, and the specific comment by Fitch regarding the “loss of electric gross margins” reveals the primary fault with Ms. Phipps’ analysis. AIC says Fitch recognized that AERG contributed to AmerenCILCO’s credit quality rather than detracted from it, specifically by generating substantial cash flow. AIC asserts that Ms. Phipps’ failure to consider the import of significant cash flows generated by AERG erroneously led her to believe AmerenCILCO would have been substantially better situated as a stand alone utility from a credit ratings standpoint. AIC claims her "asymmetrical" approach caused her to remove business risk without consideration of business return in her attempt to replicate credit rating analytics. AIC further asserts that her own testimony illustrates the magnitude of the AERG cash flows in comparison to regulated operations.

According to AIC, Ms. Phipps’ failure to include the cash and net income contributions of AERG in her analysis is exacerbated by her improper use of rating metrics and methodological guidance. AIC says Ms. Phipps assigned a “strong” S&P business risk profile to AmerenCILCO; however, a “strong” business risk profile does not lead automatically to a BBB+ issuer rating as Ms. Phipps’ analysis would tend to suggest. AIC claims that on average a utility would need to have a user profile of “excellent,” which is higher than “strong,” to receive a BBB+ issuer rating from S&P. AIC states that for her Moody’s analysis, which led to the development of her “Implied” Moody’s credit rating of A1, Ms. Phipps utilized a ratings guidance framework that did not even exist in 2008. According to AIC, she appears to have applied credit metrics in 2008 using a 2009 ratings model mixed with a previously established 2005 model. AIC claims the resulting analysis offered by Ms. Phipps in direct testimony was "staggering" because she proposed disallowing over 263.5 basis points of interest costs, leading to a proposed revenue requirement reduction totaling almost $3 million.

AIC states that while Ms. Phipps ultimately did revise her adjustment upward by approximately 50 basis points in response to the criticism made by Mr. Martin, Staff continues to rely upon the same hypothetical Moody’s stand-alone analysis to support a substantial disallowance against AIC of almost 220 basis points. AIC says Ms. Phipps dismisses the Fitch report, reasoning that since many factors contributed to the Fitch downgrade, a citation to the transfer of AERG does not warrant reconsideration of her analysis.

AIC insists a plain reading of the Fitch report contained in Ameren Ex. 24.6 reveals that the AERG transfer was a significant consideration, if not a primary driver, of the agency’s ratings downgrade. AIC also claims that the fact that Ms. Phipps would note that many factors contribute to the overall credit picture belies the foundation of the analysis she employs in support of her adjustment.

AIC believes Ms. Phipps took Moody’s comments concerning the business risk
imposed upon AmerenCILCO by AERG out of the context of a broader ratings report in
developing her analysis. AIC says Ms. Phipps agrees that a rating agency would look at
many factors when it develops ratings. According AIC, her own stand-alone analysis
focuses on one predominant factor: relative business risk associated with AmerenCILCO’s
affiliation with AERG. AIC says while acknowledging the existence of several “ratings
drivers,” she focuses on several comments appearing in a Moody’s ratings report from 2009,
under the heading “detailed ratings considerations,” and more specifically, under the sub-
heading entitled “Environmental Capital Expenditures at AERG.” AIC claims the purpose
of this section of the report was to highlight specific risks associated with the merchant
business, not to make any statement regarding whether the merchant business improved or
weakened AmerenCILCO’s overall creditworthiness.

AIC does not dispute that Moody’s did comment on the relative business risk of the
AERG merchant generating units in its report. AIC maintains that those considerations were
made within the context of environmental capital expenditures, as the heading suggests.
AIC asserts many other factors were presented in the report including the legislative activity
associated with the Illinois electric rate freeze and limited financial flexibility due the
expiration of a revolving credit facility, as well as more detailed considerations. AIC also
says Ms. Phipps acknowledges that while Moody’s did make recommendations in a section
of its report entitled “What Could Change the Ratings Up,” the particular section makes no
mention of the divestiture or transfer of AERG. It seems to AIC that if Ms. Phipps’ logic were
valid, and a stand alone AmerenCILCO unaffiliated with AERG would have been the highest
rated utility in the United States by Moody’s, the ratings agency would have made at least
passing mention of the possible transfer, divestiture, sale or other similar action in its section
entitled “What Could Change the Ratings Up.”

AIC argues that Ms. Phipps did what she held out to oppose, taking in isolation one
consideration from the context of broader considerations in a ratings agency report. According to AIC, the most glaring consideration that Ms. Phipps did not include in her
analysis are the cash and income contributions of AERG – contributions that were
considered by ratings agencies evaluating credit worthiness of AmerenCILCO.

AIC states that in rebuttal, Ms. Phipps asserts that she did not rely solely upon the
affiliation with AERG as the basis for her adjustment, but also the debt associated with
AmerenCILCO’s parent holding company CILCORP. AIC contends that her own table
demonstrates that for the years 2007 and 2008, the “Net Income” from AERG greatly
exceeded CILCORP’s “Interest Expense.” AIC says even net of CILCORP interest expense,
AERG net income exceeded what her tables identifies as “Illinois Regulated Income.” AIC
adds that Ms. Phipps’ table does contain AERG net income amounts for 2005 and 2006 that
are less than the CILCORP debt expense for the same respective period. According to AIC,
Ms. Phipps also agreed that both of those years were prior to the lifting of the Illinois rate
freeze, and she further acknowledged that Moody’s and other credit ratings agencies would
have been aware of that fact. AIC does not dispute that a credit ratings agency would look
favorably upon reduced debt of a utility or its holding company, but claims it is equally clear a credit ratings agency would also give consideration to the cash contributions of business lines. With regard to AmerenCILCO’s 2008 debt issuance, AIC maintains that AERG earnings greatly exceeded debt expense in the relevant period immediately preceding issuance. AIC believes it is asymmetrical to consider debt without associated revenue. AIC contends that while Ms. Phipps appears to argue that CILCORP debt is some separate factor she considered in addition to AERG income and cash flows, the asymmetrical analysis remains; Ms. Phipps considered non-regulated risk and debt, while at the same time ignoring the offsetting impact of non-regulated earnings and cash flows.

In AIC’s view, it is illogical and unfair to assume that had AmerenCILCO not been affiliated with AERG and CILCORP it would have been the highest rated utility in the United States, affording it the ability to obtain debt at a rate approximately 220 basis points below what was actually paid. AIC believes the record cannot support such an analysis, nor can it sustain the resulting adjustment. AIC recommends that the Commission establish a cost of long-term debt for AIC at a weighted average cost inclusive of AmerenCILCO’s 2008 debt issuance at its issued coupon rate of 8.875%.

In its Reply Brief, AIC repeats that Staff developed a hypothetical credit rating in order to replicate how Staff believed a credit ratings agency would view AmerenCILCO as a stand-alone utility in 2008. AIC alleges that Staff’s hypotheses can now be tested because the stand-alone condition actually occurred and, during that time, Fitch issued a credit rating for the utility. According to AIC, Staff’s hypothetical analysis held out that if AmerenCILCO had no affiliation with its parent, CILCORP, or its unregulated generation affiliate, AERG, it could have enjoyed a vastly improved credit rating.

AIC says Staff argues that the Commission should ignore the Fitch report because it is a “subsequent event.” According to AIC, Staff’s hypothetical stand-alone rating itself was a subsequent event. AIC contends that the only contemporaneous events would have been the conditions that led to the issuance of the debt at its stated coupon rate.

AIC adds that Staff also asks the Commission to disregard the Fitch report by arguing that several factors led to the downgrade in addition to the AERG divestiture. AIC claims the divestiture was a significant consideration of Fitch if not a driver of the downgrade. AIC also says it never held out the Fitch Report as exculpatory evidence in and of itself, but believes the report highlights the serious flaws in Staff’s analysis – particularly the failure to consider net income and cash flows generated by AERG.

Staff additionally argues that the consolidation of the three Ameren Illinois Utilities was a factor that contributed to the Fitch downgrade. AIC says Staff cites this despite the fact that Staff’s adjustment is premised on a theory that the presence of AmerenCILCO’s unregulated affiliate’s business risk increased the cost of its debt issuance. AIC notes that neither AmerenIP nor AmerenCIPS had unregulated generation affiliates. AIC argues that if
the absence of an unregulated affiliate company so dramatically improves credit quality, it is inexplicable that a planned merger with two truly stand-alone utilities would be a factor that would negatively impact AmerenCILCO’s rating, particularly considering the divestiture of AmerenCILCO’s unregulated affiliates had already occurred.

2. **Staff Position**

   AIC expects to issue $150 million bonds during October 2012 to replace the $150 million bonds that matured in June 2011. Staff recommends a 4.4% interest rate for those bonds, which equals the June 3, 2011, 3.11% 10-year U.S. Treasury bond yield, plus the current 129 basis points spread over treasuries for 10-year Baa1/BBB+ rated utility bonds. In contrast, AIC’s proposed 5.4% interest rate adds a similar spread over treasuries to the average 2012 and 2013 consensus forecasts for 10-year U.S. Treasury bonds (3.8% and 4.5%, respectively).

   Staff believes AIC’s proposed rate for the October 2012 debt issuance should be rejected because it reflects a forecasted interest rate instead of a current, observable interest rate. Staff states that while AIC argues that it is reasonable to rely on interest rate forecasts, which are based on expert analysis, for forward test year purposes, accurately forecasting interest rates is problematic, and the accuracy of a forecast diminishes as the time horizon lengthens. Staff notes this is the same argument it makes with regard to the cost of short-term debt.

   AIC argues that Ms. Phipps’ current U.S. Treasury yield is inappropriate and unreasonably conservative. AIC contends that 10-year Treasury yields are near historic lows and the prevailing opinion among economist is that yields will rise in the near term. Staff notes that 10-year U.S. Treasury bond yields have fallen since the date of Staff’s analysis. Staff says that on September 6, 2011, the 10-year U.S. Treasury bond yield equaled 2.02%, which Staff claims is much lower than the 3.11% U.S. Treasury bond yield that Staff used to derive its 4.4% coupon rate estimate, and even the 3.1% yield that professional forecasters predicted just one month earlier. Staff also asserts that Blue Chip Financial Forecast, AIC’s primary source for interest rate forecasts, has lowered its projections since the January 2011 publication that AIC relied upon for its proposed long-term debt rate. Staff states that the August 2011 Blue Chip Financial Forecast estimates 10-year T-bond yields that are 40 basis points (0.40%) lower than the January 2011 Blue Chip Financial Forecast.

   According to Staff, the effect of the decrease in interest rates can be seen in a recent bond issuance by ComEd. Staff says that in August 2011, ComEd issued $350 million 10-year bonds with a 3.4% coupon rate. Staff claims that during the next three to four months, when rates set at the conclusion of this proceeding will become effective, the market rate of interest on ten-year, BBB+/Baa1-rated utility bonds would have to rise about one percentage
point to equal Staff’s proposed 4.4% rate and two percentage points to reach AIC’s proposed 5.4% rate. Staff contends that even if interest rates are at historic lows, AIC’s forecast would require a large increase over a very short period, which is not plausible.

For the purpose of calculating the embedded cost of long-term debt (but not for the purpose of calculating the balance of long-term debt), Staff recommends reducing the balance of the $400 million 9.75% bonds that AmerenIP issued during October 2008 to $350 million. Staff says this adjustment is based on the Order from Docket Nos. 09-0306 et al. (Cons.) in which the Commission concluded that AmerenIP issued $50 million more long-term debt than required for its utility operations during October 2008.

For the current docket, Ms. Phipps used the resulting calculated embedded cost of long-term debt, 7.39%, as the coupon rate for the remaining $50 million of AmerenIP’s October 2008 bonds. Consequently, Staff Ex. 7.0, Schedule 7.02, “Embedded Cost of Long-Term Debt,” splits the October 2008 bonds into two entries. The first entry shows $350 million of bonds issued at the actual interest rate of 9.75%. The second entry shows $50 million of bonds issued at the overall embedded cost of debt rate of 7.39%. Ms. Phipps asserts that removing $50 million in 9.75% bonds from AIC’s long-term debt for the purpose of calculating the balance of long-term debt would have the perverse result of a disallowance that increased AIC’s ROR on rate base due to a shift in the capital structure weights from lower cost debt to higher cost common equity. Staff recommends that the Commission adopt its adjustment, which removes $50 million of costly long-term debt from AIC’s cost of capital that the Commission found AmerenIP did not require for utility operations in Docket Nos. 09-0306 et al. (Cons.).

In its Reply Brief, Staff contends that AIC errs when it states that Staff proposes a new adjustment to replace $50 million worth of the 9.75% debt issuance with debt having a hypothetical coupon rate equal to the overall weighted cost of capital. Staff asserts that it set the coupon rate for the remaining $50 million of AmerenIP’s October 2008 bonds equals to the 7.39% embedded cost of long-term debt. Staff maintains that this adjustment is a disallowance because AIC issued more long-term debt than required for utility operations in October 2008. According to Staff, despite AIC’s attempt to re-litigate this issue in the instant case, AIC has presented neither a single new fact nor argument that the Commission did not consider in AIC’s previous rate case – a case in which the Commission deemed AmerenIP’s issuance of $50 million more long-term bonds than required for utility operations as imprudent.

AIC alleges that Staff failed to articulate any facts or expert analysis that would support its proposed adjustment. In Staff’s view, AIC’s argument misses the point entirely. Staff insists that AIC ignores the fact that the Commission already decided this issue in AIC’s prior rate case. Staff says the Commission Order in Docket Nos. 09-0306 et al. (Cons.), clearly set forth numerous facts surrounding AmerenIP’s October 2008 debt issuance—including the bankruptcy filing by Lehman Brothers and distressed financial markets – and
concluded AmerenIP issued $50 million more long-term debt than required for utility operations. Staff also asserts that it is AIC’s burden, not Staff’s, to articulate new facts and arguments that would merit a different decision on this issue in the instant proceeding. Staff believes AIC has provided no new evidence or argument in support of its position. Staff claims such facts reveal the falsity of AIC’s allegation that Staff’s adjustment substitutes its judgment for that of the AIC management in hindsight fashion.

Staff asserts that AmerenCILCO’s affiliation with both CILCOP and AERG adversely affected AmerenCILCO’s cost of capital in December 2008 based on rating agencies’ reports that indicated AmerenCILCO’s business risk profile reflected its affiliation with AERG and CILCOP. Staff says it removed the incremental effect of both of those non-utility affiliates from AmerenCILCO’s authorized ROR in accordance with Section 9-230 of the Act.

Staff states that using the S&P rating methodology, Ms. Phipps changed AmerenCILCO’s business risk profile from “Satisfactory,” which S&P stated reflected AmerenCILCO’s non-regulated businesses, to “Strong,” which was the less risky business risk profile that S&P assigned to AmerenCIPS and AmerenIP. Staff indicates that using the Moody’s rating methodology, Ms. Phipps changed AmerenCILCO’s business risk profile from “Medium” (the typical business risk profile for integrated utilities) to “Low” (the typical business risk profile for less risky transmission and distribution utilities). According to Staff, Ms. Phipps concluded that AmerenCILCO’s implied credit rating would increase by two notches (from A1 to Aa2) if its business risk profile were “Low” instead of “Medium.” Given AmerenCILCO’s actual senior secured debt rating from Moody’s was Baa2 in December 2008, Staff says Ms. Phipps concluded that AmerenCILCO’s secured debt rating would have been two notches higher, or A3, if AmerenCILCO’s non-utility affiliates had not increased its business risk profile. Ms. Phipps recommends a 6.76% coupon rate for the bonds AmerenCILCO issued in December 2008, which reflects the average yield for A3/A- rated bonds during the same measurement period.

Staff indicates that in Docket Nos. 09-0306 et al. (Cons.), the Commission adopted this adjustment by Staff. Staff asserts that in the instant case, AIC mischaracterizes Staff’s testimony when it alleges that Staff concluded that absent a single credit factor (i.e., AmerenCILCO’s ownership of AERG), AmerenCILCO’s credit ratings would have been higher and its cost of debt would have been lower. Staff contends that both of AmerenCILCO’s non-utility affiliates – CILCOP and AERG – affected AmerenCILCO’s credit ratings.

AIC alleges that since Fitch lowered AmerenCILCO’s credit rating in May 2010 and Moody’s affirmed AmerenCILCO’s Baa3 rating following the transfer of AERG to another Ameren subsidiary, that one could conclude AmerenCILCO’s ownership of AERG did not adversely affect AmerenCILCO’s credit ratings or increase CILCO’s borrowing cost. Staff argues that the recent downgrade to AmerenCILCO’s credit rating by Fitch does not warrant revisiting the interest rate adjustment for the bonds that AmerenCILCO issued during
December 2008. Staff says that since the cost of fixed-rate debt is established at the time of issuance and does not adjust in response to changes in the market yield spreads or in the creditworthiness of the issuer, the coupon rate adjustment should be based on the facts at the time of the bond issuance. Staff believes the adjustment should not be based on subsequent events.

Staff also contends that several factors contributed to the downgrade of AmerenCILCO’s issuer default rating, which makes it impossible to separate the net effect of one factor from other factors. Staff says Fitch acknowledged that the transfer of AERG lowered the business risk of AmerenCILCO and, at the same time it lowered AmerenCILCO’s issuer default rating to BBB- from BBB, it affirmed the BBB- issuer default ratings of AmerenCIPS and AmerenIP. According to Staff, Fitch stated that commingling all the monies of AmerenCIPS, AmerenIP and AmerenCILCO supports equalization of the ratings given bondholders would share in a single pool of cash flow. Staff believes it is important that Fitch explained that AmerenCILCO’s downgrade reflects the Commission’s April 2010 rate order and the consolidation of AmerenCIPS, AmerenIP and AmerenCILCO, as well as management’s plan to transfer AERG to an affiliate that owns other merchant generation assets.

AIC argues that Ms. Phipps considered historical metrics that were not adjusted to exclude AERG’s meaningful cash flows. Staff responds that Ms. Phipps explained that AIC’s characterization of AERG cash flows as meaningful cash flow contributions that provided a significant positive impact on AmerenCILCO’s creditworthiness is based on an incomplete picture of AERG’s effect on AmerenCILCO. Staff claims AERG’s $5 million net loss in 2005 had a negative effect on AmerenCILCO’s consolidated net income and, in 2006, AERG’s net income was slightly less than the contribution by AmerenCILCO’s regulated Illinois segment. Staff also asserts that AmerenCILCO’s credit rating was constrained by $210 million of long-term debt at its intermediate parent company CILCORP, which had significantly lower financial metrics on a consolidated basis than AmerenCILCO. Staff says CILCORP paid approximately $31 million interest expense annually from 2005-2008 in connection with its outstanding indebtedness. Staff states that AERG’s net income totaled $135 million from 2005-2008. In comparison, Staff says CILCORP interest expense totaled $130 million. Staff also contends that AERG cash flows were volatile in comparison to CILCORP’s interest requirements. According to Staff, AmerenCILCO was squeezed between AERG’s higher operating risk and additional financial risk from CILCORP. Staff claims that much of AERG’s cash flows merely replaced the cash needed to service CILCORP’s debt.

In its Reply Brief, Staff says AIC attempts to cast doubt on Ms. Phipps’ evaluation of the rating that S&P would have assigned an AmerenCILCO with the same “strong” business risk profile as AmerenCIPS and AmerenIP, as opposed to AmerenCILCO’s actual riskier business risk profile of “satisfactory”). Staff maintains that the same analysis of AmerenCILCO’s implied standalone S&P credit rating was the basis for Staff’s adjustment to the December 2008 bonds in the last case, which the Commission adopted.
Staff indicates that in the instant case, Ms. Phipps revised her adjustment in response to an AIC claim that Ms. Phipps’ evaluation of the rating that Moody’s would have assigned a standalone AmerenCILCO was flawed in that it combined Moody’s 2005 and 2009 rating methodologies. Staff states that Moody’s 2005 methodology was appropriate for evaluating the effect of adjusting AmerenCILCO’s business risk profile given that AmerenCILCO’s December 2008 debt issuance preceded publication of Moody’s 2009 methodology. Staff says Ms. Phipps testified that the only distinguishable differences between those methodologies are (1) the 2005 methodology provided separate financial benchmarks for “Medium” and “Low” business risk profiles; and (2) the 2009 methodology discloses the weights that Moody’s assigns each of the credit metrics. According to Staff, there is no indication that the weights Moody’s assigns credit metrics in the 2009 methodology changed from the 2005 methodology. Nevertheless, Staff says Ms. Phipps re-evaluated the effect that changing AmerenCILCO’s business risk profile from “Medium” to “Low” would have on AmerenCILCO’s credit metrics without using those weights provided in the 2009 methodology.

In its Reply Brief, Staff also contends that AIC’s arguments regarding the 2009 Moody’s report on AmerenCILCO should be rejected given AIC’s cost of capital witness admitted he is not familiar with the 2009 Moody’s report that Ms. Phipps relied upon to support her adjustment. (Staff Reply Brief at 39, citing Tr. at 210) In Staff’s view, AIC’s arguments that a 2009 rating agency report would have mentioned the possible transfer or divestiture of AERG, which was not announced until 2010, are absurd.

AIC alleges that Ms. Phipps’ hypothetical Moody’s analysis would surmise had AmerenCILCO been a standalone utility, it would have been the highest rated utility in the United States by Moody’s. Staff claims that AIC misrepresents the evidentiary record and that this statement is false and improper on two levels. First, Staff claims it assumes facts not in evidence; that is, the highest rating Moody’s has conferred upon a utility. Second, Staff asserts the statement falsely alleges that Ms. Phipps concluded that AmerenCILCO would have been rated Aa2 had it been a standalone company. Staff argues that to the contrary, Ms. Phipps expressly stated that she did not conclude that AmerenCILCO would have been rated Aa2 on a standalone basis; rather, she increased AmerenCILCO’s actual senior secured debt rating by two notches to A3, which is the difference in credit ratings implied by comparing AmerenCILCO’s credit metrics to benchmarks for Medium risk versus Low risk utilities. Staff states that while it is correct that AmerenCILCO’s financial ratios were commensurate with an Aa2 credit rating on a standalone basis, Ms. Phipps testified that credit ratings are also based on qualitative factors. Staff also says that while acknowledging that there is no way to replicate completely what Moody’s would have done had Moody’s issued a rating for a standalone AmerenCILCO, Ms. Phipps explained that a credit rating would not be very useful if it was not possible to evaluate how changes in circumstances would affect a given company’s credit rating.

Regarding AIC’s objections to Ms. Phipps’ hypothetical Moody’s analysis, Staff insists
she explained that absolute certainty is not possible in any “what if” analysis, which by its very nature requires assumed conclusions for facts and events that did not exist. In this instance, Staff says the fact that did not exist in December 2008 was an AmerenCILCO that did not own AERG and was not a direct subsidiary of CILCORP. Staff reports that Moody’s January 30, 2009 report is clear that Moody’s did not rate AmerenCILCO as if it were a standalone company that did not own AERG and was not a direct subsidiary of CILCORP. Staff contends that Ms. Phipps found substantial evidence that AmerenCILCO would have had higher credit ratings in 2008 if not for its affiliation with AERG and CILCORP.

According to Staff, AIC erroneously argues that Ms. Phipps failed to consider the significant cash flows generated by AERG and characterizes her analysis as “asymmetrical.” Staff insists that Ms. Phipps evaluated both AERG cash flows and the interest requirements of AmerenCILCO’s intermediate parent company CILCORP and concluded that both of those affiliates negatively affected AmerenCILCO’s credit rating. Staff also contends Section 9-230 does not prohibit incremental risk of non-utility affiliates to the extent there are no benefits to offset those incremental costs. Staff asserts that Section 9-230 prohibits including even one iota of incremental cost that results from non-utility affiliates. In Staff’s view, even if this claim by AIC was correct, which it is not, it would have to be rejected because it would be based on a flawed interpretation of Section 9-230 of the Act.

Finally, Staff argues that no new facts have emerged that would cast doubt on Staff’s methodology. Staff claims that if those alleged “new facts” had emerged three years after AmerenCILCO issued those bonds, and following a rate case in which the Commission already adopted an adjustment based on the facts that existed at the time of the debt issuance, the Commission’s reliance on any new facts would constitute hindsight, which is inappropriate for ratemaking purposes. Staff maintains that the May 20, 2010 downgrade by Fitch does not warrant revisiting the adjustment to AmerenCILCO’s December 2008 bonds, particularly because several factors contributed to that downgrade, and there is no indication that the divestiture of AERG was a “primary driver.” According to Staff, AmerenCILCO’s assets (excluding AERG) comprise a mere 16% of AIC assets. In Staff’s view, it is not surprising that Fitch assigned AmerenCILCO the same rating as AmerenCIPS and AmerenIP in light of the announced merger of the three Ameren Illinois Utilities.

Staff recommends that the Commission apply the 6.76% coupon rate that Staff recommends to AmerenCILCO’s December 2008 bond issuance in order to remove any incremental risk reflected in AmerenCILCO’s business risk profile due to CILCORP and AERG, as required by Section 9-230 of the Act.

3. Commission Conclusion

As the Commission understands it, there are three contested issues relating to AIC’s embedded cost of long-term debt. Those issues relate to the coupon rate for AIC’s expected
October 2012 bond issuance; the principal amount of AmerenIP’s October 2008 bond issuance; and, the interest rate for the 8.875% bonds that AmerenCILCO issued in December 2008.

Both AIC and Staff appear to agree that the arguments relating to the coupon rate for AIC’s expected October 2012 bond issuance are the same as those underlying their positions regarding the cost of short-term debt. As the Commission has already determined, by basing its estimate of the 30-day LIBOR rate on projected three-month LIBOR rates, AIC has in all likelihood overstated the interest rate. The Commission also found that Staff’s proposal for estimating the cost of short-term debt should be adopted for purposes of this proceeding. As a result, the Commission similarly concludes that Staff’s proposal to use a 4.4% interest rate for the October 2012 bond issuance is reasonable and should be used for purposes of this proceeding.

For the purpose of calculating the embedded cost of long-term debt (but not for the purpose of calculating the balance of long-term debt), Staff recommends reducing the balance of the $400 million 9.75% bonds that AmerenIP issued during October 2008 to $350 million. Staff says this adjustment is based on the Order from Docket Nos. 09-0306 et al. (Cons.) in which the Commission concluded that AmerenIP issued $50 million more in long-term debt than required for its utility operations during October 2008. AIC argues that its actions in October 2008 were prudent and that Staff has failed to provide any fact or expert analysis that would support its proposed adjustment pursuant to an applicable legal standard.

In Docket Nos. 09-0306 et al. (Cons.), the Commission addressed this issue. The Commission stated:

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. Order (April 29, 2010) at 143.

The facts here are exactly the same and the Commission believes the results should be the same. The legal standard that apparently eludes AIC was previously stated. AIC’s actions, if not adjusted in the ratemaking process, would unnecessarily burden ratepayers with $50 million in excess debt at a relatively high interest rate of 9.75%. Under the Act, AIC is allowed to recover from ratepayers a reasonable cost of capital but if allowed to pass on the cost associated with $50 million of relatively high cost debt that was not needed, the Commission finds that AmerenIP would effectively recover from ratepayers an excessive
cost of capital.

In other words, if the Commission failed to make the adjustment proposed by Staff, ratepayers would be burdened with an unreasonable cost of capital. It appears to the Commission that while the mathematical calculation proposed by Staff in this case is different from that adopted in AIC’s previous rate case, the result is the same. The Commission finds that Staff’s proposed adjustment for the 2008 AmerenIP debt issuance is reasonable and leads to a cost of long-term debt that is reasonable and should be adopted for purposes of this proceeding.

With regard to AmerenCILCO’s bond issuance in December 2008, in Docket Nos. 09-0306 et al. (Cons.), the Commission stated:

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. Order (April 29, 2010) at 150-151.

Staff urges the Commission to make the same adjustment in this proceeding. AIC, on the hand, urges the Commission to revisit that decision and reach a different conclusion. AIC witness Martin argues that in May 2010, Fitch downgraded AmerenCILCO’s credit rating due, in part, to its divestiture of AERG. AIC believes that this effectively refutes the basis for the finding that AmerenCILCO’s affiliation with CILCORP and AERG resulted in a higher cost associated with the December 2008 bond issue. According to Staff witness Phipps, however, AmerenCILCO was squeezed between AERG’s higher operating risk and additional financial risk from CILCORP.

It appears to the Commission that AIC’s argument depends largely on the May 20, 2010 decision by Fitch to downgrade AmerenCILCO’s credit rating. Ameren Ex. 24.6. The Commission has reviewed this exhibit along with the related testimony and arguments. The Commission finds contradictory statements in Ameren Ex. 24.6. Fitch cites the loss of electric gross margin on merchant energy sales, suggesting an adverse impact on AmerenCILCO’s credit rating. On the other hand, Fitch explicitly states that the transfer of AERG will reduce the business risk of AmerenCILCO. The Commission believes that many factors identified in Ameren Ex. 24.6 combined to result in Fitch’s downgrading of AmerenCILCO’s credit rating. The Commission finds AIC’s suggestion that the divestiture of AERG contributed to the downgrade to be overly simplistic. From the record it is clear to
the Commission that AERG increased the business risk of AmerenCILCO and CILCORP increased the financial risk of AmerenCILCO. The Commission concludes that Ms. Phipps proposed cost rate for the December 2008 AmerenCILCO bond issuance, 6.76%, is appropriate and should be adopted. This conclusion is consistent with the Commission’s determination in the last AIC rate case and is consistent with the requirements of Section 9-230 of the Act.

G. Cost of Common Equity

Four parties presented the testimony of expert witness addressing AIC’s cost of common equity. AIC offered the testimony of Mr. Hevert, Staff offered the testimony of Ms. Freetly, IIEC offered the testimony of Mr. Gorman, and AG-CUB offered the testimony of Mr. Thomas. The table below summarized the recommendations of those parties offering testimony on cost of common equity.

<table>
<thead>
<tr>
<th>Cost of Common Equity</th>
<th>Summary of Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>AIC</td>
<td>10.75%</td>
</tr>
<tr>
<td>Staff</td>
<td>8.90%</td>
</tr>
<tr>
<td>IIEC</td>
<td>9.25%</td>
</tr>
<tr>
<td>AG/CUB</td>
<td>8.22%</td>
</tr>
</tbody>
</table>

1. AIC Position

AIC indicates it will not attempt to address every disagreement regarding return on common equity ("ROE"), however, AIC believes there are a few core disputes that overshadow and overwhelm all others. AIC says it does not wish to distract attention from those disputes by drowning them in the customarily lengthy and turgid discussion of ROE.

In AIC’s view, the three most significant differences among the parties’ means of arriving at ROE recommendations are: the third stage – or “steady state” or “terminal” – growth rate used in the multi-stage Discounted Cash Flow (“DCF”) analysis; the use of spot prices at one moment in time (instead of averages); and the ROE deduction proposed by Staff because AIC uses the uncollectibles expense rider authorized by the General Assembly. AIC claims that were the Commission to follow the decisions it has made recently involving other utilities, none of these would be an issue.

According to AIC, the evidence shows that it requires an ROE of no less than 10.5% for gas operations, Staff, however, contends that AIC should operate with historically low ROEs, just 8.9% for gas operations, lower than nearly all authorized ROEs nationwide during the last three years. AIC avers that Staff can arrive at its recommendations only through a disregard for what the Commission has been doing in other cases. AIC claims
that treating it comparably to other companies on the third stage growth rate would increase Staff’s recommendations by over 50 basis points, or roughly half the difference between the Staff and AIC recommendations. AIC also asserts that treating it comparably with ComEd regarding the uncollectibles rider would increase ROE another 16.25 basis points. AIC further claims that using average data instead of prices at the closing bell on what it describes as the randomly selected date of June 3, 2011 would also increase ROE.

AIC says it deserves fair treatment. AIC says the Commission cannot have one means of determining ROE for one company and a different set of rules for another. AIC wants the Commission to develop ROEs in a coherent, consistent manner. AIC wants the Commission to adopt AIC’s requested ROEs that are supported by its expert, Mr. Robert Hevert. At the very least, AIC thinks the Commission should adjust the Staff’s recommendations to reflect a proper third stage growth rate, the use of averages for data inputs and the rejection of Staff’s "arbitrary and unjustified" deduction for the uncollectibles rider.

AIC states that based on the Commission’s decision in Docket Nos. 09-0306 et al. (Cons.), Mr. Hevert relied on the multi-stage DCF model and the capital asset pricing model ("CAPM") as his primary analytical approaches. AIC says he also considered an alternative Risk Premium approach as a corroborating methodology.

a. DCF

According to AIC, DCF models are widely used in regulatory proceedings and have sound theoretical bases, although neither the DCF model nor any other model can be applied without considerable judgment in the selection of data and the interpretation of results. AIC states that in its simplest form, the DCF model expresses the cost of equity as the sum of the expected dividend yield and long-term growth rate.

The multi-stage DCF model, ACI avers, sets the subject company’s stock price equal to the present value of future cash flows received over three “stages.” In the first two stages, “cash flows” are defined as projected dividends. In the third stage, “cash flows” equal both dividends and the expected price at which the stock will be sold at the end of the period (i.e., the “terminal price”). In each of the three stages, the dividend is the product of the projected EPS and the expected dividend payout ratio.

AIC asserts that IIEC and AG/CUB proposed deeply flawed DCF analyses. AIC contends that IIEC witness Mr. Gorman submitted a constant growth DCF analysis that was of no relevance. AIC claims he also submitted a multi-stage DCF model that used inappropriate values for the terminal stage growth rate, dividend payout ratios and stock price. AIC asserts that AG/CUB witness Mr. Thomas proposes inappropriate and misguided adjustments to Mr. Hevert’s multi-stage DCF.
AIC indicates that Mr. Hevert relied on average stock prices over 30, 90, and 180 trading days. AIC claims that this approach balances the need to reflect current information with the need to consider the volatility that may occur in stock prices on any given day.

AIC indicates that Ms. Freetly used a single stock price in her model, the closing price on June 3, 2011. AIC describes this as a price at a one moment in time. She asserts that the most recent stock price reflects the market’s current perspective on a particular company given all the information that is known by investors on that particular date.

In AIC’s view, the most significant flaw in Ms. Freetly’s approach is that it fails to account for aberrant behavior in stock prices, which tend to fluctuate from day-to-day based on changes not only in investors’ assessments of fundamental factors such as earnings growth rates and projected interest rates, but also due to anomalous events that may affect stock prices on any given trading day. AIC states that for example, on May 6, 2010, the market sustained what has come to be known as the “flash crash,” in which stock prices moved significantly during the course of the trading day without any specific information that would support such erratic movement. AIC asserts that while that is an extreme example, there is little question that events and information affect securities prices every day; at times, those effects can be due to unusual, extraneous factors. AIC argues that the use of spot prices on a particular day may cause the DCF results to be susceptible to volatile market movements that may not reflect the general market trends, whereas average prices are more insulated from aberrant or anomalous events.

AIC points out that in Docket No. 10-0467, the Commission noted that it had recently rejected use of such a pure spot date approach in its North Shore decision and notes the problems that can result from using such data. AIC says the Commission went on to note that the Staff witness improperly employed a spot date approach. According to AIC, that position is consistent with the Commission’s Order in Docket Nos. 07-0241 and 07-0242 (Cons.).

In AIC’s view, there is nothing in the record to indicate that there was anything special about June 3, 2011. AIC claims it was just a date roughly one month before Staff’s testimony was due. AIC complains that Staff did not make any effort to explain why this was a particularly representative date. AIC claims Staff’s approach fails to address volatility or randomness. AIC believes Staff has not justified the use of this particular date, and asserts the Commission is skeptical of spot prices. In AIC’s view, there is nothing to justify Staff’s approach and it should be rejected in favor of Mr. Hevert’s averaging approach.

In its Reply Brief, AIC states that the results of Ms. Freetly’s DCF analysis vary by as much as 80 basis points, and the results of her CAPM analysis vary by as much as 32 basis points over a period of less than one month. AIC says in a single day, between August 10, 2011 and August 11, 2011, Ms. Freetly’s DCF results varied 20 to 24 basis points, and her CAPM results varied 8 to 12 basis points. AIC believes that while such volatility may not be
of the same magnitude as seen in broad market indicators, it demonstrates that within the study period, analyses based on spot data continue to be subject to volatile results, and lead to unreliable calculations and results.

AIC argues that the use of an averaging period, such as the 30-, 90- and 180- day averages that Mr. Hevert relied on in his analyses, mitigates the variability in ROE estimates that results from choosing an individual spot price, and allows for consideration of data over more volatile periods, such as the current period. AIC also asserts that the use of average prices eliminates the subjectivity associated with choosing a particular day to best represent the cost of equity.

According to AIC, the single most significant way in which Staff and the other parties have skewed their ROE recommendations downward is with respect to the third stage or “steady state” or “terminal” growth rate. AIC complains that this bias in their analyses is particularly inappropriate given the Commission’s rejection of a comparable approach to calculating the steady state growth rate in its May 24, 2011 Order in the ComEd rate case, issued over a month before the Staff and Interveners submitted their direct testimony in this case.

AIC indicates that the third stage in a multi-stage DCF analysis begins after the 10th year and continues in perpetuity. AIC adds that there are two components to this steady state growth rate: real (i.e., not reflecting inflation) gross domestic product ("GDP") growth and inflation. It is with respect to the real GDP growth rate that most of the difference between AIC and the other parties lies.

AIC states that Mr. Hevert calculated a long-term growth rate of 5.66 percent based on the real GDP growth rate of 3.27 percent from 1929 through 2009, and an inflation rate of 2.31 percent, revised to 5.64 percent $[\{(1+3.26\%)*(1+2.31\%)-1\}]$. In determining the future real GDP growth rate, Mr. Hevert used a historical value – the GDP growth rate experienced by the United States over an 80 year period. AIC argues that there is no better indicator of GDP growth beginning in Year 11 and beyond than the actual historical growth that the country has experienced over a meaningful period of time.

AIC states that one month after the ComEd rate case Order was issued in Docket No. 10-0467, Staff filed its testimony in this proceeding, relying on the very same sources, for essentially the same future period, that the Commission rejected in the ComEd case in response to essentially the same historical growth rate. AIC says Ms. Freetly admitted that she did not take the ComEd order into account, and her only rebut of it was confined to a footnote. AIC repeats that the Commission rejected the sources she uses in favor of an historical growth rate, and when AIC proposed virtually the same historical growth rate to apply to the virtually the same future period, AIC says Ms. Freetly simply offered once again what the Staff unsuccessfully presented in the ComEd case. AIC says she stated that the Commission’s rejection of the Staff’s position in the ComEd case did not cause her to alter
her analysis in any respect.

In AIC’s view, this is not an instance of utilities being in different circumstances. AIC contends this is an instance involving general data applicable to the U.S. economy as a whole. AIC states this is an instance in which: 1) ComEd presented a 3.4% real GDP growth rate based on historical data to apply to a terminal stage beginning in 2020; 2) AIC has presented a 3.3% real GDP growth based on historical data to apply to a terminal stage beginning in 2021; and 3) Staff is arbitrarily recommending that AIC receive materially different treatment, without any explanation, much less justification. AIC believes there is no reasonable basis for such disparate treatment and the growth rates of Staff and the other parties should be rejected in favor of Mr. Hevert’s terminal stage GDP growth rate.

AIC states that Mr. Hevert’s third stage rate of inflation of 2.31 percent is based on the average of the long-term projected growth rate in the Consumer Price Index (“CPI”), as reported by Blue Chip Financial Forecast and the compound annual CPI growth rate projected by the Energy Information Administration (“EIA”) in the 2010 Annual Energy Outlook. AIC says Ms. Freetly’s projected inflation rate is higher, but the problem is her overall nominal growth rate. AIC complains that Ms. Freetly’s estimate of long-term nominal GDP growth of 4.80 percent is 120 basis points lower than the Commission’s Order in the ComEd case.

Ms. Freetly estimated a long-term inflation rate of 2.50 percent. In addition, Ms. Freetly noted that both EIA and Global Insights estimate that real GDP will average 2.60 percent over the long-term. AIC says that combining the projected real GDP growth rate of 2.60 percent and the expected inflation rate of 2.50 percent produces a 5.20 percent projected nominal GDP growth rate. Ms. Freetly also considered the average nominal GDP growth rate forecasts by EIA and Global Insight of 4.50 percent and 4.40 percent, respectively. In establishing her estimate of 4.80 percent, Ms. Freetly averaged (1) the estimated nominal GDP growth rate of 5.20 percent and (2) the average of the EIA and Global Insights forecasts of economic growth of 4.50 percent and 4.40 percent.

AIC states that changing the long-term growth rate in the terminal stage from 4.80 percent to 6.00 percent, using Ms. Freetly’s electric and natural gas proxy groups, and holding all else constant would cause Ms. Freetly’s multi-stage DCF results to increase from 9.55 percent to 10.47 percent for electric operations, and from 8.63 percent to 9.59 percent for natural gas operations.

AIC also states that the June 2011 edition of the Blue Chip Financial Forecast, which represents a consensus forecast of approximately 50 economists, projects the 30-year Treasury yield to average 5.70 percent for the period 2018-2022. AIC notes that none of the other sources cited by Ms. Freetly (i.e., EIA’s Annual Energy Outlook, Global Insights 1st Quarter 2011 projections, or the Survey of Professional Forecasters) provides such projections.
According to AIC, if Ms. Freetly is correct that the 30-year Treasury yield is a proxy for expected long-term nominal GDP growth, the Blue Chip Financial Forecast projection of 5.70 percent is six basis points greater than Mr. Hevert’s 5.64 percent projection. AIC notes that the Blue Chip projection is 90 basis points above Ms. Freetly’s 4.80 percent long-term growth estimate. AIC suggests Ms. Freetly’s position that long-term Treasury yields are a proxy for expected macro-economic growth supports Mr. Hevert’s 5.64 percent estimate.

In its Reply Brief, AIC notes that IIEC relies, in part, on a constant growth DCF model. AIC says IIEC’s constant growth DCF analyses produce results as low as 7.41 percent for electric utilities, and 7.31 percent for natural gas utilities. According to AIC, neither of those estimates is reasonable under prevailing economic or capital market conditions. AIC also asserts that the Commission has recently placed weight on the multi-stage DCF approach, while rejecting the sustainable growth rates used in Mr. Gorman’s constant growth analysis. AIC believes Mr. Gorman’s constant growth DCF approach should be disregarded, and the debate over whether Mr. Gorman’s sustainable growth rate is appropriate becomes irrelevant.

AIC also claims that IIEC attempts to paint Docket No. 10-0467 as an anomaly and contends that the Commission has rejected the use of historical growth rates in another case, citing the Nicor decision in Docket No. 08-0363. According to AIC, this is IIEC’s third attempt to find a case to show that Docket No. 10-0467 represented an anomalous departure from long-standing practice. AIC says previously, Mr. Gorman cited two different cases, neither of which AIC believes supported IIEC’s position. AIC states that the first, Docket No. 05-0597, addressed the use of GDP growth rates (whether historical or forecasted) to estimate long-term growth in the constant growth DCF or two-stage DCF model. AIC asserts that none of the ROE witnesses in Docket No. 05-0597 proposed the use of a three-stage DCF model like the one that Mr. Hevert and Staff have proposed in this proceeding.

AIC asserts that in Docket No. 07-0566, which Mr. Gorman also cited, the Commission did not explicitly reject the use of historical GDP growth as the long-term growth rate in the multi-stage DCF model; rather, it rejected ComEd’s proposed ROE of 10.75 percent, which AIC says was based on four DCF models, two CAPM analyses, and four risk premium analyses. According to AIC, three of the four quotes provided by Mr. Gorman in his rebuttal testimony are a summary of Staff’s position and do not pertain to the Commission’s analysis and conclusion. AIC says the growth rate that was explicitly rejected by the Commission in the Order in Docket No. 07-0566 was the average analyst growth rate, not the utility’s proposed GDP growth rate of 6.60 percent.

According to AIC, IIEC contends that the 2009 Nicor decision elucidates two principles that AIC violates: 1) that the model reflect realistic expectations; and 2) that growth estimate inputs be reasonable estimates of long-term sustainable growth.
In AIC’s view, IIEC misses the point completely. AIC argues that Mr. Hevert in this case, and the Commission in Docket No. 10-0467, put forth analyses that did reflect realistic expectations, and their growth estimate inputs were reasonable estimates of long-term sustainable growth. AIC contends there is no debate in this case over whether using GDP as a proxy for the terminal growth rate in a non-constant DCF analysis has merit. AIC insists that Mr. Hevert’s analysis and the Commission’s analysis in Docket No. 10-0467 capped the terminal growth rate for companies in the sample at the GDP growth rate. According to AIC, neither Mr. Hevert’s analysis in this case nor the Order in Docket No. 10-0467 departs from whatever principles the Commission expressed in the Nicor order quoted above.

AIC believes the question is not whether to use a GDP growth rate in that terminal stage, but rather how to quantify that terminal stage GDP growth rate. AIC says Staff endorses the use of professional forecasters and rejects the use of a “mishmash of historical averages” as a basis for estimating future growth. AIC claims that what the Commission added to the development of its DCF approach in Docket No. 10-0467 was to express a well-founded skepticism that the growth rate for a period beginning 10 years from now and extending out decades would be materially lower than the growth rate we would see if we turned around and looked back over many decades at what the U.S. economy actually did. AIC also says Mr. Hevert did not average averages in his analysis, so his result (5.64%) does not represent any sort of “mishmash.”

According to AIC, Staff contends that AIC’s long-term growth rate is unreasonable because it implies ROEs for the proxy groups that are significantly higher than the ROEs for the proxy groups estimated by Value Line. AIC maintains that Staff’s assertion is premised on the “b times r” approach to estimating growth, which assumes that internal growth is defined as the product of the retention ratio (b) and the earned ROE (r). AIC adds that in prior orders the Commission has found that approach to be unreliable. AIC believes Staff’s assertion that Mr. Hevert’s long-term growth rate is not sustainable is premised on a method that the Commission has rejected.

b. CAPM

AIC states that Mr. Hevert and Ms. Freely agree on the general construct of the CAPM whereby a risk premium is added to a risk-free rate to determine the required ROR. The risk premium is calculated by multiplying the proxy group’s average beta coefficient by the overall market risk premium. AIC says they also agree on the use of a prospective or ex-ante market risk premium, rather than a historical or ex-post risk premium. According to AIC, the major areas of disagreement between AIC and the Staff regarding application of the CAPM are: (1) the use of a spot risk-free rate; (2) the appropriate beta coefficient; and (3) the calculation of the expected return on the overall market, which is used to determine the ex-ante market risk premium.
AIC repeats that in prior orders the Commission has rejected the use of spot prices. AIC notes that in the recent ComEd rate case, Docket No. 10-0467, the Commission expressly rejected Staff witness Mr. McNally’s use of spot risk-free rates. According to AIC, the Commission found that the use of a spot risk-free rate was unfair to the utility and lower than the risk-free rate investors demanded throughout the entire year (2010) at issue.

AIC asserts that Ms. Freetly’s decision to use a spot risk-free rate as of June 3, 2011 is inappropriate for the same reason as using spot stock prices to calculate the stock price component of her multi-stage DCF analysis. AIC maintains that the use of a spot risk-free rate fails to smooth out the effects of daily trading behavior and market anomalies. According to AIC, the yield on 30-year U.S. Treasury securities ranged from 4.15 percent to 4.76 percent between January 1, 2011 and June 30, 2011. By using a spot interest rate, AIC says the CAPM result during the first six months of 2011 would vary substantially depending on the specific day the analysis was performed.

AIC also argues that the use of long-term, historical beta coefficients, such as the ones relied upon by Ms. Freetly is unreasonable. Value Line and Zacks both calculate Beta coefficients based on five years of data, which includes the period of the credit crisis and financial market dislocation. AIC asserts that during the credit crisis, the relationship between the broader market, as measured by the S&P 500, and utility stock returns was significantly different than during the period prior to the market dislocation. By relying on a five-year period, AIC contends that Value Line and Zacks beta coefficients underestimate the systematic risk that investors are compensated for in the CAPM analyses.

AIC asserts that Ms. Freetly’s approach yields the lowest beta coefficients. AIC says the effect on the CAPM results of Staff’s approach would be substantial. Assuming Ms. Freetly’s 8.41 percent market risk premium, the difference in beta coefficients (electric) calculated using weekly returns with the S&P 500 Index (.81) and monthly returns with the New York Stock Exchange ("NYSE") index (.70) results in a difference in CAPM estimates of approximately 93 basis points ((.81 - .70) x .0841 = .00925), according to AIC.

AIC says while Mr. Hevert and Ms. Freetly agree that it is important to use forward-looking market risk premia rather than historical risk premia, and that the DCF model is a reasonable means of calculating the expected market return, in the CAPM, they disagree as to the appropriate methodology to estimate the expected return for the overall market, which is used to derive the market risk premium. Ms. Freetly begins with the companies in the S&P 500 and excludes those companies that do not pay dividends. While the calculation of the market risk premium that Mr. Hevert relies on is similar to Ms. Freetly’s, AIC says he includes companies that do not pay dividends.

According to AIC, Ms. Freetly states that the inclusion of non-dividend paying companies in a constant growth DCF analysis exasperates the upward bias resulting from the unsustainable growth rates used to estimate the market return. AIC claims the purpose
of that analysis, however, is to estimate the expected return for the overall market. AIC contends it is appropriate to include as many companies as possible for which growth rate estimates are available, whether or not the company pays dividends. By doing so, AIC claims it is possible to gauge equity investors' return expectations for the entire universe of large capitalization companies. AIC also asserts that the constant growth DCF model, relied upon by Ms. Freetly in her calculation of the market risk premium, assumes constant payout and price/earnings ratios in perpetuity. AIC contends that the return to investors comes in the form of dividends and/or price appreciation. In AIC’s view, it makes no difference whether or not a given company pays dividends.

AIC notes that Ms. Freetly’s estimated market return is 12.67 percent, which is only 10 basis points different than Mr. Hevert’s updated 12.77 percent estimate.

AIC notes that Mr. Hevert also calculated the market risk premium using all 1,560 companies in the Value Line universe, which AIC says Ms. Freetly relies upon in several aspects of her analyses, for which total return estimates are available. AIC says the market risk premium for the Value Line universe of companies ranges from 9.49 percent (simple average) to 10.51 percent (market-capitalization weighted average). AIC asserts that based on the results of that analysis, their respective 8.41 percent and 8.53 percent estimates are reasonable, if not conservative.

AIC asserts that in his CAPM analysis, IIEC witness Gorman employs an inappropriate market risk premium and improperly relies on Value Line as his sole source of beta coefficients. AIC contends that AG/CUB witness Thomas also proposes a number of inappropriate adjustments to Mr. Hevert’s CAPM study.

c. Other ROE Models

AIC says Mr. Hevert performed additional modeling, the Bond Yield Plus Risk Premium approach, to confirm his ROE results. AIC states that in general terms, this approach is based on the fundamental principle that equity investors bear the residual risk associated with ownership and therefore require a premium over the return they would have earned as a bondholder. According to AIC, since returns to equity holders are more risky than returns to bondholders, equity investors must be compensated for bearing that risk. AIC asserts that risk premium approaches, therefore, estimate the cost of equity as the sum of the equity risk premium and the yield on a particular class of bonds. Since the equity risk premium is not directly observable, AIC claims it typically is estimated using a variety of approaches. AIC says one alternative approach is to use actual authorized returns for electric utilities as the measure of the cost of equity to determine the Equity Risk Premium.

AIC indicates that Mr. Hevert examined data regarding allowed ROEs as derived from 483 electric utility rate cases from 1992 through December 31, 2010. According to AIC, his
analysis showed that, based on the 30-day average of the 30-year Treasury bond yield and the near and long-term projections of the 30-year Treasury bond yields, the range of ROE results is from 10.56 percent to 10.99 percent, not including the effect of AIC’s specific risk factors. AIC says this confirms the results of Mr. Hevert’s DCF and CAPM analyses.

d. ROE Adjustments

AIC states that it employs a rider to smooth out recovery of its uncollectibles expense. AIC says the rider assures that it recovers no more or less than its actual costs. Staff contends that the presence of the rider reduces regulatory risk by reducing the likelihood that AIC will earn less than its approved return, and proposes that AIC’s ROE be reduced by 16.25 basis points to reflect the effect of the rider on investor expectations. According to AIC, Staff purports to “calculate” this risk by predicting the effect of the rider on AIC’s rating from Moody’s.

AIC thinks Staff’s proposed adjustment is unreasonable and inappropriate. AIC insists there is no empirical basis for Staff’s assertion that the rider reduces risk. AIC argues that even if the rider does reduce risk, Staff’s adjustment is not properly calculated. AIC asserts that Staff’s proposed deduction would be far out of line with the treatment that other Illinois utilities have received. AIC says it would be 50% larger than the next largest adjustment. AIC recommends that Staff’s adjustment be rejected.

AIC argues that the uncollectible rider does not reduce risk relative to other utilities. AIC says Staff argued in AIC’s last rate proceeding that, historically, AIC under-recovered its uncollectibles expenses through base rates. AIC states that this was so because, until the last two years, the level included in the test year by the Commission was significantly below AIC’s actual experience. AIC says the reasons for the under-recoveries varied, and included sharp commodity price changes and the impacts of a slumping economy, and are not relevant to this issue. According to AIC, what does matter is that, generally, where an expense is increasing (as uncollectibles expenses have), the use of historical average data will understate the amount of expense to be incurred in the future.

AIC says when a utility under-recover its costs, it follows that, all other things being equal, the utility will not earn its authorized ROR. AIC states that the under-recovered expenses will reduce earnings to shareholders, dollar for dollar. In addition, AIC says under recovery puts pressure on future O&M and capital expenditures (since a company cannot continue to spend more than it recovers) and it tends to increase the cost of future financings (since the market views such situations as increasing risk to investors).

According to AIC, to address the difficulty of predicting uncollectibles expenses and accurately reflecting them in rates, the General Assembly adopted P.A. 96-0033, which authorizes the use of a rider to recover this expense. AIC says a rider ensures that the utility
will recover its actual uncollectibles expense – no more, no less. AIC adds that this means that the utility’s actual uncollectibles experience will not cause the utility to exceed or fall short of its authorized ROR.

AIC says it could not be unlucky forever, and in the last two years the level of uncollectibles expense collected through base rates has exceeded actual costs. This means that AIC has made refunds under the uncollectibles rider. According to AIC, the rider has not served to provide a means of covering a shortfall in base rates; rather, it has acted effectively to reduce base rates. AIC claims this is exactly what it said in the last case: the rider does not favor either AIC or customers. AIC asserts that it assures only that AIC will neither over-collect nor under-recover uncollectibles expense, which should be equally likely in normal circumstances.

AIC states that the adjustment, which flows from Staff’s position in AIC’s last rate case, is based on Staff’s estimate of the effect the adoption of the riders would have on AIC’s Moody’s credit ratings, and particularly the effect on the utilities’ ability to recover costs and earn returns. AIC asserts that Staff improperly assumes that approval of the uncollectibles rider would cause Moody’s to increase AIC’s credit rating by a full letter grade. AIC contends there are many elements that influence the score assigned by Moody’s for the cost recovery factor, which accounts for 25% of the overall credit rating, and there is no evidence that the implementation of a single rider such as the EUA or GUA would cause Moody’s to increase AIC’s credit rating from Baa3 to A3, as Staff has assumed. AIC maintains that an improved political and regulatory climate in Illinois, which included the legislation providing Illinois utilities with a bad debt rider, cited by Moody’s in 2009 resulted in only a one-notch upgrade by Moody’s in AIC’s credit ratings in 2009; thus, AIC believes the underlying 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 alone was without merit. According to AIC, Moody’s already had acknowledged the legislation and factored it into its decision to upgrade AIC 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. AIC asserts that Staff ignores this development, and others, since the Final Order in the last case.

AIC asserts that Ms. Freitly’s proposed adjustment necessarily will be inexact, given that yields to maturity of utility debt issuances are highly variable, even after controlling for credit rating, collateral type and approximate years to maturity. AIC says Mr. Hevert conducted a search using the Bloomberg Professional Service for senior, unsecured utility bonds carrying an A- rating by one of the three major ratings agencies. AIC says he then calculated the approximate years to maturity of those utility bond issuances. Based on that analysis, AIC states that unsecured utility bonds show a wide variation in yields as of the most recent pricing date, even at the same credit rating. AIC adds that for bonds that have approximately five years remaining to maturity, from a group of 15 individual bond issuances, the minimum yield to maturity was approximately 2.03 percent and the maximum
yield was approximately 3.25 percent, a difference of approximately 122 basis points. AIC also says that range is between 3.77 percent and 5.11 percent (134 basis points) for the five bonds with approximately 10 years to maturity, while 30-year bond yields diverge by approximately 84 basis points. Given that Ms. Freetly’s adjustment attributes 65 basis points to the difference between two letter grades, AIC believes the fact that greater variation exists within one ratings notch demonstrates the imprecision inherent in her approach.

In AIC’s view Ms. Freetly’s proposed adjustment of 16.25 basis points, which assumes that the implementation of a tracker would result in a multiple notch credit upgrade, is unsubstantiated by Moody’s ratings actions in the cases of the Illinois companies that have already implemented similar tracking mechanisms and is not supported by current utility bond market information.

In its Reply Brief, AIC says Staff suggests in its Initial Brief that there is some precision to its calculation. AIC asserts that Staff admitted in the last case that it knew of no precise way of measuring the effect of the uncollectibles rider on the cost of equity. AIC says Staff developed two methods – and averaged them, meaning that it was as confident in one as it was in the other. AIC adds that the Commission rejected one of the two methods, finding that it does not appear to provide a reliable estimate of the reduction in risk. According to AIC, Staff’s estimates under the second approach were as much as 10 times the values that the Commission ultimately accepted. AIC says Staff was willing to accept estimates that differed by as much as 10 times as being equally reliable.

AIC thinks what this should tell the Commission is just what Staff said in the last case – there is no way to precisely calculate the effect of the riders, should the Commission not find that they are reciprocally beneficial. AIC argues that Staff’s contention that it can precisely measure the effect of the riders and keep AIC at the same credit rating it would have without the riders is not only unfounded, but it is directly inconsistent with Staff’s position in the last case that it could not gauge the precise effect of the riders.

AIC complains that Staff now argues that the riders are worth precisely three credit notches, and then it purports to calculate how many basis points three notches are worth. According to AIC, there are wide variations in how much a particular credit rating is worth. AIC says the market can assign very different values to the same rating. According to AIC, there is no example of a utility that was upgraded by one credit notch as a direct result of such a rider; the notion that AIC would receive a three notch upgrade has no foundation.

AIC believes there remains the problem of the differing treatment of different companies employing the very same rider. AIC says it faces an adjustment that is, as an arithmetic matter, infinitely larger than the zero basis point adjustment received by ComEd, more than double Nicor’s and some two-thirds larger than Peoples. In AIC’s view this is arbitrary and unreasonable, and there is nothing in Staff’s Initial Brief to justify it.
AIC claims a recent Order involving Nicor highlights the unfairness. AIC states that in Docket No. 08-0363 Staff contended in that case that, had the rider been in effect for the prior ten years, Nicor would not have credited customers. AIC says Staff argued that the rider benefited the utility and proposed an adjustment to the ROE of 6.5 basis points.

AIC claims that in this case, where the utility has credited customers under the same rider in two of the last four years, and the value of the rider seems more symmetrical, Staff proposes an adjustment to the ROE of 16.25 basis points: exactly 2 ½ times the adjustment for Nicor’s rider. AIC believes there can be no justification for such disparate treatment.

AIC also claims that Mr. Hevert also performed an “event study” that demonstrates that the implementation of a rider like the GUA does not have the effect that Staff attributes to it. AIC also believes Staff’s recommended ROE adjustment is inconsistent with recent treatment received by, or recommended by Staff for, other utilities. In its recent rate case, concluded earlier this year, AIC says ComEd received no ROE deduction for its Rider UF, which tracks uncollectibles. According to AIC, Staff and Interveners did not even propose an ROE deduction in that case. AIC says Staff offers no justification in its testimony in this case for AIC being treated differently from ComEd. If Staff’s rationale is correct, AIC suggests one would think it should apply equally to ComEd. AIC also states that in its most recent rate case (Docket No. 08-0363), concluded in 2009, Nicor ROE was reduced by 6.5 basis points for use of an uncollectibles rider. AIC says this is less than half the adjustment Staff proposes for AIC. AIC complains that Staff offers no justification for the disparate treatment received by Nicor. AIC says Staff is currently proposing a 10 basis point ROE deduction for Peoples in its pending rate case (Docket Nos. 11-0280 and 11-0281), which is just two-thirds of the adjustment that Staff is recommending in this case for AIC. AIC again complains that Staff offers no justification for its differing proposals.

e. Flotation Costs

AIC indicates that Ameren issued 21.85 million shares of common stock priced at $25.25 per share on September 15, 2009. AIC says that offering raised net proceeds of slightly more than $534.7 million, and Ameren incurred flotation costs of $17,001,375 (or 3.082 percent of gross proceeds) associated with the issuance, which have not been recovered through rates.

Ms. Freethy opposes recovery of flotation costs, citing a 1994 Commission Order in Docket No. 94-0065, which states that the Commission has traditionally approved [flotation cost] adjustments only when the utility anticipates that it will issue stock in the test year or when it has been demonstrated that costs incurred prior to the test year have not been recovered previously through rates. In addition, Ms. Freethy is concerned that AIC’s calculation of flotation costs is not based on actual issuance costs that AIC has incurred but not previously recovered through rates, but on the average costs of issuing equity that were
incurred by Ameren and the proxy group companies in their two most recent equity issuances.

AIC argues that flotation costs are part of the invested costs of the utility, which are properly reflected on the balance sheet under “paid in capital.” AIC says they are not current expenses, and therefore are not reflected on the income statement. Rather, AIC contends that like investments in rate base or issuance costs of long-term debt, flotation costs are incurred over time, but remain part of the cost structure that exists during the test year and beyond. AIC says that although it does not issue common stock, it still must compete for equity capital with other Ameren affiliates. AIC contends that the common stock which has been issued by Ameren, the parent holding company, includes flotation costs, which are passed through to AIC. AIC claims its calculation of flotation costs includes the last two equity issuances for Ameren, and as such AIC believes it has met its burden of proof to demonstrate that it has incurred actual flotation costs that have not been previously recovered through rates. In AIC’s view, it is appropriate to consider flotation costs in the determination of where AIC’s ROE falls within the range of results.

2. Staff Position

Ms. Freetly measured the investor-required ROR on common equity with the non-constant DCF and CAPM analyses. For the natural gas distribution operations, Ms. Freetly applied those models to the same sample of eight local gas distribution companies utilized by AIC witness Mr. Hevert.

Staff states that DCF analysis assumes that the market value of common stock equals the present value of the expected stream of future dividend payments to the holders of that stock. Since a DCF model incorporates time-sensitive valuation factors, Staff says it must correctly reflect the timing of the dividend payments that a stock price embodies. Staff indicates that because the companies in Ms. Freetly’s Gas samples pay dividends quarterly, 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. For the first five years, Ms. Freetly used market-consensus expected growth rates published by Zacks Investment Research (“Zacks”) and Reuters as of June 3, 2011. For the second stage, a transitional growth period that spans from the beginning of the sixth year through the end of the tenth year, Ms. Freetly used the average of the first- and third-stage growth rates. Finally, for the third, or “steady-state,” growth stage, which commences at the end of the tenth year and is assumed to last into perpetuity, Ms. Freetly calculated a 4.8% expected long-term nominal overall economic growth rate beginning in 2021; that growth rate was calculated using the expected real growth rate (2.6%) based on the average of the EIA’s and Global Insight’s long-term forecasts of real GDP, and the expected inflation rate (2.5%) based on the
difference between yields on U.S. Treasury bonds and U.S. Treasury Inflation-Protected Securities. Staff says she then combined the resulting 5.2% growth estimate with the 4.5% average nominal economic growth forecasted by EIA and Global Insight.

Staff indicates that the growth rate estimates were combined with the closing stock prices and dividend data as of June 3, 2011. Based on these growth assumptions, stock price, and dividend data, Ms. Freetly’s DCF estimate of the cost of common equity was 8.63% for the Gas sample.

Staff indicates that Ms. Freetly used a one-factor risk premium model, the CAPM, to estimate the cost of common equity. The CAPM requires the estimation of three parameters: the risk-free rate, beta, and the required ROR on the market. For the risk-free rate parameter, Ms. Freetly considered the 0.04% yield on four-week U.S. Treasury bills and the 4.26% yield on 30-year U.S. Treasury bonds. Both estimates were measured as of June 3, 2011. Staff says forecasts of long-term inflation and the real risk-free rate imply that the long-term risk-free rate is between 4.5% and 5.4%. Thus, Ms. Freetly concluded that the U.S. Treasury bond yield is currently the superior proxy for the long-term risk-free rate. 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 equals 12.67%. Finally, for the beta parameter, Ms. Freetly combined adjusted betas from Value Line, Zacks, and a regression analysis. The average Value Line, Zacks, and regression beta estimates for the Gas sample were 0.66, 0.56, and 0.51, respectively. The Value Line regression employs 259 weekly observations of stock return data regressed against the NYSE Composite Index. Staff says both the regression beta and Zacks betas employ sixty 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. To avoid over-weighting the monthly data-based betas in comparison to the weekly data-based betas, Ms. Freetly averaged the Zacks and regression estimates. Staff says she then averaged that result with the Value Line beta, which produced a beta of 0.60 for the Gas Sample. Inputting those three parameters into the CAPM, Ms. Freetly calculated a cost of common equity estimate of 9.31% for the Gas sample.

a. DCF

AIC witness Mr. Hevert claims that average stock prices and bond yields should be used to estimate the investor-required ROR on common equity. For the DCF analysis, he argues that using a single day spot price fails to account for aberrant behavior in stock prices, which tend to fluctuate from day-to-day based on changes not only in investors’ assessments of fundamental factors, such as earnings growth rates and projected interest rates, but also due to anomalous events that may affect stock prices on any given trading day. In response, Staff asserts that while historical data is useful in examining trends and relationships between variables; direct use of historical data in estimating investor
expectations for the future is problematic for several reasons. According to Staff, historical data favors information that the market no longer considers relevant over the most recently-available information. Staff also asserts that historical data reflects conditions that may not continue in the future. Since stock prices reflect all current information, Staff believes only the most recent stock price can reflect the most recently available information. Staff insists that historical stock prices must include observations that cannot reflect the most current information available to the market. To the extent investors deem historical data relevant, Staff believes it is already incorporated into the most recent prices those investors pay for securities. In Staff’s view, use of a historical average requires the analyst to subjectively determine what data is no longer relevant, needlessly and inappropriately replacing the collective judgment of all investors with his own.

Staff also contends that Mr. Hevert’s use of historical data includes the added flaw of inappropriately mixing and matching data from different points in time. Staff notes that the non-constant DCF from his rebuttal testimony, upon which his recommended investor-required ROR is based, employed average stock prices for the 30-, 90- and 180-day periods ending June 30, 2011. Staff adds that the stage one growth rates that he employed in that analysis were concurrent with only the last date used to compute the averages, June 30, 2011. According to Staff, the stock prices from the preceding 30, 90 and 180 days cannot possibly reflect the June 30, 2011 growth expectations Mr. Hevert used in the analysis. Staff maintains that the market value of common stock equals the cumulative value of the expected stream of future dividends after each is discounted by the investor-required ROR. Staff claims new information becomes available every day and investors rethink their projections of future cash flows, the risk level of the company, and the price of risk. According to Staff, only a current stock price will reflect all information that is available and relevant to the market.

Staff argues that introducing old stock prices into an analysis simply substitutes one alleged source of measurement error, volatile stock prices, for another, irrelevant stock prices. Stock prices can be influenced by temporary imbalances in supply and demand; however, Staff believes any distortions such imbalances might have on the measured cost of common equity can be reduced through the use of samples, a technique which Mr. Hevert already applies.

Staff also says the Commission has adopted costs of capital based on the most recent spot data much more frequently than it has relied on outdated historical data. According to Staff, the Commission itself has noted that use of spot data is a practice the Commission has traditionally relied upon and, in fact, is reluctant to deviate from.

To demonstrate the limited impact of “aberrant” stock prices on the sample cost of common equity estimates, Ms. Freetly updated her analyses several times since filing direct testimony. If spot prices were sensitive to abnormalities, Staff claims one would expect the DCF estimates to jump around. Instead, Staff asserts that the DCF estimates reveal a trend
that would be masked by the use of historical averages.

In Staff’s view, the fact that stock prices changed over the course of two months merely demonstrates that market prices are dynamic and that investors are constantly re-evaluating their expectations. Staff believes the fact that prices are dynamic highlights the shortcomings of Mr. Hevert’s use of historical averages, as the stock prices from up to six months ago that he used obviously do not capture current investor expectations.

Staff indicates that the Commission rejected use of historical stock prices in the Docket No. 03-0403 Order (Aqua Illinois, Inc., then Consumers Illinois Water Company, rate proceeding). Staff also says that in the last rate proceedings for AIC, the Commission rejected AIC’s DCF analysis stating that the over-reliance on historical data is problematic. Consistent with the findings in the previous AIC rate cases, Staff believes Mr. Hevert’s use of historical data in his cost of common equity analysis should also be rejected in this proceeding.

In its Reply Brief, Staff notes that AIC argues against the use of spot prices, claiming that this fails to account for aberrant behavior in stock prices. Staff claims that by measuring the cost of common equity at several points in time, Staff demonstrated that stock prices were not aberrant. Staff says the DCF-derived estimates of the cost of common equity for the gas sample can be explained by trends in the broader market. Staff maintains that current market price data must be used to determine the investor-required ROR on common equity because market data continuously adjusts to reflect investor return requirements as they are continuously re-evaluated. Staff claims average prices from as long as six months ago do not capture current investor expectations and could reflect information that investors no longer consider relevant.

According to Staff, the Commission has repeatedly ruled against the use of historical data in estimating the forward-looking cost of common equity estimate. The cases that AIC cites where the Commission rejected Staff’s use of spot prices, Docket No. 10-0467 and Docket No. 07-0241 and 07-0242 (Cons.), are exceptions to the rule.

Based on the Commission’s language in Docket Nos. 07-0241 and 07-0242 (Cons.), Staff claims the Commission is not opposed to using spot data at all; to the contrary, it deviates from the practice of using spot data only with reluctance. Staff states that the standard established in that order for deviating from that Commission ratemaking practice – when it can be shown that the proxy itself strays from a zone of reasonableness to the degree where it offers an unreliable estimate of the appropriate ROE - has not been met in this proceeding.

According to Staff, in the last rate case proceedings for AIC, AIC’s witness used historical data to estimate the dividend yield in her DCF model. Staff says the Commission found Ms. McShane’s over-reliance on historical data to be problematic and rejected her
DCF analyses. Here, Staff believes the Commission should once again reject AIC’s non-
constant DCF analysis due to its over-reliance on historical data, particularly given that Staff
has demonstrated that spot stock prices have not produced “aberrant” estimates.

According to Staff, the principal difference in the application of the multi-stage DCF is
the long-term growth rate. Staff says Mr. Hevert incorrectly suggests that the long-term
growth rate used in this proceeding should be consistent with the Commission Order in
Docket No. 10-0467; however, Staff believes this approach fails to take into consideration
two crucial factors: the expected ROR on new investment (i.e., earnings) and the rate of
earnings reinvestment (i.e., “retention”). Staff says the importance of these two factors
should be obvious. Staff states that an economy-wide growth rate, whether 4%, 5%, 6% or
even more, is not sustainable on a per share basis if a company does not reinvest a portion
of its earnings. Staff adds that the growth rate per share of a company that pays out 100%
of its earnings as dividends equals 0% regardless of the magnitude of economy-wide
growth. In this case, Staff claims Mr. Hevert’s assumed earnings retention ratios of 30.39%
for his gas sample are too low to sustain the long-term growth rates he employs.

Staff contends that together with the dividend payout rate that Mr. Hevert assumed for
2025 in his updated analysis, the 5.66% growth rate requires an average ROE of 18.63% for
his gas sample. Staff indicates that Value Line projects a ROR on common equity of
11.95% for his gas sample for the 2013-2015 period. Staff says using the even higher
6.00% long-term growth rate adopted by the Commission in Docket No. 10-0467 would only
further exacerbate the unsustainability. Staff asserts that in order to sustain 6.00% growth
given Mr. Hevert’s assumed retention rates (revised in rebuttal), the companies in Mr.
Hevert’s gas sample would have to indefinitely sustain on average a 19.74% return on
retained earnings.

Mr. Hevert suggests that Staff’s analysis of the sustainability of growth rates for the
sample companies should not be considered because it is premised on the “b times r”
approach, which as been rejected by the Commission. In response, Staff says the “b times
r” formula provides insight as to what level of growth is sustainable because it can be used
to estimate the expected ROR on new common equity investment for a given growth rate,
which is necessary for assessing sustainable growth on a company-specific basis. Staff
says Ms. Freetly used the “b times r” formula as a benchmark or guideline to test the
sustainability of the growth rates Mr. Hevert employs. As Ms. Freetly is not attempting to
estimate the cost of common equity with the “b times r” growth rates in this proceeding, Staff
claims that analysis is not expected to produce implied ROEs precisely in line with the costs
of common equity recommended in this proceeding. Staff contends that one can expect
those implied ROEs to be generally consistent with the cost of common equity
recommendations in this proceeding if the growth rates are sustainable. In other words,
Staff suggests that Ms. Freetly’s use of the “b times r” approach serves as a reality check on
the level of growth that is plausible.
Mr. Hevert points out that Ms. Freetly’s recommended return for AIC’s gas operations is lower than the Value Line projected ROE. Staff contends it is important to understand that the expected ROR on new common equity investment “r” and the investor-required ROR on their common equity investment are not identical concepts. Staff says the former can include both projects that are expected to earn more than the required ROR and those that are expected to earn less than the required ROR.

Mr. Hevert also argued that Blue Chip’s forecast 5.70% 30-year U.S. Treasury bond yield for 2021 indicates that Ms. Freetly’s 4.8% growth rate is too low. In response, Staff asserts that this forecasted 30-year U.S. Treasury bond yield overstates long-term economic growth. Staff states that although Treasury yields can be an appropriate proxy for expected nominal GDP growth, the same source provides a direct forecast of nominal GDP growth, hence Staff believes there is no reason to employ a proxy. Staff says the Blue Chip Financial Forecast from which Mr. Hevert obtained the Treasury yield forecast, projected growth of 2.7% for real GDP and 2.2% for inflation as measured by the GDP price index for the 2018-2022 period, which combine into a long-term growth projection for nominal GDP of 4.9%. Staff suggests that one would expect Treasury bond yields to be higher than the GDP growth because T-bonds contain a risk premium, which makes U.S. Treasury yields biased forecasts of growth. Staff asserts that therefore, the Blue Chip forecast of 2021 30-year U.S. Treasury bond yields overstates the expected long-term growth rate of the economy.

Staff states that the 6.00% long-term growth estimate adopted by the Commission in Docket No. 10-0467 was based on historical growth and is not supported by professional forecasters. Staff maintains that the investor-required ROR is a function of investor expectations of the future, not a mish-mash of historical averages. Staff says the EIA projects nominal economic growth of 4.5% for the 2021-2035 period and Global Insight forecasted nominal economic growth of 4.4% for the 2021-2041 period. Staff witness Ms. Freetly used those forecasts of nominal economic growth in calculating her 4.80% long-term growth rate. Staff contends that the professional forecasts support the long-term growth rate that Ms. Freetly used in her analysis and show that the growth rate the Commission accepted in Docket No. 10-0467 and Mr. Hevert’s revised long-term growth rates are overstated.

In its Reply Brief, Staff maintains that AIC fails to acknowledge that the growth rate accepted by the Commission in Docket No. 10-0467 was an abrupt departure from prior Commission findings, including the previous ComEd rate case, Docket No. 07-0566. Staff says in Docket No. 07-0566, the Commission rejected ComEd’s long-term growth rate, which was derived in a nearly identical manner to the one accepted in Docket No. 10-0467, in favor of Staff’s long-term growth rate which was derived from current market data. According to Staff, that Order states “in his non-constant DCF analysis, [ComEd witness] Hadaway used a historical GDP of 6.5% as his estimate of future GDP. Published expectations of future GDP growth are much lower.” Staff says the Commission Order ruled that Hadaway’s historical GDP growth rate was overstated and accepted Staff’s 5% growth
rate. Staff states that in Docket No. 10-0467, the Commission reversed itself and ruled that Staff’s GDP growth rate was too low because it was inconsistent with actual historical growth for the U.S. economy and accepted ComEd’s historical GDP growth rate. Staff contends that the Order in Docket No. 10-0467 provides no explanation or justification for the contradictory decision with regard to the proper long-term growth rate for the non-constant DCF analysis. Staff believes AIC’s repeated cites to the Order in Docket No. 10-0467 as the one the Commission must adhere to when setting the investor required ROR on common equity should be disregarded. Staff maintains that the ComEd Order in this regard represents an exception to Commission precedent in determining the long-term growth rate. Staff recommends that the Commission adopt its long-term growth rate which was derived from current market data, consistent with the preponderance of Commission orders on the issue.

b. CAPM

Mr. Hevert insists that the estimation of the risk-free rate should not be based on spot yields. Staff contends that interest rates are constantly adjusting, and accurately forecasting the movements of interest rates is problematic. Staff says that in contrast, the current U.S. Treasury yields Staff used to estimate the risk-free rate reflect all relevant, available information, including investor expectations regarding future interest rates. According to Staff, investor appraisals of the value of forecasts are also reflected in current interest rates. Staff contends that if investors believe that the forecasts are valuable, that belief would be reflected in current market interest rates. Staff also asserts that if investors believe that the forecasts are not valuable, that belief would be reflected in current market interest rates. In Staff’s view, if one uses current market interest rates in a risk premium analysis, speculation of whether investor expectations of future interest rates equals those from a particular forecast reporting service is unnecessary.

Staff believes it is important to note that T-bond yields reflect market forces, while forecasts do not. Staff says the true risk-free rate is reflected in the return investors are willing to accept in the market. As of June 3, 2011, Staff claims investors were willing to accept a 4.26% return on T-bonds, which includes an interest rate risk premium associated with its relatively long term to maturity. Staff asserts that because the T-bond yield includes such a premium indicates that the true long-term risk-free rate is actually below 4.26%. Staff recommends that the Commission continue to rely on current, observable market interest rates in the risk premium analysis. Staff says in the last AIC rate cases, Docket Nos. 09-0306 et.al. (Cons.), the Commission found that the current yield on long-term U.S. Treasury bond is a more appropriate proxy for the long-term risk-free rate than forecasts of that rate.

Staff states that the Blue Chip forecast of 30-year Treasury bond yields that Mr. Hevert relied on projects that the yield on long-term Treasuries will increase through the third quarter of 2012. Staff asserts that if the rise in Treasury yields was indicative of an expected
overall increase to the cost of capital, projections for inflation and the growth in the economy would also be rising. Staff says the same Blue Chip forecast projects that growth in real GDP and inflation are expected to remain relatively flat. According to Staff, the projected increase in the yields on Treasury bonds must be due to an expected increase in the interest rate risk premium or a shift in supply and demand (the flow of funds from Treasuries to other investments). Staff says an increase in the interest rate risk premium should not be reflected in the risk-free rate. Staff also says a flow of funds from Treasuries to common stocks would result in higher stock prices and lower dividend yields.

Staff claims it is important to note the concurrent decline in Treasury yields with a decline in stock prices. Staff insists that it is important to update all the components of the cost of equity analysis as of the same date in order to properly reflect the movement in all of the inputs into the calculation.

In its Reply Brief, Staff says in the ComEd Rate case, ComEd argued that Staff’s “spot” risk-free rate on September 22, 2010 was unfair because it was lower than the “spot” rate on December 29, 2010. Staff states that here, Ms. Freetly used a 4.26% “spot” risk-free rate as of June 3, 2011. Staff also indicates that by mid-September, 2011, the 30-year Treasury bond “spot” risk-free rates were in the mid- to upper- 3% range, depending on the day. Staff claims that AIC did not ask for the Commission to follow the ComEd Order in this respect since more recent interest rates are lower than those reflected in Staff’s analysis. In Staff’s view, AIC is not consistent in its advocacy of findings consistent with that Order.

Staff claims that in Docket Nos. 07-0241/07-0242 (Cons.), the Commission accepted Staff’s CAPM methodology which was based on a risk-free rate estimate from a single day, despite the Commission’s rejection of spot prices for the DCF analysis in that case. In addition, Staff says the Commission accepted Staff’s CAPM analysis in AIC’s last rate case and noted that the current yield on long-term U.S. Treasury bonds is an appropriate proxy for the risk-free rate. Staff urges the Commission to accept Staff’s risk-free rate since it reflects the current market forces that impact the investor-required ROR on common equity.

In his direct testimony, Mr. Hevert estimated beta for his sample companies over a twelve month period. For his updated analysis presented in rebuttal, he estimated beta for his sample companies over an eighteen month period. According to Staff, Mr. Hevert claims that a near-term calculation better reflects the current relationship between the proxy group companies and the S&P 500. Staff believes there is an inconsistency between Mr. Hevert’s position on beta estimates and his position against the use of spot stock prices and U.S. Treasury bond yields. Staff states that on the one hand, he argues that beta must be calculated over a short period to better reflect the current relationship between sample companies’ stock prices and the overall market. Staff says on the other hand, he argues that stock prices and Treasury bond yields must be estimated using averages that include estimates from up to six months ago, which do not capture current investor expectations.
Staff argues that beta measured over shorter time periods are more prone to measurement error arising from short-term changes in risk and investor risk preferences, which can bias the beta estimate. Staff says a decrease in a company’s systematic risk could increase its estimated beta even though generally an increasing beta would be interpreted as signaling an increase in a company’s systematic risk. Staff contends that conversely, an increase in a company’s systematic risk could lower its calculated beta even though generally a decreasing beta would be interpreted as signaling a decrease in a company’s systematic risk. Staff says those counter-intuitive results are a consequence of the inverse relationship between risk and stock values. Staff states that as the risk of a stock declines, its price rises, all else equal. Staff asserts that in a rising stock market, the beta calculated will rise for a stock that is declining in risk, all else equal. Staff claims that in a declining market, the beta calculated will decline for a stock that is increasing in risk. Staff insists that a longer measurement period should be used as a more complete business cycle will include both rising and falling markets, reducing measurement error.

According to Staff, Ms Freetly illustrated the inherent volatility when calculating beta using only one year of data with 52-week betas for American Electric Power ("AEP"). Staff says the 52 week adjusted beta was 0.80 for 2004, rose to 1.02 for 2005 and then fell to 0.58 for 2006. Staff indicates that AEP’s Value Line beta, which uses 260 weekly observations, was 1.15 at the end of 2004, 1.20 at the end of 2005 and 1.35 at the end of 2006. Staff believes the wide distribution of the 52-week beta values in three consecutive years demonstrates the inherent volatility in using such a short measurement period to measure beta.

Mr. Hevert disagrees with Staff’s beta calculations because they encompass a five-year period and he points out that the beta coefficients are lowest when using the NYSE index and monthly returns. Staff says the betas used by both Mr. Hevert and Ms. Freetly are estimates of the unobservable true beta, which measures investors’ expectations of the quantity of non-diversifiable risk inherent in a security. Staff asserts that which beta estimates are more accurate is unknown. Staff states that different beta estimation methodologies can produce different betas when those methodologies employ different samples of stock return data. Staff contends that just as Mr. Hevert and Ms. Freetly used multiple models to estimate the cost of common equity, Staff used multiple approaches to estimate beta.

Staff indicates that Mr. Hevert developed two estimates of the market risk premium. First, he calculated the required return on the S&P 500 Index using the constant growth DCF on all of the companies in the index with long-term growth projections available, including non-dividend paying companies. According to Staff, the dividend growth rate of non-dividend paying companies cannot be both constant and equal to the earnings growth rate as Mr. Hevert’s estimation process assumes. Staff states that if the dividend growth rate is constant, it must remain 0%. Staff says the average dividend growth rate of the non-dividend paying companies in Mr. Hevert’s analysis equals 15.04%. Staff argues that Mr.
Hevert’s inclusion of non-dividend paying companies in a constant growth DCF analysis exasperates the upward bias resulting from the unsustainable growth rates used to estimate the market return.

In its Reply Brief, Staff argues that despite criticizing Staff’s use of spot stock prices in the DCF analysis and spot U.S. Treasury bond yields in the CAPM, Mr. Hevert relied on spot prices to calculate the required ROR on the market. According to Staff, this is inconsistent with AIC’s professed criticism that spot prices fail to account for aberrant behavior in stock prices.

For his second approach to estimate the market risk premium, Mr. Hevert assumed a constant Sharpe ratio, which is the ratio of the risk premium relative to the risk, or standard deviation of a given security or index of securities. Staff says Mr. Hevert relied on data from 1926 through 2009 to estimate the historic risk premium and market volatility. Staff says Mr. Hevert then estimated the expected market risk premium (“EMRP”) as the product of the historical risk premium, historical Sharpe ratio and estimates of expected market volatility. According to Staff, the estimate of expected market volatility was calculated using the Chicago Board Options Exchange’s (“CBOE”) three-month volatility index (i.e., the VXV) and one-month volatility index (i.e., the VIX) for April through June 2011. Staff argues that in addition to the infirmities of historical risk premiums and historical Sharpe ratios, Mr. Hevert’s reliance on VIX and VXV introduce bias into his estimate of the market risk premium. Staff says that according to the CBOE, VIX and VXV are not pure measures of expectations; they include a risk premium which varies over time. Staff says the CBOE also states that empirical evidence indicates that the risk premium for volatility is negative, which partly explains the continual historical bias of VIX over realized volatility.

Staff maintains that the use of historic data in estimating the forward-looking risk premium is fraught with problems. Staff says the magnitude of the historical risk premium depends upon the measurement period used. Staff contends that no proven method exists for determining the appropriate measurement period. Staff believes historical earned rates of return are questionable estimates of the required ROR that are susceptible to manipulation.

Mr. Hevert claims that Staff’s ROE recommendations provide investors with an inadequate risk premium because the average equity risk premium for electric and natural gas utilities was higher during 2004-2006 when the Moody’s Baa Utility Index yield averaged approximately 6.00%. Staff asserts that since the equity risk premiums that he presented for the electric and gas utilities are from before the current market crisis, they should not be used to establish the proper equity risk premium to apply in this proceeding.

According to Staff, the Commission rejected use of historical data in Docket Nos. 06-0070 et al. (Cons.), a previous rate proceeding of AIC and specifically rejected AIC’s estimate of the market risk premium. Staff also says that in Docket Nos. 09-0306 et.al.
(Cons.), the Commission rejected the risk premium analyses of AIC and IIEC because they appeared to rely too heavily on historical data for the calculation of what should be a forward-looking ROR on common equity for the market. Staff urges the Commission to reject Mr. Hevert’s use of historical data in his cost of common equity analysis in this proceeding.

c. Adjustments to Calculated ROE

Ms. Freetly recommends that her cost of common equity estimates be adjusted downward to reflect the reduction in risk associated with the use of the uncollectibles riders authorized by the Commission. Staff contends that these cost recovery mechanisms ensure more timely and certain collection of bad debt expense, thereby providing greater assurance that AIC will earn its authorized rates of return. Staff believes it is appropriate for the Commission to reduce the ROR on common equity to recognize the reduction in risk associated with the use of the uncollectibles riders.

Staff says Ms. Freetly’s proposed adjustment for Riders GUA reflects the approach accepted by the Commission in the last AIC rate cases. She estimated the effect Riders GUA would have on the Company’s Moody’s credit ratings and based her adjustments on the resulting change in the implied yield spreads. Staff states that of the four rating factors Moody’s focuses on in its analysis of electric utilities, the adoption of an uncollectibles rider would most affect the cost recovery factor, which assesses a firm’s ability to fully recover prudently incurred costs in a timely manner. Staff asserts that a rider designed to reduce uncertainty in cash flows would positively affect the cost recovery factor. Staff says Moody’s assigns a weight of 25% to the cost recovery factor in determining the overall credit rating score. Ms. Freetly assumed that the credit rating assigned to this factor would improve by one credit rating (i.e., 3 points on the numeric scale) with the uncollectible riders. Staff says since this factor composes 25% of the overall weighting, raising the score for this factor by one credit rating suggests that AIC’s ROE should be reduced by 25% of the spread between AIC’s current rating and the next higher credit rating. Staff indicates that the June 14, 2011 spread between the Company’s Baa3 rating and the A3 was 65 basis points. Ms. Freetly concluded that AIC’s ROE should be reduced by 16.25 basis points (25% * 65 = 16.25) to reflect the reduction in operating risk stemming from Riders GUA.

In its Reply Brief, Staff notes that AIC argues that Staff’s proposed adjustment is unreasonable because it is higher than the reduction authorized for other Illinois utilities with uncollectible riders. Staff responds that its proposal is not a static adjustment to apply to each utility that implements an uncollectible rider. Staff says its proposed adjustment is made in the context of spreads between bonds with different credit ratings in order to reflect the company-specific reduction in risk that will occur as a result of the implementation of the uncollectible rider.

Mr. Hevert presented an analysis of the yields to maturity for senior, unsecured utility
bonds and claimed that the wide variation in yields demonstrates the imprecision inherent in Staff’s approach to adjust for the reduction in risk due to the uncollectible riders. Staff believes Mr. Hevert’s analysis is irrelevant. Staff says the 65 basis point spread that is the basis of Ms. Freetly’s adjustment for the uncollectible riders is drawn from Reuters Corporate Spreads for utility bonds, which represent the basis point spread over U.S. Treasury for an index of securities with the same maturity that were issued at the same time. Staff says Mr. Hevert’s analysis relied on individual bond yields that Staff believes are not directly comparable rather than an index of securities. Staff says his exhibit also shows that several bond issues had not traded in weeks, demonstrating that yields on those specific bond issues are out of date and that individual bonds are illiquid. In Staff’s view, the Reuters spreads more clearly illustrate the price of the risk level attributed to different credit ratings and serves as a proxy for the risk reduction as a result of AIC being more assured of earning its authorized ROR.

Mr. Hevert performed an event study to assess investors’ reactions to the implementation of uncollectible riders, claiming that to the extent investors believe that risk will be significantly lower for companies that implement revenue stabilization mechanisms, the stock returns of companies that implement such mechanisms should be less volatile with the decoupling mechanism in place. Staff states that for his event study, he analyzed the relationship between the stock returns of a company that implemented uncollectible riders and an index of gas utility returns prior to the implementation of uncollectible riders and after the implementation of uncollectible riders. He concluded that there was no meaningful change in the relationship between the implementing company’s stock returns and the market index as a result of the implementation of the uncollectible riders. He then concluded there was no empirical basis to conclude that the implementation of uncollectible riders would meaningfully reduce investors’ return requirements.

Staff believes that Mr. Hevert’s empirical analyses should not be considered in determining whether an adjustment is necessary to reflect the decreased risk from the implementation of the uncollectible riders for four reasons. Staff claims they do not examine the effect of a single event on stock price, but rather they compare the cumulative effect of all events during his observation period. Staff says the uncollectible riders for Detroit Edison and Michigan Consolidated Gas (“MichCon”) came within rate cases in which the Michigan Public Service Commission authorized a rate increase for the Companies. Staff complains that Mr. Hevert’s analyses do not isolate the effect of a single rate design change from the broader effect of the entire rate order, let alone other company-specific changes that might have occurred during the analysis period. Staff contends that it is difficult to separate the effects of individual rider adjustments. Staff also asserts that Mr. Hevert did not investigate the reasons for large changes in DTE Energy Company’s (“DTE”) stock price during the post-event period, such as the 3.75% increase in DTE’s stock price on October 19, 2009 or earnings guidance announcements made by DTE during his event period.

Staff next complains that Mr. Hevert set the “event date,” arbitrarily. Staff believes
that if the “event date” is too early, then pre-rate decision factors will dilute the effect of the rate order on risk, but if the “event date” is too late, then the effect of the rate order on risk will be absorbed into the pre-rate decision period. Staff contends that event period uncertainty causes event studies of regulatory changes to have low power in detecting any impact. According to Staff, low power tests will cause the analyst to conclude that a change in regulation did not have any impact despite the fact that it did.

Staff next asserts that the same article Mr. Hevert alleges supports his event study methodology actually cautions against the use of one event study of a regulatory change as the representation of its true impact. Staff suggests that to confirm his results, Mr. Hevert could have looked at other variables that would be affected by the implementation of the uncollectible riders, such as the impact on the operating income of the companies. Staff says this article concludes that event studies of regulatory changes are difficult to conduct in a way that is unassailable.

Staff states that Mr. Hevert’s event studies rely on the stock returns of DTE, the parent company of Detroit Edison and MichCon, which Staff believes creates another infirmity. Staff says despite Mr. Hevert’s claim that DTE’s total operating income is highly concentrated in the Detroit Edison operating subsidiary, his own workpapers show that Detroit Edison’s net income was only 49.33% of DTE total net operating income. According to Staff, MichCon’s net income was only 15.79% of DTE total net operating income. Staff contends that the combination of non-utility earnings and the non-concurrent adoption of uncollectibles riders for gas and electric service will dilute the effect of either rider on DTE’s stock returns.

To estimate the financial risk adjustment to the Gas samples, Staff says Ms. Freetly compared the values for the 3-year average financial guideline ratios computed from 2008 through 2010 for each of the companies in the Gas and Electric samples and AIC to Moody’s guidelines for regulated gas utilities. Staff states that to assess the financial strength of gas and electric utilities, Moody’s focuses on four ratios: (1) funds from operations (“FFO”) to interest coverage; (2) FFO to total debt; (3) retained cash flow (“RCF”) to total debt coverage; and (4) debt to capitalization.

Staff claims that AIC’s 3-year average ratios are consistent with a Baa1 credit rating, the Gas sample’s 3-year average ratios are consistent with an A3 credit rating.

According to Staff, financial theory posits that investors require higher returns to accept greater exposure to risk. Staff says the investor-required ROR is lower for investments with less exposure to risk. Staff avers that in comparison to AIC’s Baa1 level of financial strength, the Gas sample’s A3 level of financial strength indicates less financial risk than AIC. Staff concludes that the Gas sample’s average cost of common equity needs to be adjusted upward to determine the final estimate of the AIC Gas’ cost of common equity.
Using 30-year utility debt yield spreads published by Reuters, Staff says Ms. Freely calculated the yield spreads between the credit ratings implied by the financial ratios for AIC and those of the Gas samples. Staff indicates the spread between the implied ratings of Baa1 for AIC and the A3 for the Gas sample is 30 basis points. To determine the cost of common equity adjustments, Ms. Freely multiplied the yield spreads by 30%, which Staff says is the percent of the overall credit rating that Moody’s assigns to the financial ratios. Staff indicates that Ms. Freely’s financial risk adjustment to the cost of common equity is an increase of 9 basis points for AIC’s natural gas distribution operations to reflect the higher financial risk of AIC in comparison to the Gas sample.

Mr. Hevert claimed that Ms. Freely failed to consider company-specific business risk in comparing the risk of AIC to that of her Gas samples. Staff says he specifically mentions two-company specific risks that Ms. Freely allegedly failed to consider: (1) the weather-related risk for the Company’s natural gas operations due to the lack of a weather normalization clause; and (2) the higher level of regulatory risk for utilities in the State of Illinois. According to Staff, the same credit ratings range that Ms. Freely used to establish comparability (and which Mr. Hevert criticized as being “too restrictive”) reflects both of those risks. Staff also asserts that Ms. Freely compared the Standard & Poor’s business profile scores for AIC and the Gas samples. Staff says S&P states that AIC’s “excellent” business risk profile reflects its lower-risk pure transmission and distribution operations and is also affected by its ability to manage its regulatory risk. Staff states that the average business risk profile of Staff’s Gas samples is also “excellent.” Staff concludes that its samples are comparable to AIC in terms of business risk. Staff also notes with regard to the lack of weather normalization, AIC is allowed to recover 80% of fixed costs through rates. Staff claims this high level of fixed cost recovery mitigates the need for weather normalization as it largely decouples rates from usage.

d. Flotation Costs

Staff believes the flotation cost adjustment proposed by Mr. Hevert is inappropriate. Citing the Commission Order from Docket No. 94-0065, Staff says the Commission has traditionally approved flotation cost adjustments only when the utility anticipates it will issue stock in the test year or when it has been demonstrated that costs incurred prior to the test year have not been recovered previously through rates. Staff also emphasizes that the utility has the burden of proof on this issue. According to Staff, flotation costs are to be allowed only if a utility can verify both that it has incurred the specific amount of flotation costs for which it seeks compensation and that those costs have not been previously recovered through rates. In Staff’s view, AIC has done neither.

Staff says Mr. Hevert’s flotation cost calculations were based on the costs of issuing equity that were incurred by Ameren and his sample group companies in their two most recent common equity issuances. Staff states that based on those issuance costs, he
calculated a flotation cost of 0.13% for the natural gas distribution operations. According to Staff, he did not make a specific flotation cost adjustment, but claims to have considered the effect of flotation costs in determining where AIC’s ROE falls within the range of results.

Staff says the Commission has repeatedly rejected generalized flotation cost adjustments in previous cases as an inappropriate basis for raising utility rates. Staff argues that since Mr. Hevert’s calculation is not based on issuance costs that AIC has incurred but has not previously been recovered through rates, it should not be considered in setting the investor required ROR on common equity.

3. IIEC Position

IIEC witness Mr. Gorman recommends that the Commission award AIC a ROE for gas operations of 9.25%, which is the midpoint of his 8.85% to 9.60% estimated range of AIC current market cost of common equity for gas operations. IIEC says his recommendations were based on the results of a constant growth DCF model, a sustainable growth DCF model, a multi-stage growth DCF model, and a CAPM analysis. According to IIEC, these analyses used observable market information for a group of publicly traded gas utility companies. IIEC believes those samples of companies approximate the investment risk of AIC’s gas operations.

In addition to their analyses and cost of equity estimates, IIEC notes that Mr. Gorman and Mr. Hevert presented reviews of relevant market conditions that were used as checks on the appropriateness of their estimates or to select point estimates within the ranges produced by their analyses. Mr. Gorman found the credit rating outlook for gas utilities is strong and supportive of the industry’s financial integrity. IIEC says his review of the industry market outlook showed that gas utilities’ stocks exhibited strong return performance and are characterized as “safe haven” investments.

Focusing on AIC specifically, IIEC says that AIC’s credit standing is impacted by its consolidation with its parent and affiliate companies. IIEC asserts that because of its low risk, pure transmission and distribution operations, AIC is considered a low operating risk business within the Ameren structure. IIEC further contends that AIC’s regulatory/legislative risk is improving, notwithstanding comments to the contrary in some financial publications. IIEC claims AIC’s regulatory uncertainty was largely based on credit analysts’ concerns with legislative actions relating to the state’s transition to competition. IIEC also asserts that more recent concerns can be traced to AIC’s decision to use a historical test year with aggressive adjustments, rather than pursue less risky rate case filing options such as a future test year.

Mr. Hevert’s review of the market emphasized data he presented as measures of volatility and investor risk perceptions. According to IIEC, he concluded that these measures
indicate an increased cost of equity in capital markets. IIEC says Mr. Hevert does not claim or demonstrate that his general finding applies equally to regulated distribution utilities. IIEC believes such a claim would ignore the market’s perception of utilities as safe havens during periods of market uncertainty and historically low interest rates, the current environment. IIEC disagrees, asserting that capital market costs have declined, particularly since AIC’s last rate case and noting specifically the observable decline in “A” and “Baa” rated utility bond yields.

In its Reply Brief, IIEC states that rather than discuss any perceived weaknesses in IIEC’s analysis, AIC’s Initial Brief focuses instead on dire warnings to the Commission, pleas for “what the other guy got,” and a request for “something extra” in its return award. IIEC says AIC warns the Commission of possible Wall Street reaction if it does not receive a high return, apparently without regard to what the record requires. Citing Docket No. 10-0138, IIEC urges the Commission to be independent of pressure to please investors at the expense of record-based decision making and fairness to ratepayers.

After estimating AIC’s market required cost of equity, IIEC’s Mr. Gorman verified that his recommended cost of equity was adequate to maintain an investment grade bond rating and financial integrity for AIC. His analysis compared key credit rating financial ratios for AIC, at the capital structure proposed by AIC and the return on equity Mr. Gorman recommends.

Mr. Hevert criticizes Mr. Gorman’s evaluation of AIC’s financial integrity at IIEC’s recommended return level. He states that the credit metrics Mr. Gorman developed would support an investment grade bond rating even at a return on equity of 5%, concluding that this calls into question whether the evaluation is meaningful in determining whether that return on equity will support AIC’s credit ratings. According to IIEC, that assessment of Mr. Gorman’s evaluation is a bare mathematical exercise that ignores the more important aspects of Mr. Gorman’s evaluation.

IIEC says Mr. Gorman’s evaluation of metrics begins only after he has estimated a return on equity for AIC. According to IIEC, the evaluation is based on both an assessment of the current market cost of equity for AIC and the metrics-based assessment of whether or not the estimated fair return on equity and capital structure will support AIC’s credit rating and financial integrity.

Mr. Hevert’s argument suggests that the market does not distinguish among securities or review actual financial ratios, as long as the firms are in the same ratings category. IIEC insists that is not true. IIEC asserts that a return on equity of 5% does not produce strong credit metrics, when compared to IIEC’s recommended return on equity of 9.85%. IIEC maintains that credit metrics based on a 5% return are categorically weaker than those produced by IIEC’s recommended return.
In IIEC’s view, Mr. Hevert’s calculation of these ratios at a 5% return on equity does show that there is flexibility in the returns adequate to maintain supportive financial ratios, a point that is inconsistent with AIC’s insistence that only its recommended return will preserve its financial integrity. IIEC maintains that its recommended return on equity of 9.85% provides an opportunity for AIC to achieve strong credit metrics, giving strong support to its investment grade bond rating, while providing fair compensation for the utility. Mr. Gorman also reviewed the cost of equity estimation analyses performed by Mr. Hevert. IIEC claims his findings indicated that his proposed return levels for AIC (both electric and gas operations) are overstated and unreasonable.

IIEC asserts that Mr. Hevert’s multi-stage growth DCF analysis is based on a long-term growth rate estimate that is inflated and does not reflect current market participants’ growth outlook. IIEC believes this inflated long-term growth rate input produces an overstated DCF estimate. IIEC also contends that Mr. Hevert's CAPM return estimates are based on unrealistic and inflated market risk premiums and flawed beta estimates that do not reflect long-term investment risk characteristics of regulated utility operations. IIEC says his analyses do not produce reliable CAPM return estimates. In IIEC’s view, Mr. Hevert’s bond yield plus risk premium model is based on an inflated equity risk premium and produces an unreasonable return estimate.

Mr. Gorman also offered proper adjustments to eliminate some of the deficiencies in Mr. Hevert’s return studies. According to IIEC, they result in more reasonable and balanced return on equity estimates. IIEC asserts that Mr. Gorman’s modest corrections to Mr. Hevert’s studies show that a fair return on equity for AIC in this case is less than 9.5% for gas.

In its Reply Brief, IIEC says that AIC argues that if the Commission would only give it what ComEd got, its problems in this area would disappear. According to IIEC, AIC does not show that such findings would be supported by this record or are warranted for AIC. In addition, IIEC maintains that decision represented a departure from the Commission’s longer-standing “coherent, consistent manner” of determining a utility’s cost of equity. IIEC also says that AIC presumes to instruct that the Commission should be setting rates in a way that allows AIC to put some breathing room between it and sub-investment grade status, characterizing its current ratings position as daredevil, tightrope-walking regulation. According to IIEC, AIC warns that if an investment-grade credit rating is not maintained, AIC’s borrowing costs - costs that are ultimately borne by ratepayers - will increase. IIEC contends no party has proposed a loss of investment grade status. IIEC says every party has conducted analyses that show their proposed returns will maintain AIC’s credit rating.

IIEC also contends that AIC refuses to acknowledge that Staff’s and IIEC’s return on equity recommendations are low today because capital market costs for utility companies are at historically low levels. IIEC claims that observable utility bond costs dropped in this case relative to the last case. IIEC also says that in AIC’s last case, a “Baa” utility bond yield
was 6.92%; in this case, the cost of the same bonds is 5.92%. IIEC believes this indicator of AIC’s cost of capital is clearly observed to be at least 100 basis points lower in this case than it was in the last case. To the extent bond rating analysts expect rational regulatory outcomes, IIEC says the Commission must recognize this change in the cost of capital. If the Commission does not recognize a cost decrease, when capital costs increase, IIEC claims credit rating agencies and the markets will not have confidence that the Commission recognize the change in costs to a higher cost of capital.

According to IIEC, AIC challenges other parties’ findings that their lower cost of equity recommendations reflect that AIC is not as risky as the utility contends through its recommendation. AIC argues that other parties’ recommendations are not logically consistent with its observations on the market. IIEC contends that the parties’ assessment of the relative risk of AIC against the market and treasury instruments is simply that AIC is one of the safer investments in the market. In IIEC’s view, there is no logical inconsistency in recognizing that Treasury instruments, because of their unique status, are even less risky.

IIEC alleges that acknowledging the outlier status of its cost of equity recommendations, AIC’s Initial Brief emphasizes different, lower costs of equity. IIEC says AIC now advocates prominently for the low end of Mr. Hevert’s ranges of estimates. IIEC contends that despite this unexplained change, AIC’s range of cost of equity estimates remains unreasonably high.

a. DCF

Mr. Gorman’s analyses included a constant growth DCF model using analysts’ forecasts, a constant growth DCF model using a sustainable growth rate, and a multi-stage non-constant growth DCF model. The three results are averaged to produce Mr. Gorman’s DCF estimate, which defines the lower end of his range of reasonable cost of equity estimates.

IIEC reports that after reviewing Mr. Hevert’s testimony on cost of equity estimation analyses and his response to the critiques of non-utility experts, Mr. Gorman concluded that the differences between Mr. Hevert’s approaches and other parties’ DCF studies relate to fundamental arguments about the elements of a proper estimation of reasonable and reliable DCF returns. According to IIEC, the input that sets Mr. Hevert’s DCF analyses apart is his excessive long-term growth rate, which raises his estimates.

IIEC states that the constant growth DCF model requires a growth rate that can be sustained over an indefinite period. IIEC also indicates that the final stage of a multi-stage DCF model similarly requires a growth rate that is sustainable over the infinite period as the model is designed on the assumption this growth will hold constant into perpetuity.
According to IIEC, in Mr. Hevert’s criticism of other experts’ analyses and in his own DCF input choices, he dismisses that basic requirement. IIEC also contends that Mr. Hevert appears not to accept that when growth rates fail customary tests of sustainability and rationality, the DCF model will produce unreliable results.

IIEC believes that principles underlying DCF models that should continue to be followed by the Commission include: (i) requirements that the model reflect realistic expectations; and (ii) that growth estimate inputs be reasonable estimates of long-term sustainable growth. IIEC contends that Mr. Gorman’s DCF models respected these constraints. IIEC says Mr. Gorman assessed the analysts’ growth rates used in his constant growth model and determined that they are not sustainable, as they exceeded the projected growth rate of the entire U.S. economy, as represented by the GDP. IIEC reports that he also concluded that because of the excessive growth rate the model was not reliable as the sole basis for a cost of equity estimate. IIEC says he continued his analysis by using, in addition, sustainable growth and multi-stage DCF models.

IIEC states that the sustainable growth DCF model is a constant growth DCF model, but the growth rate used in the model is developed based on internal growth plus external growth factors that can be sustained indefinitely by companies. According to IIEC, a company’s growth is fueled by its reinvestment of earnings and new investment. IIEC says the funds available for reinvestment are in turn tied to how much of the company’s earnings are paid out in dividends. IIEC states that difficulties with ascertaining market outlooks are for the factors underlying this growth estimate, require that this model also not be the sole basis for a cost of equity estimate. IIEC says Mr. Gorman completed his analysis with the addition of a multi-stage non-constant growth DCF model, in which IIEC claims he also respects the accepted limitations on growth rate inputs and reflects investors’ rational expectations of future growth.

According to IIEC, Mr. Hevert suggests that growth can be produced in ways other than reinvestment of earnings or growing book value by selling additional stock at market prices above book value – though IIEC says he has not identified any such alternative earnings growth source nor explained how this unidentified growth source can be used as a valid sustainable long-term growth rate. IIEC finds it surprising that Mr. Hevert quarrels with use of internal growth as a limiting factor on sustainable growth rates, since he uses the Gordon Model, which uses the retention rate to determine a terminal stock price, as the basis for his multi-growth DCF model input.

IIEC says Mr. Gorman found Mr. Hevert’s criticisms based on academic literature, reliance on an aberrant Commission determination that reflects the use of historical, instead of forward-looking inputs, and unpersuasive. IIEC claims his academic literature arguments are based on studies concerning real growth rates, not the distinct nominal growth rates required by the DCF model. IIEC says he also relies on a Commission decision using an unsustainable growth rate (a recent ComEd case). IIEC claims that decision is a departure
from the Commission’s long-standing approach. According to IIEC, the Commission has rejected a long-term sustainable growth rate derived from historical GDP growth data (like Mr. Hevert’s) in several cases preceding that most recent ComEd case. IIEC asserts that the Commission has more consistently rejected historical GDP growth rate estimates as reflective of investor expectations for future growth and it has viewed published GDP growth projections as a reasonable proxy for the ceiling on growth rates for a utility. IIEC also claims that by relying on historical data, Mr. Hevert fails to reflect the consensus market participants’ outlooks of future long-term GDP growth and overstates the DCF return estimate.

In his analysis, Mr. Hevert relied on a growth rate (based on historical data) of 5.72% as a long-term sustainable growth in the third stage of his multi-stage growth DCF study. IIEC finds that input excessive and flawed, and recommends that Mr. Hevert’s multi-stage growth DCF analysis be disregarded. IIEC claims that in his analysis, Mr. Hevert went through the motions of observing the accepted GDP ceiling on long-term sustainable growth, by calculating a GDP growth estimate that he used as his long-term growth rate input. IIEC says his calculation combines a real GDP growth rate outlook with a CPI inflation outlook that is not based on GDP.

According to IIEC, this CPI inflation is not based on GDP but rather is based on a subgroup of the U.S. economy that reflects a consumer basket of goods. IIEC asserts that the CPI, unlike the GDP price deflator, is far more heavily weighted with personal consumption items rather than a measure of the U.S. economy. IIEC claims the CPI is heavily weighted with medical costs and that the GDP price deflator includes medical costs but not to the same extent as the CPI. IIEC argues that the CPI inflation factor is not designed to reflect the entire U.S. economy. In order to accurately measure the GDP nominal growth, IIEC contends one must combine the GDP real return with a projection of the GDP price inflation. IIEC says the U.S. Department of Commerce uses the GDP price deflator as the inflation measure for the entire U.S. economy and claims because Mr. Hevert did not use the GDP price deflator, he did not accurately measure nominal GDP growth.

In its Reply Brief, IIEC claims that both it and Staff constructed their DCF and CAPM studies in this case in a manner similar to what they did in AIC’s last rate case. IIEC says the Commission accepted those analyses and used them in its cost of equity determination in that case. IIEC states that AIC’s witness, Mr. Hevert, used variations of the DCF and CAPM models that are inconsistent with those models traditionally found to be reliable by the Commission and by other utility regulators.

IIEC also alleges that AIC did not make any substantive argument responding to the challenges to the growth rate used by its witness, Mr. Hevert. IIEC claims AIC asks the Commission to adopt the very high growth rate used in a recent ComEd case, irrespective of what the record in this case shows for this utility.
According to IIEC, the Commission does not make findings on the precise numbers used as cost of equity model inputs as a matter of policy that it carries from case to case. IIEC insists that the law requires that the Commission make findings in each case on the basis of the record before it, not on the basis of "what the other guy got."

IIEC also complains that AIC's Initial Brief dismisses IIEC's cost of equity evidence in only two sentences. In IIEC's view, such subjective characterizations are not persuasive. IIEC also alleges that AIC's Initial Brief incorrectly summarizes its own testimony. IIEC says Mr. Hevert criticized IIEC's sustainable growth DCF, not its multi-stage growth DCF model, asserting concern with the dividend payout ratios. IIEC states that AIC's only argument addressing Mr. Gorman's multi-stage growth DCF model concerned the final stage sustainable growth rate.

According to IIEC, AIC's complaint that Mr. Gorman's constant growth DCF model analysis is not relevant -- if accepted by the Commission -- would exclude Mr. Gorman's highest DCF result from his calculation of the results' average, lowering the return estimated by Mr. Gorman's DCF analyses.

IIEC contends that AIC does not address the relative, substantive merits of the approaches taken by the expert witnesses on the sustainable growth rate in this case. IIEC believes such a legal and factual analysis is what the Act requires to support a record-based cost of equity determination. But instead of attempting to meet the substantive challenges to its outlier growth rate input, IIEC asserts that AIC's Initial Brief looks over the fence at the growth rate ComEd used in its last case and asks the Commission for the same, irrespective of the record before the Commission.

IIEC indicates that AIC asserts that the Commission will appear arbitrary instead of reliable if it does not adopt that element of the record in another case. IIEC complains that AIC has selected as the standard of Commission behavior a single case, which is itself a departure from the Commission's more consistent approach in prior cases, where reasonable, sustainable growth rates for the final stage of the DCF model were required.

In IIEC's view, AIC's suggestion of arbitrariness is not applicable to the growth rate used as the terminal growth rate of IIEC's multi-stage DCF model. IIEC says the long-standing practice of the Commission is to rely on consensus analysts' growth rate projections, including GDP growth rates, for use as long-term steady-state growth rate inputs to a multi-growth DCF model. IIEC claims the Commission departed from this long-standing practice in the 2010 ComEd rate case. IIEC claims that if there is arbitrariness, it is the ComEd decision that is "arbitrary." IIEC argues that the position of Staff, IIEC, and AG-CUB that proper growth rates must be sustainable over the infinite period of the DCF model tracks the traditional approach of Commission decisions.

IIEC also contends that AIC does not (or refuses to) recognize that the growth rate
finding in the ComEd rate case had to be a factual determination, based on the record in that case. IIEC claims there is no Commission policy that national GDP growth should be (or would be considered to be) 6% in every case, for all time. IIEC believes such a decision -- even if the Commission had intended that result -- would be unlawful.

IIEC argues that the record in this case does not support AIC’s excessive growth rate. According to IIEC, the record in this case provides substantive reasons to maintain the Commission’s long-standing practice of relying on consensus analysts’ projections of future GDP growth for this terminal stage DCF growth estimate and looking to the GDP as a ceiling on sustainable growth rates. IIEC says AIC relied on historical real growth, with projected inflation rates. IIEC believes Mr. Hevert relied on unrealistic expectations that future real GDP growth will be comparable to historical real GDP growth, even though the U.S. now competes in a worldwide economy that presents far greater competition for commerce than the U.S. economy faced historically.

b. CAPM

IIEC says Mr. Gorman’s CAPM analysis was the fourth estimation model process he employed to estimate AIC’s market required cost of equity. IIEC indicates that he applied the CAPM to the same proxy group of publicly traded utilities he used with his DCF models. IIEC reports that Mr. Gorman’s CAPM estimate establishes the upper end of his range of estimates.

Mr. Gorman used forecasted 30-year Treasury bond yields as his risk-free rate. IIEC claims that because this input includes some effects of inflation, it can produce an overstated estimate for companies with betas less than one. IIEC says his beta input was derived from published Value Line beta estimates for the proxy group firms. For the market risk premium input, Mr. Gorman derived two estimates, one forward-looking and the other based on a long-term historical average. According to IIEC, the forward-looking estimate was derived by estimating the expected return on the market, as represented by the S&P 500 (as the sum of expected inflation and historical real return on the market), then subtracting the risk-free rate from this estimate. IIEC indicates the historical estimate was derived using Morningstar’s published estimates of the historical arithmetic average real market return (8.7%), to which he added a current consensus analysts’ inflation projection (2.3%). IIEC says these estimates (summed) yield an expected market return of 11.20%, and subtracting his 5.2% risk-free rate estimate produce a market risk premium of 6.00%.

IIEC expresses concern about the beta estimates used by Mr. Hevert. IIEC believes one of the two beta estimates he uses is over-stated and unreasonable. IIEC says for his gas proxy groups, Mr. Hevert uses an average of the published beta estimates by Value Line and Bloomberg from historical beta and a (higher) current beta that Mr. Hevert computed from a small set of recent data. IIEC claims the beta estimates computed from 12 months of
data are based on substantially fewer observations than the published beta estimates, making that statistical derivation of beta much less reliable, since it will reflect short-term movement that will smooth over a longer period.

IIEC also asserts that such short-term data are more consonant with the information relied on by short-term speculators than by investors willing to fund long-term investments. IIEC also believes Mr. Hevert’s concern that recent volatility would not be captured in published betas appears unfounded. IIEC claims the data periods used for those beta estimates include the periods of instability Mr. Hevert cites, and the estimates themselves are consistent with current beta estimates.

IIEC also believes that Mr. Hevert’s market risk premium estimates (9.21% and 8.09%) are inflated. IIEC says Mr. Hevert’s first market premium is a DCF-derived estimate that is based on a market return of more than 13.5%, which incorporates a growth rate of more than 11.5%, which IIEC says is more than twice the long-term GDP growth outlook. IIEC insists that is a growth rate estimate too high to be a rational, sustainable growth rate estimate, and produces results that are not a reliable basis for the Commission’s determination. IIEC asserts that Mr. Hevert’s beta and market risk premium estimate methods have never been adopted by a regulatory commission. In IIEC’s view his experiment should not be the basis for setting rates for AIC ratepayers.

In its Reply Brief, IIEC states that AIC claims IIEC witness Gorman employs an inappropriate market risk premium and improperly relies on Value Line as his sole source of beta coefficients. IIEC says AIC offers no further substantive argument regarding IIEC’s positions and testimony and that there are only bare references to the testimony of its witness, Mr. Hevert.

IIEC says Mr. Hevert’s criticism of Mr. Gorman’s use of published beta estimates is based entirely on his opinion that betas derived from a shorter data period should be given more weight. IIEC indicates that he uses the higher beta he calculated specifically for this litigation from a shorter period of data. IIEC claims that elsewhere AIC has criticized the use of brief periods of data as susceptible to volatile market movements that may not reflect the general market trends. IIEC complains that AIC embraces the higher betas derived from such data.

According to IIEC, based on his flawed methodologies and other changes that do not reflect utility stock and bond investment risk, Mr. Hevert made substantial inappropriate adjustments to the measured utility beta estimates and the market risk premium estimates used in his analysis. IIEC urges the Commission to reject Mr. Hevert’s CAPM return estimates.

c. Other Models
IIEC indicates that because the Commission has consistently declined to consider the results of risk premium cost of equity analyses, Mr. Gorman did not perform one. Only Mr. Hevert performed such an analysis, using a risk premium derived from reported returns approved by other commission for other utilities. IIEC contends that Mr. Hevert has not provided any information that shows the risk premium approach to be superior or to warrant a change in the Commission’s historical position.

IIEC says Mr. Hevert constructs a risk premium return on an equity estimate based on the premise that equity risk premiums are inversely related to the interest rates. IIEC believes that Mr. Hevert’s simplistic inverse relationship premise is not supported by relevant academic research and that the results of this exercise are unreliable and should be discarded.

d. Adjustments to ROE

IIEC did not propose an adjustment to recognize the effect having an uncollectibles rider has on AIC’s level of risk. However, IIEC believes that regulatory mechanisms that increase AIC’s assurance of full cost recovery (such as Rider GUA), will lower AIC’s operating risk. IIEC says the appropriateness of an adjustment would depend on the extent to which the risk reduction attributes of such regulatory mechanisms are fully reflected in the risk factors considered by credit rating analysts and the selection of the proxy group identified firms of comparable risk.

e. Flotation Costs

IIEC indicates that Mr. Hevert developed a flotation cost recovery adjustment that would increase AIC’s return on equity by 14 basis points. IIEC says Mr. Hevert did not make an adjustment to his recommended cost of equity; instead, he stated that he considered flotation costs in determining where within his range of estimates AIC’s return on equity should fall. IIEC claims the precise effect of Mr. Hevert’s flotation adjustment on his cost of equity recommendation is unknown. In IIEC’s view, approval or disapproval of his adjustment thus would seem to be a moot exercise for the Commission.

According to IIEC, if the Commission decides to address this issue, it must do so in hypothetical terms and without common ground for the various arguments presented. IIEC says the Commission has not regularly included flotation costs in its determination of a utility’s cost of equity.

In response to Mr. Gorman’s and Ms. Freetly’s observations that AIC had not shown that it had actually incurred flotation costs and the amount thereof, Mr. Hevert abandoned his estimate based on equity issuances by Ameren and proxy group firms for an estimate based
on Ameren costs. IIEC asserts that AIC, the utility, has not incurred, and indeed cannot incur flotation costs. IIEC complains that Mr. Hevert simply assumes that any identified amount has not been recovered. Citing Section 9-230 of the Act, IIEC also argues that there is no basis on which the Commission could approve recovery of estimated costs of incurred by AIC's unregulated parent firm.

Citing Staff witness Freely, IIEC says historical flotation costs (even when actually incurred by a utility) may have been recovered as expenses. IIEC says Mr. Hevert does not even claim to know the actual historical treatment of even the non-utility costs he offers as the basis for his adjustment. IIEC states that AIC asks the Commission to use the utility's unfounded conclusion about past costs for another company as data for its future test year ratemaking and to grant the utility continuing, increased future earnings based on the alleged past costs. IIEC says the requested mechanism for this grant is a perpetual return on equity adjustment, as proposed by Mr. Hevert. IIEC believes AIC’s proposal respecting flotation costs should be rejected.

4. **GCI Position**

GCI urges the Commission not to be swayed by the rhetorical excesses presented by AIC’s witnesses in their rebuttal testimony. GCI believes that AIC fundamentally asks that the Commission abandon its past practice of relying on objective market data and financial models by emphasizing subjectivity and fear over objective analysis. Of the expert recommendations in this record, GCI notes that the one offered by Mr. Hevert (10.75% for AIC's gas operations) was by far the highest -- some 150 basis points above the high end of Mr. Gorman’s recommended return 9.25%. GCI also notes that Staff witness Freely recommends even lower returns for AIC, 8.9% for gas operations. GCI adds that Mr. Gorman and Ms. Freely recommended ROEs at the top of the range of reasonable results that Mr. Thomas identified.

GCI asserts that Mr. Thomas’ analysis fits right within the range identified by Staff and IIEC, with a return of 9.02% for AIC’s gas operations. GCI believes that risk premiums of 6-7% are excessive in relation to the riskiness of the public utility business. GCI also asserts that application of the DCF model requires growth rates that are reasonable for the low-growth utility industry. GCI believes that application of the CAPM must be done in a manner consistent with the way the model is used by financial professionals outside the rate setting process. To limit the scope of the cost of equity debate in this case, GCI says Mr. Thomas narrowed the range of issues addressed in his analysis. Instead of conducting a completely separate analysis, GCI indicates Mr. Thomas reviewed Mr. Hevert’s analyses and data, and suggested corrections based on prior Commission Orders, the governing legal precedents and the evidence presented by AIC.

GCI says Mr. Thomas corrected Mr. Hevert’s DCF analyses to set the long-term
sustainable growth rate in a manner that is consistent with the Commission’s Final Order in the Company’s last rate case, Docket Nos. 09-0306 et al. (Cons.). GCI states that he corrected Mr. Hevert’s DCF analysis to remove his inappropriate and unsupported assumption that dividend payout ratios will increase. Next, GCI says he corrected the beta estimates used in the CAPM to reflect observations from more than one financial reporting source. According to GCI, Mr. Thomas corrected the CAPM market risk premium to reflect a balance of historic risk premiums and projections presented by Mr. Hevert. Finally, GCI says Mr. Thomas examined Mr. Hevert’s additional proposed analyses which were previously rejected by the Commission, including the “Bond Yield Plus” risk premium analysis and proposed flotation cost adjustment.

GCI indicates the Commission has typically relied on averages of the DCF and CAPM, something that GCI believes is appropriate to do again here with the DCF results marking the upper boundary of reasonable returns. Using this framework, GCI says Mr. Thomas concluded that for the AIC Gas operations, reasonable results range from 7.41% to 9.02%, with an average of 8.22%.

According to GCI, AIC has not presented any objective basis for the Commission to adopt its recommendation. GCI says AIC warns that the Commission should be concerned about Wall Street’s reaction if its determination, no matter how well-founded, does not align with the decisions of other state commissions. GCI believes AIC would rather the Commission focus on investor expectations than deriving AIC’s real cost of capital from objective market data.

GCI says three different AIC witnesses try to focus the Commission away from the models it has always relied on and towards credit rating agency expectations. GCI states that in Docket No. 10-0138, the Commission questioned whether appealing to investors is something that is within the Commission’s purview or even within its statutory jurisdiction. GCI asserts this is even before the record evidence in this case that credit rating agencies have been widely criticized for their investment-grade ratings of subprime mortgage backed securities, which are seen as the major issue precipitating the economic crisis of 2008. According to GCI, there is no evidence that AIC’s credit ratings have been negatively impacted when the Commission awarded the utility significantly less than it requested. GCI says this action did not negatively impact the utilities’ credit ratings.

AIC characterizes the recommendations of Staff, IIEC and GCI as unreasonable compared to other electric and natural gas utility authorized returns on equity. GCI believes such comparisons are not only irrelevant but of dubious value, since AIC provides no investigation of the comparability of risk for each of the companies and no detail on any regulatory framework within which those companies operate. In GCI’s view, the fact that the Commission does not compare favorably to some other state regulatory commissions in similar positions is merely demonstrative of the Commission’s efforts on behalf of the consuming public to ensure that all costs that are passed on to the general rate-paying
public are reasonable.

GCI believes the Commission should base its determination of a fair return on the relative riskiness of the regulated company. According to GCI, AIC’s attempts to persuade the Commission to ignore the objective approaches of Staff, IIEC and GCI should be rejected. GCI asserts that the foundation of the Commission’s decision is market data, appropriate financial models based on those data, and bedrock economic/financial principles. GCI says the Commission has been, for a long period of time, dedicated to ensuring that only reasonable and legally-recognizable costs are passed on to ratepayers.

In its Reply Brief, GCI says that AIC accuses Staff and other parties of low-balling their ROE recommendations. GCI alleges this is not surprising, asserting that AIC has high-balled its own ROE recommendations to the point of being a lone outlier, even the lowest end of its range is a full 90 basis points above any other ROE recommendation in the case. GCI claims AIC invokes scare tactics in an attempt to intimidate the Commission into submitting to its over-inflated requested ROE by claiming that keeping AIC’s ROE right where it is, is akin to daredevil, tightrope-walking regulation that will result in AIC being on the verge of collapse. GCI states that AIC further claims that a Commission decision based on Staff, IIEC and GCI recommendations would be an arbitrary departure from the Commission’s recent practice and that such arbitrariness and randomness must be avoided. In GCI’s view, such rhetoric should be disregarded for what it is: a ploy to distract the Commission from its required review of the evidence in this proceeding, in line with the controlling law and Commission-developed policies, demonstrating that an ROE in the range of 7.41% to 9.02% would be the only supportable, justifiable and appropriate ROE.

GCI agrees with AIC that the Commission should develop returns on equity in a coherent, consistent manner. GCI states that AIC suggests the Commission will recognize arbitrariness by looking not to the instant record or to an appellate court, but to statements made by credit rating agencies. GCI claims the Commission has previously rejected such an analysis. Citing Docket No.10-0138, GCI says the Commission's task is to determine the market required return on equity investments in the Companies -- not the information available to investors. GCI claims the market required return is the result of the interaction of that information available to investors, the financial environment, how investors react to available information, and all other factors that influence the market required return. GCI contends that how investors subjectively felt or what they thought, though interesting to contemplate, is not the task at hand.

GCI complains that AIC does not explain how its proposed ROEs conform with past Commission decisions other than to simply dismiss the testimony of Mr. Thomas and IIEC witness Gorman. GCI says the criticisms of both witnesses with respect to Mr. Hevert’s DCF models are not addressed. GCI indicates that AIC presents detailed criticism of the testimony of Staff witness Freetly regarding the use of spot prices and growth rates in both the DCF and CAPM models as well as the appropriate beta coefficient in the CAPM model.
According to GCI, the Commission has typically relied on averages of the DCF and CAPM, and GCI believes it would be appropriate to do so here, with the caveat that the DCF average should represent the upper boundary of reasonable results.

a. **DCF**

GCI states that Mr. Hevert relies on a multi-stage DCF model, which assumes that growth in the short-term (typically years 1 to 5) will transition (in years 5 to 10) to long-term sustainable growth rate (typically beginning in year 10). Through his applications of DCF financial models to selected financial data, GCI indicates that Mr. Hevert derives DCF estimates of AIC’s cost of capital that range from 9.51% to 11.24% for AIC’s gas operations. While the Commission has previously accepted multi-stage DCF models using analysts’ growth forecasts in the short-term, transitioning to the long-term growth rate in GDP over time, GCI believes the Commission in this case must correct the long-term growth rate that Mr. Hevert used in his analysis to conform with prior practice, and to be consistent with current implied growth rates in GDP. GCI suggests the Commission must also remove the inappropriate and unsupported adjustment that Mr. Hevert made to AIC’s dividend payout ratio. GCI states that Mr. Thomas used the same sample groups and analysis used by Mr. Hevert, which he corrected by using an appropriate long-term growth rate of 4.825% and by removing the assumption that dividend payout ratios will revert to anything other than their current levels. GCI says these corrections result in DCF Results for the Gas Sample that range from 8.80% to 9.02%.

GCI states that the growth component of a DCF model represents the sustainable growth that investors expect in their investment due to increases in a company’s earnings. According to GCI, the rate used has to be consistent with, and supported by, the economic conditions and dividend payout policies expected to occur. Since both Mr. Thomas and Mr. Hevert relied on a multi-stage DCF model in their analyses, GCI says the growth rate is assumed to change over time. GCI asserts that empirical reviews of analyst growth rates previously relied on by the Commission show a pattern of upwardly biased analyst growth rate forecasts in comparison to the actual requirements of investors reflected in stock prices. GCI claims that several empirical studies have documented optimistic bias in analysts’ earnings forecasts, indicating that the DCF model must be adjusted downward. GCI argues that when looking beyond two years in the future, the best forecast of earnings growth is the historical average growth rate.

GCI believes Mr. Hevert’s long-term sustainable growth rate is overstated. GCI says he relies on a long-term growth rate of 5.72% based on real chain weighted GDP growth of 3.28% and a 2.37% estimate of inflation based on Blue Chip Financial Forecasts and the EIA’s projected compound annual CPI growth rate. GCI says Mr. Thomas analyzed the consensus forecast published in the Blue Chip Economic Indicators and found that it varied significantly over time. GCI states that on February 10, 2011, the real GDP forecast was
3.2% in 2011 (up from the 2.5% forecast made in December 2010) and 3.3% in 2012. GCI says adding real GDP growth to inflation, as measured by the CPI, implies growth of 5.1% and 5.3% being forecasted in February, 2011 - a significant increase from the 4% being forecast in December 2010.

GCI contends that growth returns should reflect unbiased growth estimates as indicated by market prices since utility companies cannot reasonably be expected to grow faster than the overall economy. GCI urges the Commission to continue to use the long-term growth in GDP as the upper boundary of sustainable growth for utility companies. GCI states that using the Commission’s traditionally accepted methodologies, Mr. Thomas calculated a long-term sustainable growth rate of approximately 4.825%, well within the range of all other experts in this proceeding, except AIC’s.

b. CAPM

According to GCI, even though the CAPM is widely used and relatively simple, there are several well-known problems with both the theory and the practical application of the model. GCI claims economists have studied the relationship between actual market behavior and the CAPM model for a number of years, in particular, how to evaluate the risk of a company as compared to that of the marketplace overall. GCI suggests the CAPM should be used with its limitations understood and that it is best employed as a check on the results of a DCF model.

GCI indicates that the Commission has traditionally accepted beta coefficients that are adjusted for mean reversion, or a supposed tendency to revert to the market mean (1.0), as valid CAPM inputs. GCI says this is the method commonly relied on by Value Line, one source used by Mr. Hevert in his analysis, but this method also means that the Value Line beta (and Mr. Hevert’s CAPM analysis) is upwardly biased in comparison to a broader sample of the published estimates of that critical input. GCI says Mr. Hevert averages this Value Line beta with one from Bloomberg for the proxy group companies, and calculates short-term betas, resulting in a range from .703 to .862 for the gas sample.

GCI asserts that comparing Mr. Hevert’s results to the published betas demonstrates his upwards bias, and highlights the problem with relying on few sources. GCI says betas from different sources exhibit wide variability. To be complete, GCI suggests the Commission should consider a range of betas reported by the various reputable financial data reporting sites so the Commission can avoid unintended bias in various estimates used in a cost of equity determination.

GCI states that the EMRP represents the premium, above the risk-free rate, that investors expect when they take on the risk of an investment in the market portfolio, or the universe of potential investment opportunities available to investors. Mr. Hevert uses EMRP
values ranging from 8.09% to 9.36% in his analysis, which are estimates derived from academic studies of market performance or using EMRP estimates calculated for particular situations.

According to GCI, the EMRP is the premier question relating to the cost of capital, for theorists and practitioners alike. GCI contends the overwhelming conclusion from current research on the EMRP is that the return expected by investors and appropriate for use in the CAPM is far lower than returns calculated from selective samples of historical information. GCI says historical estimates found in most textbooks, which often report numbers near 8%, are too high for valuation purposes because they compare the market risk premium versus short-term bonds, use only 75 years of data, and are biased by the historical strength of the U.S. market. GCI suggests the general consensus is that the aggregate stock market exhibits negative autocorrelation, resulting in an arithmetic mean that is upwardly biased.

GCI suggests the Commission should consider an EMRP analysis that relies on a reasonable range of EMRPs, which the academic research indicates is within the range of 3.0 to 5.0%, with some research indicating that the actual EMRP is much lower. GCI says Mr. Thomas calculated two different CAPMs using the end points of a spectrum of EMRP estimates. GCI adds that at one end of the spectrum is the historic EMRP of 6.70%, as reported in Mr. Hevert’s work papers but not used in his testimony, and at the other end is the 9.36% estimate calculated by Mr. Hevert, which is clearly outside the estimates found in the academic research.

GCI says the CAPM model is very sensitive to changes in the selected beta – that is, small changes in the beta coefficient produce large changes in the overall CAPM result. GCI indicates Mr. Thomas adjusted Mr. Hevert’s CAPM analyses with a variety of reported betas and expanded the EMRP using inputs identified in Mr. Hevert’s testimony. If the Commission believes that the CAPM is a valuable tool, GCI suggests it should use these results to find that the cost of equity for AIC should be at the lower end of any range of valid estimates.

c. Other Models

GCI states that the risk premium method that Mr. Hevert uses is another measure of capital costs based on the same principle of evaluating the relative riskiness of a security to the market. GCI says the analysis he presents is similar to other risk premium analyses presented to the Commission in past cases. Citing Docket Nos. 07-0241/07-0242 (Cons.), GCI says the Commission previously rejected this type of analysis.

GCI says when AIC and IIEC last presented this approach to the Commission it was rejected, with the Commission concluding those analyses were no reason to deviate from past practice wherein it has relied on the DCF and CAPM models to estimate cost of
common equity. Because of the similarities between Mr. Hevert’s analysis and the past analyses rejected by the Commission, GCI urges the Commission to reject the proposed risk premium method once again.

d. Flotation Costs

Mr. Hevert also proposes that the Commission adopt a 13 basis point adjustment to recognize flotation costs for AIC’s gas operations. GCI says flotation costs are the costs the company incurs when it issues securities. GCI adds that Mr. Hevert’s proposal to include adjustments to recover flotation costs is based upon estimates of other utilities’ flotation costs, not in relation to any specific costs incurred by Ameren. Citing Docket Nos. 07-0241/07-0242 (Cons.), GCI contends this is an inappropriate and unnecessary adjustment that has been previously rejected by the Commission. GCI urges the Commission to reach the same conclusion here, both because AIC has not proven that the costs are actually unrecovered, and because it is fundamentally inappropriate to recover costs that AIC has not actually incurred.

5. IBEW Position

IBEW contends that AIC must be allowed to earn a reasonable ROR. IBEW says AIC still faces a rising regulatory risk. IBEW believes recent rate case outcomes in Illinois have caused concern to ratings agencies, such as Moody’s, about the political and regulatory risks for companies in the state and the outcome of future rate cases. IBEW claims a stable credit outlook is contingent on future rate case outcomes being more supportive of credit quality. IBEW suggests the recommended returns of some parties could potentially lower AIC’s credit ratings. IBEW says the returns recommended by Staff, GCI, and IIEC could make it difficult for AIC to maintain its financial integrity, causing AIC to reduce staff and contractors. These actions would be particularly harmful to IBEW and its members in these difficult economic times.

IBEW also says while the Commission is not bound by other states’ ROE awards, these are considered by investors and should be considered when evaluating the alternative ROE recommendations in this case.

a. DCF

According to IBEW, all ROE witnesses in this proceeding place significant weight on the results of the multi-stage DCF model. However, one main point of disagreement between the ROE witnesses in this case is the differences in the terminal growth rate assumptions (because the terminal stage of that model tends to represent a significant portion of the analytical results). IBEW says the Commission recently found a 6.00% long-
term growth estimate to be reasonable in ComEd’s last rate case. IBEW agrees with AIC witness Hevert that this should be a reference point when evaluating terminal growth rate assumptions within various ROE witness recommendations.

Regarding the multi-stage DCF model, IBEW suggests the principal analytical issue is whether long-term growth rates of 4.80% to 4.90% are more plausible than the 5.64% growth rate included in AIC’s updated analyses, or the 6.00% growth rate recently relied upon by the Commission. IBEW supports AIC’s recommendations that the Commission find the long-term growth rates assumed by the other ROE witnesses unduly low, and therefore produce ROE estimates that are well below AIC’s cost of equity.

**b. Adjustments to ROE**

IBEW notes that Staff proposes to reduce AIC’s ROE by 16.25 basis points to reflect the effect of the uncollectibles rider on investor expectations. IBEW says while Staff purports to “calculate” this risk by predicting the effect of the rider on AIC’s rating from Moody’s, IBEW thinks there is no empirical basis for Staff’s assertion that the rider reduces risk. IBEW agrees with AIC that Staff’s ROE deduction is inappropriate, even if such a risk existed. IBEW says since the passage of legislation in July 2009, ComEd, Peoples, North Shore, and Nicor all received Commission Orders authorizing their respective bad debt riders on February 2, 2010. IBEW thinks such a discrepancy flies in the face of conventional wisdom. IBEW says this is neither consistent nor fair public policy.

### 6. Commission Conclusion

As previously noted, four parties presented the testimony of expert witnesses addressing AIC’s cost of common equity. AIC offered the testimony of Mr. Hevert, Staff offered the testimony of Ms. Freetly, IIEC offered the testimony of Mr. Gorman, and GCI offered the testimony of Mr. Thomas. The table below summarizes the recommendations of those parties offering testimony on cost of common equity.

<table>
<thead>
<tr>
<th>Summary of Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>AIC</td>
</tr>
<tr>
<td>Staff</td>
</tr>
<tr>
<td>IIEC</td>
</tr>
<tr>
<td>GCI</td>
</tr>
</tbody>
</table>

Before the Commission turns to the details of the parties’ return on equity estimates, it is apparent some parties want the Commission to abandon or deviate from certain past practices in light of new evidence or circumstances. Other parties argue that the Commission is strictly bound by decisions it has made in previous proceedings, for AIC or
other utilities. The Commission must balance competing interests in evaluating such proposals. While the Commission does not wish to totally ignore its past practices, which appear to have served utilities and ratepayers for many years, the suggestion that the Commission is strictly bound to follow decisions in previous proceedings with different evidentiary records is simply wrong. Nor does the Commission wish to engage in cost of equity estimation in a manner that might be viewed as random or arbitrary, but at the same time the Commission recognizes that it must consider the possibility that new evidence or research has been developed that should cause the Commission to deviate from past practices. While recognizing that due to the competing interests present, it is not possible to satisfy all parties, the Commission will undertake to reach well-reasoned conclusions that are based on the record and consistent with previous Commission decisions, to the extent possible.

Also as discussed above, AIC’s briefs focused on what it considered to be the three most significant differences among the parties. Those issues are the third stage growth rate used in the multi-stage DCF analysis, the use of spot prices rather than average prices, and the proposal to reduce ROE because AIC uses the uncollectibles expense rider. It appears to the Commission that AIC is correct that these three issues are significant and will, therefore, be the focus of the Commission’s decision. The Commission will, nevertheless, address other contested issues to the extent necessary to determine the reasonable cost of equity for establishing rates in this proceeding.

a. DCF

As the Commission understands it, AIC witness Hevert relied upon a multi-stage DCF analysis, which he updated in rebuttal and surrebuttal testimony. GCI witness Thomas relied upon Mr. Hevert’s DCF model with modified inputs. Staff witness Freetly also relied upon a multi-stage DCF analysis. IIEC witness Gorman relied upon a constant growth DCF analysis with analysts’ growth rates, a constant-sustainable growth rate DCF analysis, and a multi-stage DCF analysis, giving equal weight to all three DCF estimates.

Historically speaking, the Commission has relied heavily on the constant growth DCF model; however, in recent years the Commission has tended to favor the multi-stage DCF model over the constant growth model due to concerns about the sustainability of analysts’ growth rate estimates. Even Mr. Gorman suggests that his analysts’ growth rates may not be sustainable for his electric sample. See IIEC Ex. 3.0 at 32. The Commission would not be surprised if circumstances change such that, at some point in time, it would be appropriate to rely on the constant growth DCF model. Of the four witnesses, only Mr. Gorman suggests that time has arrived. The Commission, however, is not convinced he is correct on this point. Instead, the testimony of the other three witnesses, particularly Ms. Freetly who thoroughly explained her rationale for choosing the multi-stage DCF model over the constant growth DCF model, demonstrates that for this proceeding, the constant growth
DCF model is not appropriate for purposes of this proceeding. See Staff Ex. 8.0 at 5-6.

It appears to the Commission that Mr. Gorman may have decided to rely, in part, on a constant-sustainable growth DCF analysis because of concerns about the sustainability of the analysts’ growth rates in his constant growth DCF analysis. To the extent this is true, it supports the Commission’s view that relying on Mr. Gorman’s constant growth DCF analysis is questionable. Mr. Gorman developed the sustainable growth rate inputs based upon internal growth plus external growth factors that Mr. Gorman suggests can be sustained indefinitely by companies. IIEC Ex. 3.0 at 26.

As an initial matter, the Commission notes that it generally has not relied upon a constant-sustainable growth DCF model for establishing the cost of common equity in rate cases. In fact, the Commission declined to rely on AIC witness McShane’s and Mr. Gorman’s sustainable growth DCF model in AIC’s last rate case, Docket Nos. 09-0306 et al. (Cons.). See Order (April 29, 2010) at 216. In previous cases, the Commission has expressed concern that sustainable growth estimates are problematic in that they rely upon a proxy for ROE as an input when estimating the investor required return. The Commission is concerned that such internal growth rates are not reliable enough for use in directly estimating a utility’s cost of common equity. Mr. Gorman has not provided any analysis or arguments that convince the Commission it should change its view on the reliability of internal growth rates. In fact, Mr. Gorman expressed "strong concerns" about the constant-sustainable growth DCF for the Gas Proxy Group. See IIEC Ex. 3.0 at 28-29. The Commission concludes that there is not a sufficient basis for relying on the constant-sustainable growth DCF in establishing the cost of common equity for AIC in this proceeding. Accordingly, the Commission concludes that it is appropriate to rely upon the multi-stage DCF model in determining AIC’s cost of common equity.

One of the most important inputs into the multi-stage DCF model, and most contested in this proceeding, is the steady-state growth rate. AIC witness Hevert calculated a steady-state growth rate of 5.66% and, relying heavily on the Commission’s decision in Docket No. 10-0467, AIC suggests a steady-state growth rate of 6.00% is appropriate in the current proceeding. To develop his steady-state growth rate, Mr. Hevert summed his estimate of long-term inflation, 2.31%, and his estimate of long-term nominal GDP growth, 3.3%. Mr. Hevert’s long-term inflation estimate is based on projections of growth in CPI while his estimate of long-term nominal GDP is based on long-term historical growth in GDP (e.g., 1929 through 2009).

Staff witness Freitly’s estimate of the steady-state growth rate is 4.80%. Ms. Freitly’s estimate of inflation, 2.50%, is derived from the difference in yields on U.S. Treasury bonds. Her estimate of the real long-term growth is based upon forecasted growth in GDP from EIA and Global Insight.

IIEC witness Gorman’s estimate of the steady-state growth rate is 4.9%. Mr. Gorman
relied upon forecasts of nominal GDP growth as well as forecasts of real GDP growth and forecasts of inflation to derive his estimate of the steady-state growth rate.

GCI witness Thomas says that in AIC’s last rate case, the Commission relied upon the implied 20-year forward U.S. Treasury rate in 10 years and Blue Chip economic forecasts of nominal GDP growth. Mr. Thomas estimates the steady-state growth rate to be 4.825%. His estimate is based upon the implied 20-year forward U.S. Treasury rate in 10 years. He declined to rely upon the Blue Chip forecasts because he believes they are too volatile.

It is obvious to the Commission that the estimates of the steady-state growth rate provided by Ms. Freetly, Mr. Gorman, and Mr. Thomas are relatively consistent, particularly when compared to Mr. Hevert’s estimate. The three similar estimates share the characteristic that each relies on forward-looking data while Mr. Hevert’s estimate relies, in part, on long-term historical growth in GDP. The record demonstrates that the primary criticism of Mr. Hevert’s steady-state growth rate is his reliance on historical growth in GDP. In Docket Nos. 09-0306 et al. (Cons.), the Commission found Ms. McShane’s over-reliance on historical data in the development of the steady-state growth rate to be problematic. See Order (April 29, 2010) at 215-216. It appears to the Commission that Mr. Hevert’s steady-state growth rate was developed in a manner similar to Ms. McShane’s. However, as previously noted, each evidentiary record must stand on its own merits and the Commission does not find this sufficiently problematic in this proceeding to dismiss the use of the model in its entirety.

Also at issue in the DCF analyses is whether the Commission should rely upon spot stock prices or averages of historical stock prices. Mr. Hevert relied upon 30-day, 60-day, and 90-day average stock prices in his analyses. Mr. Thomas used the same stock prices as Mr. Hevert. Mr. Gorman relied upon the average weekly high and low stock prices over a 13-week period ended May 20, 2011. Ms. Freetly relied upon closing stock prices on June 3, 2011.

Generally speaking, over the last few decades the Commission has tended to rely upon spot stock prices. The Commission has typically expressed concern about the economic value of historical stock prices in establishing a forward-looking cost of common equity, as well as concerns about how to determine the appropriate period over which to average stock prices. In some recent cases, however, the Commission has also expressed concerns over spot stock prices, particularly in light of the volatility in the stock market. In this case, it appears that AIC has conceded that the issue of average versus spot stock prices is not a significant issue. Additionally, Ms. Freetly presented an analysis that is intended to demonstrate that her results do not depend heavily upon the particular day selected for the spot prices.

Having reviewed the evidence, the Commission finds that the analysis presented by
Ms. Freetly mitigates some of the concerns the Commission has recently expressed regarding the use of spot prices. The Commission also concludes, however, that as AIC suggests, the timing of stock prices is not significant in this case. For purposes of estimating AIC’s cost of common equity in this proceeding, the Commission concludes that it is appropriate to average the multi-stage DCF results of AIC, Staff, IIEC, and the GCI as shown in the table below:

<table>
<thead>
<tr>
<th>DCF Results</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>AIC</td>
<td>10.53%</td>
</tr>
<tr>
<td>Staff</td>
<td>8.63%</td>
</tr>
<tr>
<td>IIEC</td>
<td>8.43%</td>
</tr>
<tr>
<td>GCI</td>
<td>8.90%</td>
</tr>
<tr>
<td>Average</td>
<td>9.12%</td>
</tr>
</tbody>
</table>

b. CAPM

There are three inputs to the CAPM: beta, the risk-free rate, and the EMRP. The other parties take issue with the beta estimates used by Mr. Hevert, particularly the beta estimates he calculated using a 12-month measurement period. The Commission has traditionally relied upon betas calculated with five years of data. While Mr. Hevert explained his rationale, the Commission is not convinced that betas calculated with twelve months of data are reliable or appropriate for use in establishing the cost of common equity.

Mr. Thomas relied upon variety of published betas in his CAPM analysis. In the past, Mr. Thomas has endorsed the use of unadjusted betas, which the Commission does not rely upon. In his direct testimony, Mr. Thomas specifically states that he included Value Line betas, which are adjusted. It is not entirely clear to the Commission, which if any of his other sources calculate adjusted betas. In contrast, the betas relied upon by Ms. Freetly (Value Line, Zacks, and calculated regression betas) as well as Mr. Gorman (Value Line betas) are clearly the types of betas the Commission has traditionally relied upon in implementing the CAPM.

For the risk-free rate, Mr. Hevert relied upon the current 30-day yield on 30-year Treasury bonds and the near-term projected 30-year Treasury yield. Mr. Gorman used the Blue Chip projected 30-year Treasury bond yield as a proxy for the risk-free rate. Ms. Freetly relied upon yields on 30-year Treasury bonds as a proxy for the risk-free rate. It appears that Mr. Thomas used Mr. Hevert's proxy for the risk-free rate. While measured in slightly different ways, there does not appear to be much disagreement over estimating the risk-free rate.

With regard to the EMRP, Mr. Thomas relied upon what he describes as estimates provided by academic research. The Commission has rejected Mr. Thomas' similar proposal.
for estimating the market risk premium in previous cases. See, e.g., Docket Nos. 07-0585 et al. (Cons.) Order at 213. Among other things, the Commission continues to believe that Mr. Thomas’ suggestion does not seem to allow for the EMRP to change over time, which the Commission believes is necessary for any approach or method adopted.

Ms. Freetly developed an estimate of the EMRP by performing a DCF analysis on dividend paying firms that comprise the S&P 500. From that, she subtracted her estimate of the risk-free rate. Mr. Gorman expressed concern that Ms. Freetly’s DCF analysis overstates the return on the market because he believes her growth rates are excessive.

Mr. Hevert developed two estimates of the EMRP; the first was calculated in a manner similar to Ms. Freetly, except that he included non-dividend paying companies in the S&P 500. Ms. Freetly asserts that by doing this, Mr. Hevert overstates the expected market return. Mr. Hevert’s second estimate depended upon an assumption of a constant Sharp ratio. Ms. Freetly expressed concern that, among other things, this second analysis relied too heavily on historical data to estimate a forward-looking, expected market return.

Mr. Gorman derived a forward-looking EMRP and a long-term historical average estimate of the EMRP. For one EMRP estimate, Mr. Gorman estimated the long-term historical arithmetic average real return on the market, to which he added an expected inflation rate. It is not clear to the Commission, however, that using a long-term historical average real return constitutes a forward-looking real return. The Commission believes this approach relies too heavily on historical data. For his other estimate of the expected market return, Mr. Gorman performed a multi-stage growth DCF analysis on the S&P 500, which he averaged with Mr. Hevert’s constant growth estimate of the return on the market. While it is not entirely clear from his testimony, it appears this is the very estimate which Ms. Freetly complained overstates the market return.

The Commission has serious concerns with the betas used by Mr. Hevert and Mr. Thomas. Similarly, the Commission has serious concerns with the EMRP estimates relied upon by Mr. Hevert and Mr. Thomas. Finally, the Commission has concerns with at least one, if not both, of the EMRP estimates used by Mr. Gorman. All things considered, the Commission finds that the only CAPM analysis that is clearly free of significant problems and which can be relied upon in this case is the one performed by Ms. Freetly.

c. Other

Mr. Hevert also performed a Treasury yield plus risk premium analysis. For this analysis, Mr. Hevert performed a regression analysis on his risk premium (authorized returns on equity less 30-year Treasury yields) and 30-year Treasury yields, using data from 1992 through 2010. Among the many problems the Commission finds with this approach is its reliance on utility authorized returns on equity throughout the U.S. Additionally, there is the
concern about the heavy reliance on historical data and the difficulty in determining an appropriate historical period to rely upon. In summary, the Commission continues to question the validity of the bond yield plus risk premium approach. The Commission finds that for purposes of this proceeding, Mr. Hevert’s analysis should not be relied upon.

d. Adjustments to ROE

Staff recommends that its cost of equity estimates be adjusted downward to reflect the reduction in risk associated with the use of uncollectibles riders. Staff recommends a downward adjustment of 16.25 basis points. AIC argues that the uncollectibles rider does not reduce risk relative to other utilities. AIC also asserts that it is not possible to calculate an adjustment with the precision that Staff has attempted. Finally, AIC complains that Staff’s proposed adjustment is larger than the adjustment proposed for other utilities.

As an initial matter, the Commission finds that AIC’s suggestion that the uncollectibles riders do not reduce risk is unpersuasive. Whether the uncollectibles riders also benefit ratepayers is irrelevant. All else equal, the presence of the uncollectibles riders reduces the variation in AIC’s revenues and therefore, its risk. The Commission believes this is indisputable, notwithstanding the event study performed by Mr. Hevert. Staff identified difficulties with performing an event study associated with regulatory actions generally and with Mr. Hevert’s study specifically.

In the Commission’s view, the only question is how to best quantify the impact of the uncollectibles riders in AIC’s risk. While AIC takes issue with Ms. Freetly’s quantification, it presents no real alternative. As a result, the Commission finds that the record supports Staff’s recommendation to reduce AIC’s cost of equity by 16.25 basis points to reflect the reduction in risk that the Commission finds results from the existence of the uncollectibles riders.

e. Flotation Costs

In his direct testimony, Mr. Hevert calculated a 14 basis point increase in the cost of common equity to reflect the impact of flotation costs. Ameren Ex. 3.7E shows that Mr. Hevert derived that 14 basis point adjustment by calculating the mean flotation cost of Ameren and ten other utilities. In his rebuttal testimony, Mr. Hevert suggests that his flotation cost estimate is based upon the last two common equity issuances by Ameren, and therefore AIC has met its burden of proof to demonstrate that it has incurred actual flotation costs that have not been recovered through rates. In his surrebuttal testimony, Mr. Hevert repeats a statement in his direct testimony that he is not proposing an upward adjustment to the cost of equity to reflect flotation costs. Instead, Mr. Hevert "considered" flotation costs when determining where within the range of results the ROE reasonably falls.
The Commission concludes that the record in this proceeding does not justify an upward adjustment to the cost of common equity to reflect flotation costs. In fact, it appears no witness has proposed such an adjustment. Staff correctly points out that the Commission is open to considering the impact of flotation costs on the authorized return on equity in certain circumstances. The Commission is not, however, amenable to approving a flotation cost adjustment based upon an average of flotation costs for other utilities, as Mr. Hevert calculated in his direct testimony. Despite all of the testimony and argument on this issue, the Commission finds no basis to consider flotation costs in establishing AIC’s cost of common equity in this proceeding.

f. Approved ROE

The Commission notes that no party’s position is without flaw as indicated by the parties’ respective testimony in this proceeding. Each party has advocated a cost of equity that other parties believe reflects incorrect calculations through subjective, biased inputs. However, the Commission does not believe the imperfections in the models presented in this case are so flawed as to warrant an outright dismissal of the model for purposes of determining a reasonable rate of return. The Commission, based upon the cost of equity evidence presented, does not believe that any party’s cost of equity position stands out as being sufficiently superior to any other position, such that a single party’s estimation technique should prevail. Accordingly, the Commission will weight each position equally by taking an average of the positions advocated by AIC, Staff, AG/CUB, and IIEC’s multi-stage DCF analyses, which, as previously stated, is the appropriate model upon which to rely in determining AIC’s cost of equity. The Commission notes that AIC witness Hevert provided a range of DCF results from 9.51 to 11.54. The Commission will utilize the midpoint of that range (10.53%) for purposes of this proceeding. The Commission believes, based on the record before it, that blending the parties’ proposals in this manner results in an average return that significantly diminishes any perceived upward or downward bias as set forth in the different positions of the parties.

The Commission further notes that a certain level of confusion arose with respect to the Proposed Order in the instant proceeding due to a scrivener’s error in the gas revenue requirements. This apparently occurred as a result of the Proposed Order’s use of numbers in an earlier version, instead of the Corrected version, of IIEC witness Gorman’s Direct Testimony. The unintentional error was subsequently corrected. The Commission finds this scrivener’s error in the Proposed Order to be a non-issue. As such, any suggestion that IIEC’s multi-stage DCF not be included in the average of DCF results, is unwarranted.

Additionally, the Commission will accept the CAPM analysis of Staff and will average Staff’s CAPM results with the averaged DCF results to derive a ROE. Finally, the Commission will make a downward adjustment to the cost of common equity to reflect the reduced risk resulting from the existence of the uncollectibles riders. The Commission
concludes that AIC’s gas operations should be authorized a ROE of 9.06%. The table below illustrates how the ROE was derived.

<table>
<thead>
<tr>
<th>DCF Results</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>AIC</td>
<td>10.53%</td>
</tr>
<tr>
<td>Staff</td>
<td>8.63%</td>
</tr>
<tr>
<td>IIEC</td>
<td>8.43%</td>
</tr>
<tr>
<td>AG/CUB</td>
<td>8.90%</td>
</tr>
<tr>
<td>Average</td>
<td>9.12%</td>
</tr>
<tr>
<td>CAPM</td>
<td>9.31%</td>
</tr>
<tr>
<td>Estimated ROE</td>
<td>9.22%</td>
</tr>
<tr>
<td>Risk</td>
<td>0.16%</td>
</tr>
<tr>
<td>Adjustment</td>
<td></td>
</tr>
<tr>
<td>Approved ROE</td>
<td>9.06%</td>
</tr>
</tbody>
</table>

H. Authorized Rate of Return on Rate Base

Having reached conclusions regarding all contested aspects of ROR, the Commission finds that AIC’s gas operations should be authorized a return on rate base of 8.332%. The table below illustrates how the returns on rate base was derived.

<table>
<thead>
<tr>
<th>Authorized Rates of Return on Rate Base</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>AIC Gas Delivery Services</td>
</tr>
<tr>
<td>Capital Component</td>
<td></td>
</tr>
<tr>
<td>Short-term Debt</td>
<td>$6,473,198</td>
</tr>
<tr>
<td>Long-term Debt</td>
<td>$1,591,564,788</td>
</tr>
<tr>
<td>Preferred Stock</td>
<td>$59,158,692</td>
</tr>
<tr>
<td>Common Equity</td>
<td>$1,889,251,000</td>
</tr>
<tr>
<td>Bank Facility Fees</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$3,546,447,678</td>
</tr>
</tbody>
</table>

VII. COST OF SERVICE

As a part of every rate case, the Commission must determine what portion of a utility’s costs each class of customers will be responsible for. AIC divides retail natural gas customers into six rate classes. The GDS-1 Residential Gas Delivery Service rate class tariff contains customer and delivery charges for residential customers. The GDS-2 Small Gas Delivery Service rate class tariff includes customer and delivery charges for non-residential customers whose highest Average Daily Usage (“ADU”) is less than 200 therms
per day. The GDS-3 Intermediate General Gas Delivery Service rate class tariff includes customer and delivery charges for non-residential customers whose highest ADU is equal to or greater than 200 therms per day and less than 1,000 therms per day. The GDS-4 Large General Gas Delivery Service rate class tariff includes customer, delivery, demand, and Maximum Daily Contract Quantity ("MDCQ") overrun charges for non-residential customers whose highest ADU is greater than 1,000 therms per day. The GDS-5 Seasonal Gas Delivery Service rate class tariff includes customer, delivery, and demand charges for eligible non-residential customers willing to limit gas usage on days when the average forecast temperature is 25°F or less. The GDS-7 Special Contract Gas Delivery Service tariff is available to any existing or prospective customer located within such distance of an interstate natural gas pipeline providing gas transportation service that bypass of AIC’s gas distribution system is, in AIC’s judgment, economically feasible and practical.

Generally, the Commission prefers to allocate costs among the various classes as close to the cost of serving each class as is reasonably possible and/or appropriate. The purpose of doing so is to assign costs to those who cause them. The Commission typically accomplishes this goal through a COSS. A COSS compares the cost each customer class or subclass imposes on the utility’s system to revenues produced by each class or subclass. A properly performed COSS shows the cost to serve each class or subclass and the ROR for each class or subclass. Customer classes or subclasses with a ROR equal to the total system ROR are paying their cost of service. Customer classes paying less than the total system ROR are not paying their cost of service. From time to time circumstances arise that warrant allocating costs at least in part on non-cost based criteria. Whether such circumstances are present in this proceeding is discussed below.

A. Resolved Issue - Allocation of Rider TBS Costs to Gas Customer Classes

AIC proposes an unbundled, subscribable transportation banking service presented in Rider Transportation Banking Service ("Rider TBS"). AIC determined the effect on various base rates which will occur once Rider TBS becomes operational. Specifically, transportation banking services costs were removed from transportation-related base rates in Rates GDS-2, GDS-3, GDS-4, and GDS-5. This removal of costs from the calculation of transportation base rates will result in lower proposed base rates. For example, the Rider TBS associated costs allocated to GDS-5 will result in a lower Delivery Charge for customers taking this service.

For Rider TBS to be approved, Staff believes that it should not only make sense from a policy perspective, but that AIC must demonstrate that the rates charged under the rider are reasonable, i.e., cost based. Staff witness Rukosuev recommends that Rider TBS be approved for the following reasons: (1) his primary concerns with the gas Rate Zone COSS have been addressed, (2) the allocation of costs to the customer classes are based upon various allocation methodologies Staff finds acceptable, and (3) AIC’s customers want
alternative banking services. AIC agrees with Mr. Rukosuev’s recommendation as it regards cost of service and considers this issue resolved with respect to the allocation of costs to the customer classes under Rider TBS. The Commission finds the resolution of this issue reasonable for purposes of this proceeding and adopts it.

B. Contested Issues

1. Use of AIC’s Gas COSS

On August 26, 2010, AIC’s three legacy utilities initiated Docket No. 10-0517 by filing a petition with the Commission seeking approval of certain modifications to the manner in which they recorded and maintained various accounting data upon executing the reorganization that created AIC on October 1, 2010. Among the five proposed modifications was a request that the newly formed utility be allowed to provide in future rate cases a single set of testimony and schedules under Part 285, 83 Ill. Adm. Code 286 “Submission of Rate Case Testimony” (“Part 286”), and Part 287; a single class COSS; a single jurisdictional COSS and revenue requirement; a single combined rate base; and a single combined capital structure for its electric and for its natural gas businesses. Before Docket No. 10-0517 was resolved, however, AIC filed on February 18, 2011 the Proposed Tariffs leading to the initiation of this rate proceeding. The Proposed Tariffs reflected the implementation of AIC’s still pending accounting proposals in Docket No. 10-0517. On March 15, 2011, the Commission entered an Order in Docket No. 10-0517 accepting in part and rejecting in part the accounting proposals. Among the proposals rejected are the modifications described above concerning the next rate case filing (excluding those pertaining to capital structure). The Commission also observed in its conclusion that if AIC already implemented its proposals, it did so at its own risk and expense. Docket No. 10-0517 Order at 22.

AIC’s decision to file the Proposed Tariffs based on its unapproved proposals in Docket No. 10-0517 have given rise to a significant contested issue. In response to the February 23, 2011 deficiency letters seeking separate information for natural gas service in each Rate Zone, AIC provided separate COSS on March 24, 2011. Whether these COSS are sufficiently reliable upon which to base rates is in much dispute.

a. AIC Position

In support of its Rate Zone COSS submitted in response to the February 23, 2011 deficiency letters, AIC asserts that Staff found acceptable AIC’s customer class allocators used therein. AIC also understands that Staff found the Rate Zone COSS consistent at the functional level and a sufficient basis for assessing Rate Zone costs overall. AIC recognizes that Staff expressed concern with the accuracy of the Rate Zone allocations of FERC account and subfunction balances for plant and reserve. But in response to that concern,
AIC states that it adjusted the inputs for the allocated FERC account balances in its rebuttal testimony to improve the Rate Zone COSS from a cost causation standpoint.

Despite having made this effort to improve the COSS, AIC laments that Staff is still not satisfied. AIC disagrees with Staff’s contention that its adjustments presented in its rebuttal testimony came too late to provide Staff with sufficient time to determine if the Rate Zone COSS provide a reasonable cost foundation. AIC points out that while Staff rejects any use of the rebuttal Rate Zone COSS for establishing revenue targets for AIC’s customer classes, no other party agrees with Staff’s position. AIC urges the Commission to dismiss Staff’s concern.

To counter Staff’s arguments, AIC asserts that its rate design and pricing methodology did not change from its original February 2011 filing, which it understands Staff approved of in its direct testimony. The only changes were to the Rate Zone inputs (also known as the amounts for the individual FERC accounts in the models themselves). As a result of those changes, AIC contends that the revised FERC account data more closely aligned with the legacy utilities’ historical costs, which was Staff’s principal concern. AIC insists that the incremental review following AIC’s submission of its rebuttal testimony gave Staff sufficient time to examine the FERC input changes. AIC understands that Staff now agrees that the rebuttal Rate Zone COSS now use consistent data to derive Rate Zone balances at the functional and FERC account levels and address discrepancies at the subfunctional level within individual FERC accounts. If Staff had any other specific class cost or revenue allocation issues (beyond the FERC account Rate Zone adjustments), AIC contends that Staff could have identified them in its direct or rebuttal testimony. While Staff complains it had a truncated timeframe to review AIC’s rebuttal Rate Zone COSS, AIC states that any particular cost or revenue allocations that require additional review by Staff remain unknown.

AIC acknowledges that it did not present changes to its ratemaking proposals in its deficiency response and then presented a revised set of cost studies and ratemaking proposals in rebuttal testimony. AIC reiterates that it took these steps to address Staff’s concerns. According to AIC, changes to customer class revenue allocation methodologies are common during the course of rate cases. AIC argues that the fine tuning of the product to an improved and more accurate cost model should be encouraged, not disparaged.

b. Staff Position

Staff expresses frustration with AIC’s preparation and presentation of its COSS in this proceeding. To begin with, rather than wait for the resolution of the docket that AIC itself initiated, Staff criticizes AIC for filing the Proposed Tariffs based on the presumption that it would receive the relief requested in Docket No. 10-0517. There is no question that the filing of a single natural gas COSS for the entire Illinois service territory constitutes a change from
AIC’s previous rate cases (Docket Nos. 09-0306 et al. (Cons.)) where the legacy utilities separately filed for their respective electric and gas operations separate COSS. Staff avers that AIC’s behavior reflects a knowing disregard of the regulatory process.

Staff cites the testimony of AIC witness Jones to buttress this conclusion. Mr. Jones acknowledges that AIC was well aware that, at the time of its initial filing, the Commission had yet to decide in Docket No. 10-0517 between using one or three COSS (for each type of service) for ratemaking. Tr. at 763. Mr. Jones states that he was not aware of any concern expressed within AIC before the initial filing that the filing might not be consistent with a Commission Order in Docket No. 10-0517. Id. at 756. Staff points out that AIC did not even consider providing three Rate Zone COSS for each service type in its initial filing to address the possibility that the Commission would rule against AIC on the COSS issue in Docket No. 10-0517. Staff also challenges Mr. Jones’ claim that “at no point did AIC attempt to take preemptive measures that limit the Commission’s range of action.” Ameren Ex. 13.0 at 15. When asked directly whether he considered filing a single COSS before the Commission decided between one and three COSS in Docket No. 10-0517 to be a preemptive measure, Mr. Jones insisted it was not. Tr. at 762. Staff counters that the available evidence says otherwise and avers that filing a single COSS was a preemptive measure with adverse consequences for the parties and the regulatory process.

When AIC did submit three COSS for each service type on March 24, 2011 in response to the February 23, 2011 deficiency letters, Staff complains that they presented a number of problems. First, Staff states that it lost a month in its review of the filing. Second, the six Rate Zone COSS were significantly flawed in Staff’s opinion. Third, the deficiency Rate Zone COSS were not accompanied by testimony or explanation of how they were prepared which, Staff contends, further inhibited the parties’ review. Fourth, Staff states that the March 24, 2011 reply to the deficiency letters contained no rate design changes which means that AIC continued to base rates on a single gas COSS despite the Commission’s directive in Docket No. 10-0517 that these be based on the three separate Rate Zones.

Staff relates that Staff witness Rukosuev extensively explored the shortcomings in the March 24, 2011 Rate Zone COSS, identifying various problems with the balances for both plant and reserve for depreciation accounts. Staff maintains that the problems lie not in the overall general functional categories of costs such as intangible plant, transmission plant, distribution plant, and general plant, but rather at individual FERC account levels. One problem troubling Staff concerns the accuracy of the costs presented at the FERC account level which were determined in a different way than in previous COSS for the three legacy utilities. The March 24, 2011 Rate Zone COSS used the expedient approach of basing Rate Zone FERC account balances on allocations reflecting their respective shares of the general plant category containing that FERC account. Staff is concerned because AIC offered no support for its assumption that a Rate Zone’s FERC account balance is proportional to its share of the general plant category containing that account. In fact, Staff contends, evidence from AIC’s previous rate cases, Docket Nos. 09-0306 et al. (Cons.), suggest that
individual accounts will diverge from the functional totals. See for example, Staff Ex. 14.0, Schedule 14.02 and Staff Ex. 15.0, Schedule 15.03. Staff therefore concludes that there is no reason for AIC to assume that the ratios of FERC account balances between the three Rate Zones will be the same.

Aside from the concerns presented above, which focus on how functional categories are broken down into individual FERC accounts, Staff also expresses concerns because the sum of the FERC accounts for the three Rate Zones did not always equate to the total for those accounts in the Illinois-wide gas COSS presented in the original filing. Staff presented an illustration of the differences in individual FERC accounts between Rate Zone and Illinois-Wide COSS reserve for depreciation. (See Staff Ex. 15.0, Schedule 15.04)

Another concern of Staff’s is that these problems with AIC’s March 24, 2011 Rate Zone COSS also affect those expenses that are allocated according to plant totals. Staff contends that any inaccuracies in distribution plant balances at either the FERC account or subfunction level distorts the resulting allocations of these expense accounts.

Taken together, Staff avers that these shortcomings affect the degree to which the March 24, 2011 Rate Zone COSS can be used in the ratemaking process. The problems at the FERC account level, Staff explains, mean they cannot be used to allocate revenues or design rates at the customer class level. Staff, however, recognizes that the COSS can still play a limited role in guiding the allocation of total system costs to the three Rate Zones. Staff reminds the Commission that the problems with the studies lie not at the general functional level but rather with the individual FERC accounts. Staff states that those general functional level costs may still be used to determine how each of the Rate Zones recover costs on an overall basis under current and proposed rates. Staff suggests that the higher return for Rate Zone 3 indicates it should receive a smaller increase than Zones 1 and 2. Since Rate Zone 3 has higher current rates, Staff states that the results provide support for moving closer to uniform rate levels as AIC proposes.

Staff acknowledges that AIC revised the Rate Zone COSS in response to Staff’s concerns. While Staff considers the Rate Zone COSS provided in AIC’s rebuttal testimony to be an improvement upon AIC’s previous efforts in this case, Staff nevertheless finds the COSS problematic. Staff is frustrated by the length of time AIC took to address the shortcomings in its previous COSS approaches which severely impaired the review by Staff and other parties. Staff reiterates that AIC failed to submit the required six COSS with its February 18, 2011 Proposed Tariffs. On March 24, 2011, Staff continues, nine days after the March 15, 2011 Order requiring separate Rate Zone COSS, did AIC submit the required Rate Zone COSS in response to the February 23, 2011 deficiency letters. Staff observes that the March 24, 2011 filing lacked an explanation of how those COSS were developed. Not until five months after the filing of the Proposed Tariffs, Staff points out, did AIC witness Jones present a revised set of cost and ratemaking proposals based upon the revised COSS for each of the three Rate Zones and service type. Staff complains that this sequence of
events left it and other parties with only rebuttal testimony, hearings, and briefs in which to
discuss and debate AIC’s revised ratemaking proposals. Staff concludes that this truncated
schedule inhibited a complete and thorough discussion of the rate design issues in this case.

Based on the forgoing, Staff submits that the revised Rate Zone COSS presented in
AIC’s rebuttal testimony could not be verified as reasonable for ratemaking purposes in this
proceeding. Staff explains that the significant delay in producing the revised Rate Zone
COSS made it difficult to determine whether these studies do, in fact, provide a reasonable
foundation for ratemaking. Each COSS, Staff continues, contains hundreds of cost accounts
that are allocated by a variety of allocators based on data developed for each Rate Zone.
According to Staff, a thorough review of the accuracy of each study requires considerably
more time than that provided in the rebuttal stage of a rate case.

c.  Kroger Position

Kroger recommends that the Commission rely upon the COSS that AIC offered in its
rebuttal testimony for purposes of revenue allocation among both Rate Zones and customer
classes in this proceeding. Kroger contends that AIC provided in its rebuttal testimony
reasonable certainty about the costs of serving the various groups of AIC’s customers.
Kroger states further that the Commission should use AIC’s rebuttal COSS in order to
uphold the principle of cost causation in setting rates.

d.  IIEC Position

IIEC supports the use of AIC’s Rate Zone COSS as presented in AIC’s rebuttal
testimony as a starting point for revenue allocation in this proceeding, subject to the
modifications proposed by IIEC and discussed elsewhere in this Order.

e.  Commission Conclusion

With regard to the gas COSS, the Commission understands that Staff and the other
parties are in general agreement that AIC’s gas COSS presented in its rebuttal testimony are
sufficient for purposes of this proceeding.

As discussed above, in Docket No. 10-0517, the legacy utilities sought permission to
do what AIC eventually did when it filed tariffs leading to the initiation of this rate case: AIC
filed a single gas COSS and a single electric COSS for all of the Rate Zones combined. AIC
did so even before receiving permission to do so in Docket No. 10-0517. To remedy this
problem, the Administrative Law Judges issued on February 23, 2011 a deficiency letter to
AIC directing it to submit the required gas COSS for each Rate Zone. The Commission
entered an Order in Docket No. 10-0517 on March 15, 2011 consistent with the deficiency
letter. AIC complied with the deficiency letter on March 24, 2011. The Commission understands that AIC had ceased tracking individual costs by Rate Zone prior to the resolution of Docket No. 10-0517 and therefore provided separate COSS by Rate Zone based on various allocators. Using such allocators is consistent with what the legacy utilities had proposed in Docket No. 10-0517. While it is clear that the gas COSS offered in AIC’s rebuttal testimony are an improvement over the COSS submitted with the initial tariff filing, the Commission cannot conclude that they are without flaws. While AIC’s gas COSS offered in its rebuttal testimony is not perfect, it is the least objectionable alternative for establishing the cost of serving each rate class. Accordingly, the Commission adopts AIC’s gas COSS as presented in its rebuttal testimony for purposes of setting rates in this proceeding.

But the Commission’s frustration with this issue does not end here. When the legacy utilities initiated Docket No. 10-0517, it is not plausible that they truly felt they had no obligation to obtain the Commission’s permission to submit a single gas COSS, as AIC suggests. Otherwise there would not have been any reason to include such a request in its petition. But rather than responsibly wait a few weeks for the conclusion of Docket No. 10-0517, AIC apparently ceased recording costs by Rate Zone and chose to file its new tariffs assuming it would receive the relief it requested. To be clear, a utility may file a rate case at the time of its choosing. But at the same time, AIC’s choice of action leads one to question AIC’s judgment and perhaps its motives. By taking the action it did, AIC effectively obtained in this regard what the Commission found it should not have.

VIII. REVENUE ALLOCATION

While determining the cost of service is concerned with identifying the cost to the utility of serving each rate class, determining the appropriate revenue allocation (along with rate design) is concerned with establishing how much of a utility’s revenue requirement will be recovered from each rate class. The revenue recovered from a particular rate class may be different from the cost of serving that particular rate class for various reasons.

With respect to the allocation of the gas revenue requirement to Rate Zones and customer classes, in its rebuttal testimony Staff recommended that the Commission accept its proposal to move half the distance from equal percentage, across-the-board increases to full cost-based revenue allocations for AIC’s Rate Zones, but also accept AIC’s proposed modification to move individual rate classes toward cost based rates subject to a constraint that no class exceeds an increase of 1.5 times the overall average increase allocated to the respective Rate Zone. Thus, the first step in the revenue allocation method calculates the overall average percentage increase to AIC (total percentage increase for all Rate Zones). The second step examines the individual cost-based revenues for the three Rate Zones. The revenue allocation moves proposed gas revenues for the three Rate Zones half the
distance from an across-the-board (step 1) to a fully cost-based approach (step 2). In response, AIC suggested modifying Staff’s proposed gas revenue allocation methodology to extend to individual rate classes, subject to a constraint that no class exceed an increase of 1.5 times the overall average increase allocated to the respective Rate Zone. Staff agrees with this modification and no other party has raised concerns about this issue. The Commission finds the agreed gas revenue allocation reasonable for purposes of this proceeding and adopts it.

IX. RATE DESIGN

A. Resolved Issues

1. Billing Units

AIC and Staff agree that AIC’s gas forecasts for customers and usage appear to be reasonable. The Commission finds that AIC’s gas forecasts for customers and usage are appropriate, and will be adopted for use in this proceeding.

2. Increase for Charges (except GDS-1 and GDS-5)

The parties indicate that AIC’s only proposed change to the Rate GDS-1 tariff reflects its proposed revenue requirement. For Rate GDS-1, the parties state that the determined constrained revenues by Rate Zone were split into Customer Charge and Delivery Charge revenues, and the individual Rate Zone’s Customer Charge revenues were then divided by the respective number of customer bills in each Rate Zone to derive the proposed monthly Customer Charge. They further note that the residual Delivery Charge revenue for each Rate Zone was then divided by the annual therms to derive the therm/unit Delivery Charge.

AIC states it proposes no tariff charge changes to the Rate GDS-3 tariff other than to adjust rates to reflect its proposed revenue requirement. AIC notes that the monthly Customer Charges and two Delivery Charges for Rider S and Rider T were increased based on the percent increase determined in the constrained revenue determination presented in Ameren Ex. 13.6G. Also, AIC proposes no tariff charge changes to the Rate GDS-5 tariff other than to adjust rates to reflect its proposed revenue requirement. In keeping with the Rate Moderation proposal, Staff supports adoption of AIC’s Rates GDS-1, GDS-3, and GDS-5 rate design proposal. The Commission finds this proposal to be reasonable, and it will be adopted for this proceeding.

3. Single PGA/Rider PGA
AIC proposes in this proceeding to adopt a single PGA tariff covering all three of its Rate Zones, where currently there is a separate PGA tariff for each of the three Rate Zones, corresponding to the three legacy utilities – Rate Zone 1 (AmerenCIPS), Rate Zone 2 (AmerenCILCO), and Rate Zone 3 (AmerenIP). Staff reviewed AIC’s request and the benefits AIC asserted would result from the use of a single PGA, and found no reason to dispute AIC’s request.

Based on analyses prepared by AIC and Staff, Staff agrees with AIC that the monetary effect on customers of a single PGA tariff would be minimal. Staff also reviewed an analysis prepared by AIC of the impact a Demand Gas Charge (“DGC”) would have on GDS-4 Rider S customers in Rate Zone 1. Currently, there is no demand component in the rates charged to those customers as there is in Rate Zones 2 and 3. However, under a single PGA, all GDS-4 Rider S customers would be subject to a DGC.

The parties indicate that the analyses show that all customers but one would have paid less over a 12-month period beginning November 2009 and ending October 2010. If a single PGA is approved by the Commission, AIC proposes to freeze the over/under recovered balances for each legacy Rate Zone on the effective date of the single PGA. In addition to the single PGA rate, for a 12-month period AIC will set rates by legacy Rate Zone to credit/charge the over/under recovered balances to the applicable customers, and will continue to track the outstanding balances and make a monthly PGA filing for the respective legacy Rate Zone until the balances are reduced to the point that an adjustment would no longer have a measurable impact on customers’ bills.

Staff recommends that within the 12-month time frame proposed by AIC, the process continue until the respective rate per therm is less than .01 cents per therm. Staff recommends that the balance remaining when a rate can no longer be set, or at the end of the 12-month period, be rolled into the single PGA charge as an “Other Adjustment” on Schedule II of the respective PGA charge. Additionally, if it is necessary to continue the process of over/under recovery longer than two months, beginning in the third month the rates should be calculated at two-month intervals. On alternate months the rates should be set at $0.00. Staff suggests this allows time for AIC to better gauge the respective over/under recovered balance before the next billing month. AIC agrees with Staff’s recommendations.

If a single PGA is approved by the Commission, Staff recommends that the following language be inserted in Rider PGA to describe (1) how the outstanding over/under recovered balances on the effective date of the single PGA will be refunded to or collected from customers and (2) how potential over/under recoveries (“Factor O’s”) for prior reconciliation periods that may be ordered by the Commission, subsequent to implementation of a single PGA, will be addressed:

Section A – Applicability of Rider PGA:
During the transition period from rate zones to a single rate, a factor will be used to adjust up or down the single PGA rate so that each rate zone will receive or be charged its respective over/under recovered balances existing on the effective date of the single PGA. For a maximum twelve-month period subsequent to the effective date of the single PGA, the Company will separately track and calculate a rate on each outstanding balance until the rate is less than 0.01 cent per therm, at which time the remaining balance will be rolled into the respective single PGA charge as an “Other Adjustment” on Schedule II. If it is necessary to continue the process of over/under recovery longer than two months, beginning in the third month the rates shall be calculated at two-month intervals in order to permit the Company an opportunity to better gauge the respective over/under recovered balances before the next billing month.

Additional over/under recoveries (“Factor O’s”) ordered by the Commission for PGA reconciliation periods prior to the implementation of a single PGA will be refunded/charged in the same manner described for outstanding over/under recovered balances on the effective date of the single PGA, if within the applicable twelve-month time frame. Subsequent to the twelve-month time frame, the Factor O’s will be included in the calculation of the appropriate single PGA charge.

AIC agrees with the recommended language changes.

Whether or not the Commission approves a single PGA tariff, AIC also agrees with Ms. Jones’ recommendation to add language to Rider PGA that describes the type of costs included in the calculation of the DGC:

Section F(c) – Demand Gas Charge

The Demand Gas Charge calculation shall include all demand or reservation costs paid to gas suppliers and pipelines for gas supplies and transportation capacity, all leased storage costs, and any other fixed costs of gas supply that meet the definition of recoverable gas costs in Section D apportioned to Customers receiving the Demand Gas Charge.

The Commission finds that the parties are in agreement that it appears appropriate at this time to allow AIC to have a single Rider PGA which would cover each of its three Rate Zones. Staff has identified some additional language which should be added to AIC’s Rider PGA, and AIC has indicated that it has no objection to Staff’s recommendations. It also appears to the Commission that no party to this proceeding has indicated it has any objection to a single Rider PGA which would cover AIC’s Rate Zones. The Commission
believes that that it is appropriate to authorize AIC to institute a single PGA to cover all of the Rate Zones, subject to the conditions identified by Staff.

4. **Conformity of GDS-2 Customer Charge - 600 Therms**

   AIC proposes to conform the GDS-2 rate structure of Rate Zone 3 to the rate structure of Rate Zones 1 and 2. Currently, Rate Zones 1 and 2 have two Customer Charges – one for Customers that use less than or equal to 600 therms per year and a second for Customers who use more than 600 therms per year. Conversely, Rate Zone 3 has one Customer Charge, regardless of annual use. AIC proposes that Rate GDS-2 in Rate Zone 3 would also have two Customer Charges based on annual use.

   Staff recommends that the Commission approve the changes to GDS-2 to conform the GDS-2 Customer Charge rate structure for Rate Zone 3 to that of Rate Zones 1 and 2, as AIC’s rate design proposal, which is to conform the GDS-2 Customer Charge rate structure for Rate Zone 3 to that of Rate Zones 1 and 2, is in the best interest of its customers.

   The Commission finds this recommendation to be reasonable, and it will be adopted for this proceeding.

5. **Conformity of GDS-4 Demand Charge - MDCQ**

   AIC indicates that it proposes a number of changes to the GDS-4 rate class to make the Rate Zones more uniform. AIC proposes that Customer Charges for all Rate Zones be based on MDCQ. According to AIC, use of MDCQ provides a closer approximation of the design load that gas planning engineers estimate is required to serve a customer, which in turn provides a closer link to cost of service. AIC states that for Rate Zone 1, delivery charges for both Rider S and Rider T customers will no longer be distinguished by pressure, and demand charges for Rate Zone 1 would be added and will be distinguished by operating pressure for both Rider S and Rider T customers. AIC asserts that this approach to rate design for the GDS-4 customer class was developed as a step toward rate structure uniformity.

   Staff recommends that the Commission accept AIC’s proposal to move Rate Zones 1, 2, and 3 GDS-4 toward price uniformity. Staff avers that AIC’s rate design proposal for the GDS-4 customer class is in the best interest of its customers. Despite the problems with AIC’s revised Rate Zone COSS discussed previously, Staff finds that the Commission’s directive with respect to the GDS-4 customer class in Docket Nos. 09-0306 et al. (Cons.), and AIC’s subsequent evaluation and findings with respect to the GDS-4 customer class, provide a sufficient basis for adoption of this proposal.
The Commission finds this proposal to be reasonable, and it will be adopted for this proceeding.

B. Contested Issues

1. GDS-1 Customer Charge

a. AIC Position

AIC notes that in its 2007 rate case, Docket Nos. 07-0585 et al. (Cons.), the Commission directed AIC to modify its monthly customer charges for the GDS-1 and GDS-2 classes so that 80% of delivery services costs were recovered through the customer charge. Order (September 24, 2008) at 237. AIC notes the Commission further ordered “that the approved ratio of fixed costs recovered from the customer charge and volumetric rate must remain in place until at least December 2012.” Id. at 238. AIC states that the Commission affirmed that rate design in AIC’s 2009 rate case. AIC notes that the Commission also recently approved recovery by Nicor of 80% of its costs through the customer charge. Docket No. 08-0363 Order (March 25, 2009) at 90-91. AIC asserts that the Commission has also consistently supported, as a policy matter, the recovery of a greater portion of fixed costs through the customer charge. See Illinois-American Water Co., Docket No. 07-0507 Order (July 30, 2008) at 122; Illinois-American Water Co., Docket No. 09-0319 Order (April 13, 2010) at 169; ComEd, Docket No. 10-0467 Order (May 24, 2011) at 232. Consistent with that directive and Commission policy, AIC notes that it has been recovering 80% of its residential class revenue requirement through the customer charge since 2008. AIC proposes in this docket to continue recovering 80% of the class revenue requirement for the GDS-1 and GDS-2 customer classes through the customer charge, and notes that Staff accepts this proposal.

AIC witness Althoff explains the reasoning behind this proposed continued recovery, testifying that the vast majority of AIC’s gas costs of service, over 97% in fact, are “fixed” in nature in that they do not vary with usage. AIC states this is best understood by breaking those costs down into two categories, “capacity” related costs and “customer” related costs. AIC asserts that “capacity” related costs of service are those costs tied to the tangible assets necessary to provide gas utility service to customers, such as gas distribution mains and gas storage facilities, noting that the costs of these assets, once installed, do not vary with monthly customer usage and so are fixed. AIC states that “customer” related costs are similarly “fixed” costs. AIC indicates that “customer” related costs are based on the number of customers served by AIC and include the costs of meter installations, services, customer administration and billing, and meter reading, among others, which costs do not vary with usage. AIC asserts that it is appropriate to recover costs such as these which do not vary with usage, and thus are “fixed,” through a corresponding pricing mechanism, a fixed
customer charge.

While GCI characterize 45% of AIC’s costs as “demand” costs, AIC claims these costs are more properly categorized as “fixed” costs because they are capacity-related, meaning they must be incurred to make the gas system available to customers: even if a customer uses no gas. Ms. Althoff explains that customers expect that the system will be available to deliver gas when they demand it, and that availability has a cost, irrespective of usage. For this reason, AIC argues that GCI’s characterization of these costs as “demand” costs is incorrect.

AIC notes that GCI witness Rubin contends that AIC’s costs of service should be evaluated over the long run, and, when so evaluated, they are in fact not “fixed” costs. As AIC witness Althoff explains however, costs traditionally considered by economists as “variable,” such as labor and customer service costs, in fact do not change in the utility setting with short-term fluctuations in load. AIC indicates that the Commission also recently rejected the same argument presented by GCI in ComEd’s most recent rate case, Docket No. 10-0467.

AIC states that GCI also argues that AIC’s proposed residential customer charge adversely impacts low use customers and raises rate discrimination and social welfare concerns. AIC notes that GCI contends that AIC’s proposal shifts costs from high-use customers to low-use customers, but does nothing to improve the overall efficiency of service. GCI contends this could lead to inefficient consumption decisions, as consumers would not receive proper price signals reflecting the true cost of meeting customers’ demands for energy services.

AIC contends however, that because AIC’s costs to distribute gas services are primarily fixed, the cost to provide such service to low-use customers differs little from the cost to provide such service to high-use customers. AIC states its proposal sets the proper pricing signal for customers with respect to those costs by establishing fixed charges for such fixed costs, while noting that these fixed distribution charges comprise only a small portion of a residential customer’s bill. AIC asserts that a significant portion of the bill is comprised of the customer’s gas commodity charge which is tied to therm usage, and it is this therm charge which sends the appropriate pricing signal regarding the customer’s gas consumption.

AIC opines that recovery of costs through a higher volumetric charge, as apparently championed by GCI, could result in a subsidy of low-volume customers by high-volume customers, which would penalize those customers because, under GCI’s proposal, they would pay more than their appropriate share of the fixed costs to serve them. AIC notes that in alleging an inappropriate “cost shift,” GCI ignores that AIC has been recovering 80% of its residential class revenue requirement through the customer charge since the Commission’s directive that it do so in AIC’s 2007 rate case.
AIC notes that GCI also argues that certain of the “capacity” related costs AIC considers “fixed” in nature are, in fact, not “fixed” at all. Mr. Rubin points specifically to the cost of gas storage fields, which he contends are “variable.” AIC explains however, that the cost of service for underground storage fields is tied to tangible assets including land and land rights, structures and improvements, wells, non-recoverable natural gas necessary for the fields to operate, lines, and storage equipment, and to the expense incurred to operate and maintain those facilities. Therefore, AIC asserts that storage costs are fixed.

AIC claims that over 97% of its costs of gas service are “fixed” costs, as they do not vary based on gas consumption, and to recover such costs through variable charges sends consumers the wrong pricing signal. AIC opines that when proper pricing signals are utilized, ratepayers’ consumption decisions will be based on the actual cost of delivery service. AIC suggests that its proposal to continue recovering 80% of the class revenue requirement for the GDS-1 and GDS-2 customer classes through the customer charge, as approved by the Commission in the AIC’s last two rate cases, should be approved.

b. GCI Position

GCI states that AIC is proposing to recover its proposed increase in revenue requirement from residential customers by continuing to recover approximately 80% of its residential cost of service through its customer charge. GCI notes that AIC’s existing residential rates consist of a monthly customer charge and a per-therm distribution charge for each of the three Rate Zones AIC established for this proceeding. Under AIC’s proposal, Rate Zone 1 would go from a customer charge of $19.31 to $22.39 and the per-therm distribution charge would go from $0.07724 to $0.08971. GCI states that the Rate Zone 2 customer charge would increase to $18.41 from $15.60, while the per-therm charge would go from $0.05649 to $0.07035. Lastly, GCI indicates that Rate Zone 3 has a customer charge of $19.57 which would increase to $22.01, and has a per-therm charge of $0.07589, which would increase to $0.08982.

GCI notes that over the past few AIC rate cases, AIC has had a steady, non-cost-justified increase in the customer charge portion of the monthly bill based on AIC’s definition of “fixed” costs and the supposition that its delivery service costs are not affected by gas consumption. GCI argues however that AIC’s own COSS shows that there are substantial demand-related costs that are incurred because of the amount of gas consumed by customers.

In this case, GCI states that AIC is proposing per-therm distribution rates that are significantly less than the per-therm demand costs incurred to serve residential customers, noting that the demand cost is approximately 19 cents per therm, while AIC is proposing distribution charges of between 7 and 9 cents per therm. In effect, GCI asserts AIC proposes to recover most of its demand-related costs on a per-customer basis, which is
inconsistent with the setting of cost-based rates for utility service. GCI opines that AIC has tremendous diversity within its residential classes, ranging from customers who do not use natural gas for space heating to those who use many hundreds of therms per month during the winter for space heating. GCI asserts that this diversity means that these customers in fact place different demands and impose different costs on AIC’s natural gas distribution system.

GCI states that while demand-related costs account for approximately 45% of AIC’s total cost of serving residential customers ($107 million out of $235 million), AIC has proposed rates that do not recover these residential demand costs from the customers who cause them to be incurred (those customers who use more gas). Instead, GCI avers that AIC has proposed rates that would require low-use residential customers to provide substantial subsidies to high-use residential customers – charging higher-use customers less than one-half the demand cost that they impose on the system.

GCI states that utility rates rest on a fundamental notion that rates should be “just and reasonable” and that rates should not improperly discriminate among customers; that people should not be asked to pay different rates for the same service. In order to determine whether rates are just, reasonable, and not improperly discriminatory, GCI indicates the Commission must rely on information about the cost to serve different types of customers. GCI asserts that differences in rates among different types of customers should be related to differences in the cost of providing service so that regulators can have confidence that the rates are not improperly discriminatory.

While AIC has identified these types of costs, GCI complains that AIC does not propose rates that fairly recover that cost from the customers who cause it. GCI avers that AIC’s proposed rates are highly discriminatory against low-use residential customers because they would require those customers to pay substantially more than the cost that is incurred to serve them. GCI opines that the evidence shows that heating customers place dramatically larger demands on the system than do non-heating customers, and larger heating customers place greater demands on the system than smaller heating customers, therefore, it is grossly unreasonable to recover most demand-related costs on a per-customer basis.

GCI, therefore, recommends a transition to cost-based residential rates by recommending any rate increase allocable to residential customers be recovered solely from the per-therm distribution charge. GCI notes that AG/CUB Ex. 2.4 shows the residential rates that it recommends under AIC’s proposed revenue requirement, and notes there would not be any increase in the GDS-1 customer charges in this case.

GCI recommends the Commission seriously consider the fairness and reasonableness of how a disproportionate increase in the minimum charge in this case would impact low usage customers. GCI argues the resulting rate design would send a
confusing message to low usage consumers who could experience a significant increase in the overall rate that they pay, even if they are conserving in an aggressive way. By dramatically increasing monthly customer charges, GCI claims customers could see any small savings in volumetric charges that will result from conservation offset by a huge increase in the minimum portion of their bills.

While AIC apparently refers to “fixed” costs to mean costs that do not vary in the short-term as the throughput of gas changes, GCI submits that a standard economic definition of a “fixed” cost is one “whose quantity cannot be changed during the period under consideration,” and the relevant period, short or long, for determining whether a utility cost is fixed or variable should be the long run.

GCI states that AIC’s COSS shows its total proposed revenue requirement is $343,728,700, which AIC then divides by the average number of customers over a year to determine that its fixed cost per customer of $34.89 on a total-company basis ($26.07 for residential customers). On the following line in its study, GCI notes it then calculates what it calls “Total fixed 80% recovery,” that is, the recovery of 80% of so-called “fixed” costs through the customer charge, which is $27.91 on a total-company basis and $20.85 for residential (GDS-1) customers. GCI asserts this shows that AIC has treated all of its costs as being fixed, yet for the DS-1 class AIC’s own data show that it incurs substantial costs related to the peak demand that each residential customer places on the system. GCI claims these demand-related costs are apparent in the sizing of distribution mains, storage facilities, and other types of distribution facilities and related O&M costs. GCI indicates that AIC’s COSS shows residential demand-related costs to be $107,174,100, which, if recovered from residential customers in proportion to their annual consumption (that is, recovering the cost on a per-therm basis), the demand cost per therm would be 18.99¢ per therm. GCI asserts these costs should be recovered from customers in proportion to the amount of natural gas that they use, particularly when that gas is used during the winter.

GCI claims that AIC’s focus on the short run to determine whether costs are fixed or variable is not appropriate for setting utility rates or evaluating a utility’s cost of service, and believes there is no support among reputable public utility economists or among public utility commissions for setting utility rates based on short-run marginal costs. GCI opines that such a method of utility pricing is simply a method of transferring wealth from one group of customers to another, and not only is there no discernible increase in overall societal welfare and no improvement in the efficiency of use of the utility’s service, such a pricing proposal could lead consumers and utilities to make decisions that are not in their long-run best interests.

GCI avers that the essential flaw in pricing utility distribution service based on short-run marginal cost is that the industry exhibits economies of scale, which in turn means that the marginal cost declines as more of the product is supplied. In an industry that exhibits economies of scale, GCI states setting prices equal to short-run marginal cost results in the
firm being unable to recover its costs. GCI asserts it is unreasonable and improper to treat most of AIC’s costs as “fixed” and to recover them on a per-customer basis when AIC’s own COSS shows that more than 45% of its cost of serving residential customers is related to those customers’ demand for natural gas, therefore the Commission should adopt GCI’s proposed residential rate designs for natural gas distribution service.

c. Commission Conclusion

In accordance with the Commission’s directive in its 2007 rate case, the Commission notes that AIC has been recovering 80% of the class revenue requirement for the GDS-1 and GDS-2 customer classes through the customer charge. The Commission notes also that AIC has proposed to continue setting its customer charges using the same approach, and that Staff has accepted AIC’s proposal on this issue. GCI, however, suggests that AIC has overstated its fixed costs, and suggests that AIC’s COSS supports their argument.

The Commission finds that AIC’s proposal to recover 80% of the fixed cost of serving GDS-1 and GDS-2 customers is in conformity with established Commission policy. The Commission also finds that AIC has properly accounted for its fixed versus variable costs in serving GDS-1 and GDS-2 customers, and has properly taken them into account in calculating its proposed customer charge. The Commission believes that GCI’s opposition is contrary to the Commission’s established policy to allow recovery of a greater portion of fixed costs through the customer charge. The Commission, therefore, finds that AIC’s proposed method for determining the customer charge is just and reasonable in this case.

2. GDS-5 - Expansion of Rate Class Availability

a. AIC Position

AIC notes that its current GDS-5 rate is a seasonal service that allows customers to avoid demand charges, provided they consume gas only on days when the average temperature exceeds 25 degrees Fahrenheit. AIC proposes retaining the GDS-5 temperature based customer class structure in its current form, and proposes no changes to the GDS-5 tariff.

AIC states that the GDS-5 tariff is the tariff most applicable to the GFA and its members. AIC states that GFA supports utilization of the current temperature based GDS-5 rate, however, GFA also proposes incorporating into the GDS-5 rate design additional tiers of customer charges applicable to small and intermediate customers of the GDS-2 and GDS-3 size, and revising the GDS-5 tariff accordingly. AIC notes that GFA witness Adkisson testifies that while all customers are eligible to receive the GDS-5 rate if they are willing to curtail their gas usage on certain days, as a practical matter, that rate is only available to
large consumers because the GDS-5 customer charges are comparable to those for GDS-4 Large General Service Customers. AIC notes GFA claims the GDS-5 rate design does not send the appropriate pricing signals to small and intermediate GDS-2 and GDS-3 customers, contending that a typical small to intermediate size grain dryer would not be expected to utilize the GDS-5 rate because of the proposed high monthly fixed charges.

While GFA takes the position that a broader range of customer charges within the GDS-5 rate equal to that proposed for the GDS-3 rate would encourage greater off peak usage by those customers, AIC recommends that GFA’s proposal be rejected. AIC asserts GFA’s position overlooks the fact that AIC must properly assess charges to recover the costs necessarily incurred to provide service to its customers. In this regard, AIC claims GFA’s proposal ignores the basis for the respective customer charges incorporated into the GDS-3 and GDS-5 rate designs. AIC asserts that GDS-5 rate customers who consume gas on days when the temperature is at or below 25 degrees Fahrenheit incur a demand charge based on that day’s use, thus, the GDS-5 rate structure requires interval metering based on discrete incremental measurements of gas consumption. In contrast, AIC states the GDS-3 rate structure does not assess demand charges, and as such, GDS-3 metering equipment is more simplistic and less costly. AIC believes the evidence shows that the average installed cost of a GDS-3 meter is approximately $5,400, while the average installed cost of a GDS-5 meter is $10,800. AIC notes these figures do not include the cost of regulators or interval metering equipment necessary for GDS-5. AIC avers further that because the design of the GDS-5 rate tariff offers a price break for seasonal usage to GDS-5 customers; meter reading and billing, too, are more complex and, as a result, more costly for GDS-5 grain drying customers relative to GDS-2 and GDS-3 general use customers.

AIC claims that if GDS-3 customers were to switch to the GDS-5 rate, AIC would be required to install this more costly demand metering equipment for those customers, and incur related costs, but those customers would not be assessed the appropriate customer charge under GFA’s proposal. AIC states the result would be cross-class subsidization; GDS-2 or GDS-3 customers using the seasonal rate would not pay enough to cover the associated costs, which would then have to be borne by other customers.

While GFA contends the installed cost of meters and regulators capable of recording discrete hourly and daily demands as required by the GDS-5 rate schedule are available and can be installed for less than $5,000, AIC contends that GFA’s analysis is inaccurate. AIC states that GFA’s estimation of the equipment necessary to serve GDS-2 and GDS-3 customers under the GDS-5 rate structure focuses on therm usage, ignoring other service criteria, and is therefore incomplete. Moreover, AIC asserts the equipment suggested by GFA and identified on GFA Exhibits 2.01G and 2.02G would not be appropriate for GDS-5 customers. AIC notes the regulator cost estimated by GFA is too low for the volumes of gas used by most grain dryers; the labor cost estimated by GFA to install GFA’s proposed equipment is too low given that GDS-5 meter sets are greater in size, complexity, and installation time, than GDS-3 meter sets, and the total cost estimated by GFA to install a
GDS-5 capable meter set for a GDS-2 or GDS-3 customer is inaccurate and low.

While GFA asserts that AMC’s meter charges support its position, AIC claims the AMC tariff is not comparable. AIC alleges the AMC’s cost development reflects the cost of service, net of accumulated depreciation, of the average cost of the equipment in AMC’s plant records, in contrast to the costs of GFA Exs. 2.01G and 2.02G, which are current costs. AIC indicates it utilizes the current costs of the installed meters set by GDS customer groups to allocate the recorded plant costs of these assets. In other words, AIC states the $5,400 or $10,800 installed meter costs for GDS-3 and GDS-5 customers are used to allocate the historical plant dollars of the meter assets, and they cannot be compared to the AMC charges.

AIC argues that GFA’s proposal also should be rejected in light of the admission that AIC would experience revenue erosion if a significant number of GDS-2 and GDS-3 customers switched to the GDS-5 seasonal rate, as GFA recommends. AIC notes GFA is not proposing the incorporation of an additional customer charge for GDS-2-size customers at this time, but rather claims there are 12 grain dryers’ accounts which would be eligible to switch from the GDS-3 to the GDS-5 seasonal rate under its proposal. AIC asserts that if all 12 were to switch, the revenue erosion would be approximately $20,000 annually, based on AIC’s requested rate increase, which revenue erosion AIC recommends the Commission find unacceptable.

AIC notes GFA also overlooks the additional, significant potential revenue erosion that would result if eligible GDS-3 customers other than those identified by GFA were to switch to the GDS-5 rate. AIC states it has over 80 other grain drying customers served under the GDS-3 rate structure, and if all were to switch rate classes, the revenue erosion and cost subsidization resulting from the difference in cost between GDS-3 and GDS-5 metering equipment would be significant. AIC notes that Staff indicates that GFA’s proposal would add ambiguity for rate administration, which would result in uncertainty for recovery of a utility’s approved revenue requirement. AIC asserts that GFA concedes it has not fully considered the ramifications of its proposal, therefore GFA’s proposal should be rejected and AIC’s GDS-5 rate design and tariff should remain unchanged.

b. GFA Position

GFA indicates that it supports expansion of the current temperature based GDS-5 rate to GDS-3 size customers, and claims that doing so would achieve greater utilization of, and revenues from, the AIC natural gas distribution system during the winter months while protecting system integrity. GFA notes the GDS-5 rate was specifically designed to provide benefits to all AIC customers by relieving the AIC distribution system peak, and is accomplished by encouraging GDS-5 customers to self interrupt when the temperature is 25 degrees or below. GFA claims that continuing to make the GDS-5 interruptible feature
available only to GDS-4 customers and not GDS-3 customers would be a lost opportunity to provide further system wide benefit.

GFA states that while all customers are technically eligible for the GDS-5 rate, as a practical matter, the GDS-5 rate is only available to larger customers because the GDS-5 customer charges are in the same range as the GDS-4 Large General Service rate. GFA believes that AIC should add an additional tier to its range of customer charges within the GDS-5 rate for customers of the GDS-3 intermediate size. GFA claims adding this tier will encourage greater off-peak utilization of the AIC distribution system. GFA proposes an additional tier for customers having a MDCQ of greater than 200 and less than 1,000, which is the eligibility requirement for a GDS-3 customer, and proposes replicating the GDS-3’s Customer Charges for this tier.

GFA notes that AIC opposes the additional tier, alleging that the DS-3 customer charge will not fully recover the cost of an interval demand meter, service line and other costs. GFA further notes that AIC claims that the cost of an interval demand meter and equipment of a GDS-3 size is about double the cost of a regular GDS-3 meter. GFA argues that its evidence shows that the cost of a complete installation of a regulator meter with demand recording capability with temperature and pressure compensation and data storage electronics is less than $5,000, or about the same as currently for a GDS-3 meter. GFA asserts that the GDS-3 customer charge is a reasonable proxy for GDS-3 size customer charge for an expanded tier in the GDS-5 rate.

Although AIC witness Althoff recites a higher meter cost for GDS-5 customers, GFA claims that she admits that the cost is for existing GDS-5 customers, most of whom are GDS-4 size customers. Because GDS-4 customers use a higher volume, GFA claims that they need larger, more expensive equipment than GDS-3 size customers. While Ms. Althoff points out that her analysis includes more than the cost of a meter and includes the cost of a regulator, and other related equipment, GFA argues that she does not take into account that a GDS-3 customer would not change its burners when switching to the GDS-5 rate and therefore the service line, meter and regulator and associated equipment would have the same flow capacity requirement as before. Although AIC complains that GFA’s analysis does not take into account regulators or interval metering equipment, GFA notes that its Ex. 2.01G includes the cost of a regulator and interval metering equipment.

To further support its cost analysis, GFA notes that it checked AIC’s meter charges in a neighboring state, Missouri, including AMC standard transportation tariff sheets 10 and 20.1, which are for a customer whose annual transportation requirements are expected to be 600,000 Ccf or less (therms or less), which GFA states approximates an AIC GDS-3 size customer. GFA states that the AMC standard transportation tariff contains a customer charge, an electronic gas administration charge and a meter equipment charge, which total $93.17 per month. Additionally, GFA notes the monthly meter equipment charge for electronically recording and telemetry of customer demands is $21.00. GFA opines that a
conservative 1% per month of installed utility facility carrying charge equates to an AMC
standard transportation meter cost of about $2,186, which is very close to the vendor meter
to quotes obtained by GFA. GFA avers that a monthly facilities carrying charge of 1.25%,
equates to an even lower meter cost of $1,680, which may be possible when utilities
purchase meters in larger quantities.

GFA indicates that AIC alleges that a massive switch to GDS-5 by GDS-3 customers
is possible and that such an event would cause such enormous rate administration
ambiguity and financial uncertainty for AIC, that GFA’s proposal should be rejected, which
concern is shared by Staff. While GFA believes that these concerns are overstated, to allay
these fears and to mitigate any financial impacts on AIC, GFA proposes to delay
implementation of the expanded GDS-3 customer charge tier to May 1, 2012. GFA states
this delay will allow time for GDS-3 customers to assess the optional GDS-5 seasonal rate,
time for AIC to implement the expanded GDS-5 rate after the Commission’s final order, and
to allow AIC to minimize any revenue erosion and adjust charges to actual when AIC files its
next gas rate case. Additionally, GFA does not oppose implementing the expanded GDS-5
rate on an experimental basis.

While Staff raises the concern that GFA’s proposal has the potential to set back the
attainment of cost-based rates, GFA asserts that the GDS-5 rate was specifically designed
to provide benefits to all AIC customers by relieving the distribution system peak by GDS-5
customers’ self interruption when the temperature is 25 degrees or below. Moreover, GFA
notes it has not proposed to change cost allocation to classes in this case and therefore its
proposal cannot possibly set back the attainment of cost-based rates. GFA indicates that its
proposal is to add another customer charge tier to the cost-based rate that is ordered in this
case for GDS-5, and to use exactly the cost-based customer charge that the Commission
orders in this case for the GDS-3 rate for GDS-3 size customers taking GDS-5 service under
the proposed expanded tier.

Although Staff claims that implementation of GFA’s proposal would not be
straightforward, GFA states that currently any GDS-3 customer can choose to subscribe to
GDS-5 service, therefore AIC can already implement GDS-5 for GDS-3 size customers, as
long as the customer has a meter that can record daily demand. While Staff further
complains that GFA fails to address the impact of its proposal, including rate design, cost
allocation, bill impact analysis, customer rate migration, revenue instability and cost analysis,
GFA asserts there will be no cost shifting in this case and therefore no cost impact to other
customers. GFA contends that instead, it furthers the benefits that GDS-5 provides currently: system costs savings and reliability by having more GDS-5 customers interrupt
when the temperature is 25 degrees or less.

Based on the evidence presented in this case, GFA requests that the Commission
approve the GDS-5 tariff expansion as proposed in GFA Ex. 1.01G, and if the Commission
deems necessary, to delay the implementation to May 1, 2012, and possible limiting the
number of customers that can utilize the new tier.

c. Staff Position

Staff states that according to AIC, the GDS-5 rate structure is unchanged from what is currently in effect; however, rates and charges are adjusted to recover the increased costs to serve this class based on revenue constraints. Staff notes that GFA presented a number of arguments concerning temperature-based pricing for a broader range of customers taking service under the GDS-5 rate, asserting that the benefits of the GDS-5 rate should be available to large, intermediate, and small customers that are willing to curtail usage on days when the average temperature is equal to or below 25 degrees Fahrenheit. Staff indicates that GFA believes that a GDS-2 and GDS-3 customer would not be inclined to pay more for their current delivery charges to avail themselves of the off-peak provisions of the GDS-5 rate, while in contrast, GDS-4 Large General Service customers are more likely to switch since their current customer charges are “in the same range” as the GDS-5 customer charges.

Staff states that GFA proposes adding a new tier with a lower fixed charge within the GDS-5 rate for smaller off-peak customers to encourage greater utilization of AIC’s distribution system, but GFA does not at this time propose an additional tier for small GDS-2 size customers to allow for operational experience and an assessment of acceptance of the GDS-5 seasonal rate by GDS-3 intermediate size customers before considering whether to expand GDS-5 to GDS-2 small customers.

Staff alleges that GFA’s proposal has the potential to set back the attainment of cost-based rates, and believes that implementation of GFA’s proposal would not be as straightforward as GFA suggests. Staff notes that the GDS-5 tariff is the tariff most applicable to GFA’s members since it reflects the different impacts seasonal-use customers have on costs associated with gas delivery. Staff states the purpose of the GDS-5 tariff is to promote system reliability by discouraging gas use by individual customers whose operation on days when space heating demands increase would cause reliability issues, noting the GDS-5 rates are based costs, reflecting the different impacts that seasonal customers have on fixed and variable costs.

Staff believes that GFA fails to address the impact that its proposal may have on customers, and fails to provide any substantive analysis of the rate or bill impacts of its proposal on AIC, its membership, or on any other customers. Despite proposing entirely new GDS-5 tier provisions for all three Rate Zones, Staff indicates that GFA provides no meaningful analysis of the effects (i.e., rate design, cost allocation, bill impact analysis, customer rate migration, revenue instability, or cost analysis) of his proposed recommendation.
Staff is concerned that GFA’s proposed modification is likely to lead to an inequitable assignment of costs among customer classes, because AIC already incorporates the different impacts that seasonal customers have on fixed and variable costs, and reflects those impacts in the billing components and associated charges of GDS-5. Without thorough analysis, Staff avers that the extent to which this change in rate design will affect AIC’s cost recovery is unknown. To avoid the possibility of revenue erosion, Staff believes a complete analysis of the affected service classifications to determine realignment of class billing determinants would be necessary, which analysis would require assumptions for expected customer migration. In the absence of a thorough analysis, Staff believes GFA’s proposal would add ambiguity for rate administration, which would result in financial uncertainty for the recovery of a utility’s approved revenue requirement.

Staff believes that AIC’s proposed GDS-5 tariff charges are reasonable. Although under AIC’s current GDS-5 tariff provisions, small and intermediate GDS-2 and GDS-3 customers might not financially benefit from switching to the optional GDS-5 tariff (because of the proposed high monthly fixed charges), Staff asserts this fact alone does not necessarily render the GDS-5 tariff unreasonable. Staff states the current GDS-5 rates are based on cost and no showing has been made that an additional tier would better capture the cost impacts of seasonal customers. Staff opines that GFA’s proposal is unsupported, and insufficient analysis has been provided as to the impacts on costs for the customers or revenue for AIC. Staff recommends that the Commission reject GFA’s proposal to add an additional tier to GDS-5 across all Rate Zones.

Should the Commission decide to adopt in part GFA’s proposal in this proceeding relating to the expansion of the GDS-5 rate class availability, then Staff recommends that the Commission initially limit the number of customers that can utilize the new tier to twelve in order to address the concerns outlined by Staff and AIC. These would be the twelve customers upon whom GFA based its initial revenue erosion analysis that AIC witness Althoff did not challenge. Staff suggests this experimental expansion of the new tier would (1) minimize revenue erosion for AIC; (2) assess the true costs associated with metering and other equipment suited for GDS-3 customers taking service under the GDS-5 rate; and (3) allow both parties to present their finding and analysis in AIC’s next rate case.

d. Commission Conclusion

The Commission recognizes on this issue that AIC proposes retaining the GDS-5 temperature based customer class structure in its current form, and proposes no changes to the GDS-5 tariff, while GFA proposes to add an additional tier of customer charges for GDS-3 customers. AIC argues that GFA’s proposal overlooks that AIC must properly assess charges to recover the costs necessarily incurred to provide service to its customers, and ignores the cost basis for the respective customer charges incorporated into the GDS-3 and GDS-5 rate designs. AIC contends that were GDS-3 customers allowed to switch to the
GDS-5 rate, AIC would be required to install more costly demand metering equipment for those customers and incur related costs; however, those customers would not be assessed the appropriate customer charge. AIC asserts the result would be cross-class subsidization; in that GDS-2 or GDS-3 customers using the seasonal rate would not pay enough to cover the associated costs, which would then have to be borne by other customers.

AIC also notes GFA overlooks the additional, significant potential revenue erosion that would result if eligible GDS-3 customers other than those identified by GFA were to switch to the GDS-5 rate. AIC states it has over 80 other grain drying customers served under the GDS-3 rate structure, and if all were to switch rate classes, the revenue erosion and cost subsidization resulting from the difference in cost between GDS-3 and GDS-5 metering equipment would be significant.

GFA suggests that the Commission consider adding an additional tier to the range of customer charges within the GDS-5 rate for customers of the GDS-3 intermediate size. GFA contends that adding this tier will encourage greater off-peak utilization of the AIC distribution system. GFA also proposes an additional tier for customers having a MDCQ of greater than 200 and less than 1,000 therms – which is the eligibility requirement for a GDS-3 customer. GFA notes the proposal would also replicate the GDS-3 Customer Charges for this tier.

The Commission notes that Staff suggests that AIC’s proposed GDS-5 tariff charges are reasonable, although under AIC’s GDS-5 tariff provisions, small and intermediate GDS-2 and GDS-3 customers might not financially benefit from switching to the optional GDS-5 tariff due to high monthly fixed charges. Staff asserts this fact alone does not necessarily render the GDS-5 tariff unreasonable.

Staff suggests that should the Commission consider adopting GFA’s proposal in this proceeding, that the Commission initially limit the number of customers that can utilize the new tier to 12 in order to address the concerns outlined by Staff and AIC. Staff indicates these would be the 12 customers upon whom GFA based its initial revenue erosion analysis. Staff suggests this experimental expansion of the new tier would minimize revenue erosion, assess the true costs associated with metering and other equipment suited for GDS-3 customers taking service under the GDS-5 rate, and allow both parties to present their finding and analysis in AIC’s next rate case.

The Commission believes that based on the evidence presented by in this proceeding, there is a possibility of benefit to AIC from adoption of the tariff suggested by GFA, including system costs savings and in system reliability. The Commission also
recognizes that there are certain risks inherent in its adoption, including revenue erosion to AIC and possible cross-class subsidization.

The Commission will, therefore, approve the GDS-5 tariff expansion as proposed in GFA Ex. 1.01G; however, the Commission will delay the implementation of the tariff to May 1, 2012. The Commission also agrees with Staff’s suggestion that the use of this new tariff will be limited to the 12 customers identified by GFA in its initial revenue erosion analysis.

Because the Commission is authorizing this tariff expansion on a limited, experimental basis, the Commission believes that to continue this process, and in order to contemplate continuation of the tariff or further expansion, evidence must be presented in AIC’s next rate case that demonstrates that the expanded tariff: improves system costs savings and reliability by having more GDS-5 customers interrupt when the temperature is 25 degrees or less; minimizes revenue erosion; and properly assesses the costs associated with metering and other equipment for GDS-3 customers taking service under the GDS-5 rate.

X. PROPOSED RIDERS/TARIFF CHANGES

A. Resolved Issues

1. Pension Benefits Rider

In the interest of narrowing the number of issues in the case, AIC has withdrawn its request for a pension rider.

2. Uncollectibles Rider

Staff recommends that the Commission order AIC to begin using the net write-off method instead of using Account 904 for the purpose of determining the utility’s uncollectible amount in rates. Staff calculates the percentage of uncollectibles related to delivery services using the net write-off method for each Rate Zone. AIC rejects Staff’s proposal to switch to the net write-off method and the calculation of an individual percentage for each Rate Zone. These issues are addressed earlier in the section of the Order regarding uncollectibles expense.

Should the Commission agree with Staff’s recommendation to adopt a net write off methodology, the parties note that tariff changes are necessary for Rider GUA. As AIC witness Jones explains, presently, Rider GUA states that the incremental uncollectible
adjustment amounts reflect the difference between the actual uncollectible expense amounts for Account 904, and the uncollectible amounts included in the utility’s rates that were in effect for such reporting year. If a switch is made, pursuant to Section 19-145(a), AIC and Staff indicate the switch must be made effective at the beginning of the first full calendar year after the new rates approved in such proceeding are first placed in effect. Assuming this docket concludes in January 2012, the parties state the first full calendar year after new rates are approved would be 2013. Thus, AIC and Staff note the first Rider GUA incremental adjustment amounts reflecting a net write-off basis would be in May 2014 for factors effective from June 2014 through May 2015, reflecting the difference between net write-offs and the amount included in rates for 2013. AIC and Staff indicate a paragraph should be added to the “Incremental Uncollectible Adjustment” sections of both Rider GUA that addresses the switch to the net write-off method for the 2013 reporting year, and subsequent reporting years. Additional relatively minor tariff language changes would be needed to clarify that through the 2012 reporting year, Account 904 will be used, but that starting with the 2013 reporting year, a net write-off method will be used. AIC and Staff assert no party has opposed these changes. The Commission notes that earlier in this Order it did adopt the net write-off method for uncollectibles expense; therefore the Commission agrees that tariff changes are necessary for Rider GUA. The Commission directs AIC to adopt the changes discussed above, as agreed to by the parties.

B. Contested Issues

1. Rider TBS - Transportation Banking Service

   a. AIC Position

   In response to concerns raised in AIC’s prior rate case regarding AIC’s gas transportation banking service, AIC has submitted alternative tariffs setting forth an unbundled, subscribable banking service - Rider TBS. AIC indicates its proposal allows transportation customers to individually choose the bank service level, up to 15 days of bank, desired by the customer. As such, AIC asserts it provides transportation banking customers’ greater banking service flexibility and is a reasonable solution to the concerns that arose in the last rate case, and therefore should be approved.

   AIC notes, however, that Staff proposes to modify AIC’s proposals by replacing much of the Rider TBS tariff with Nicor tariff banking provisions. AIC asserts that Staff’s proposal to apply Nicor tariff provisions to AIC, however, does not take into account AIC’s operational circumstances. AIC notes that Staff admits there are operational differences between AIC and Nicor, and claims that Staff has failed to explain why Nicor provisions should nevertheless be applied to AIC. For this reason alone Staff’s proposed modification to Rider TBS should be rejected, however AIC claims further that Staff’s proposed modifications will
cause AIC to incur increased costs, which will be borne by sales customers, and expose AIC to operational difficulties.

In Docket Nos. 07-0585 et al. (Cons.) AIC notes its legacy utilities were ordered to implement a gas transportation banking program, known as Rider T, which became effective in 2008. In AIC’s last rate case, Docket Nos. 09-0306 et al. (Cons.), AIC states there was substantial disagreement between AIC, Staff, and several gas marketers regarding whether the total bank size should be significantly expanded. Ultimately, AIC notes the Commission did not order any changes to the banking provisions of Rider T, however, the Commission did direct that workshops be held prior to AIC’s next gas rate cases for the purpose of discussing alternatives to AIC’s current banking terms and conditions. AIC indicates the Commission required that AIC submit a tariff implementing the Nicor method for determining bank size, but allowed AIC to offer an alternative.

AIC states that workshops were held on November 17, 2010 and December 13, 2010 at the Commission’s offices in Springfield, Illinois, and based on the input received at the workshops, AIC agreed to offer a subscribable bank, where transportation customers could select any number of days, from 0 to 22 (later corrected to 0 to 15), that when multiplied by their MDCQ would determine their bank size.

As required by the Commission in Docket Nos. 09-0306 et al. (Cons.), AIC provided in its initial filing tariffs which contained the banking provisions resulting from the use of the Nicor and Peoples/North Shore models. AIC states it calculated the number of days of bank that would result from the application of the Nicor and Peoples/North Shore methods to its storage resources, which was 29 and 22 days, respectively. AIC’s proposed tariff utilized the Nicor method, the more conservative of the two, however, AIC asserts that the tariff utilizing the Nicor method is not workable for AIC’s system.

AIC indicates that to address concerns raised in the workshops, and as authorized by the Commission in Docket Nos. 09-0306 et al. (Cons.), AIC submitted alternative tariffs setting forth unbundled, subscribable banking service, presented in AIC’s tariffs for Rider TBS. AIC states its proposal also provides for the allocation of on-system storage costs to Rider T customers, unsubscribed bank cost recovery language in Rider S, an election process that allows Rider T customers to subscribe to their preferred bank size between 0 and 15 days times their MDCQ limit for individual bank size as part of the Bank Election Process, and other implementation and service management provisions. AIC’s asserts its proposal provides transportation customers with the flexibility to individually choose the bank service level desired by the customer.

As part of AIC’s proposal, AIC notes it proposes a banking service limit (“BSL”) of 10 times the total aggregate MDCQ bank capacity of transportation customers, which bank capacity represents 21% of the total nameplate capacity of AIC’s on-system storage. AIC argues its proposed allotment of storage capacity is reasonable because AIC’s
transportation service does not impose on its users the requirement to bank gas in the summer and empty banked gas in the winter as required by the Nicor and Peoples/North Shore tariff. AIC avers that to operate its on-system storage fields in the manner necessary to meet sales customers’ peak day needs and consistent with good engineering practice, AIC must cycle on-system storage to the maximum extent possible.

AIC notes it also proposes to recover 50% of storage costs through a Deliverability Charge and 50% through a Capacity Charge in Rider TBS. AIC claims a proper allocation of on-system storage costs includes a deliverability component reflecting a transportation customer’s access to their banks on a peak day and a bank capacity component reflecting the overall size of a customer’s bank. Stated differently, AIC states there is a cost associated with a customer’s daily access to a bank and a cost associated with the size of the customer’s bank. AIC notes this concept has been termed the “Equitable Method” for developing storage rates. See e.g., Tennessee Gas Pipeline Company, 56 FPC 120, 160 (1976), reaffirmed by FERC Opinions, Orders and Notices in Equitable Gas Company, Docket CP85-876-000 (1986). AIC opines that the “Equitable Method” allocates 50% of fixed storage costs to peak delivery rights and 50% of fixed storage costs to overall storage capacity, also called maximum storage volume.

In rebuttal, AIC notes its Nicor method calculation was corrected, producing a bank limit for each individual customer of 15 times their MDCQ (instead of 22 times) and a proportional share of AIC’s on-system storage of 8.22 billion cubic feet (“Bcf”) (32%). In light of the correction, AIC proposes adoption of an individual bank limit of 15 days, with the BSL remaining at 10 days. AIC states unsubscribed capacity will be offered to those customers wanting more than 15 days, so customers who want additional storage capacity may receive more than 15 days under the election process. Should the Commission adopt the 15 days of bank for the overall BSL, as calculated under the Nicor method, AIC recommends that the Commission reject the rest of Mr. Sackett’s proposed Nicor-based tariff modifications to AIC’s Rider TBS.

AIC states that Staff witness Sackett takes the position that Rider TBS should be approved, but with modifications, however AIC asserts that these proposed modifications so materially alter AIC’s Rider TBS proposal as to essentially gut AIC’s proposal. Further, AIC claims Staff’s modifications affect the collective sales customers’ rights to storage, and that sales customers are the backstop for transportation customers and are adversely impacted by Staff’s proposal, despite the fact that Staff agrees sales and transportation customers should be fairly assigned the same rights.

Staff proposes modifications to AIC’s proposal based on what Staff calls the “Nicor method,” however, AIC avers there is a distinction between the “Nicor method,” utilized in past Nicor rate proceedings to determine the number of days of bank, and the numerous other Nicor transportation tariff provisions that Staff seeks to impose on AIC. AIC claims Staff appears to be advocating that the Commission approve not just the Nicor method for
establishing days of bank, but apply to AIC certain Nicor tariff provisions as well. In particular, AIC notes Staff seeks to impose the following other Nicor transportation tariff provisions on AIC in this case: an injection target provision, the 2.2% of customer bank access on a Critical Day ("CD") provision, and the on-system storage cost allocation and Rider TBS rate derivation. AIC states that Staff's application of the Nicor method based on its proportionality position is improper. Additionally, because Staff does not establish that AIC’s and Nicor’s systems are operationally comparable, AIC claims that Staff fails to establish that application of Nicor’s tariff provisions is appropriate for AIC.

AIC notes the concept of “comparability” in establishing utility rates and tariffs with reference to other utilities is well established under Illinois law, stating the Commission should not “afford any appreciable weight or reliance on” a comparison of utility rates, costs or tariffs to those of entities not shown to be “comparable.” See Antioch Milling Co. v. Public Serv. Co. of N. Ill., 4 Ill.2d 200, 210 (1954) (holding that evidence on the rates charged by other utilities should be disregarded where the party proffering the evidence failed to show “that the [utilities’] conditions of service were comparable”); Citizens Util. Co. of Ill., Docket No. 94-0481, 1995 WL 612576, *16-20 (Sept. 13, 1995) (declining to rely on a Staff depreciation analysis comparing utility to other utilities, where no showing of comparability to those utilities was made). Thus, AIC asserts that specific operational differences between AIC and Nicor should be considered before applying the Nicor method and tariff provisions. AIC argues that no two storage fields operate in the same manner, stating that their size, geology, weather, proximity to pipelines among other factors make their operation distinct from each other. Yet AIC opines that Staff’s proposals implicitly assume they all operate the same way. Further, AIC avers that no two distribution systems are the same, as pressure, distance from the pipeline, size of the pipe, and end use load characteristics all play a vital part in managing the operations of the systems. AIC argues these differences are not accounted for by Staff. AIC contends that Staff is advocating a one-size-fits all approach to transportation banking for utilities that are not the same “size”, operationally speaking.

AIC states that the evidence shows that Nicor provides service to over two million natural gas customers in a geographic area roughly half the size of AIC’s service territory, which AIC notes serves less than 900,000 customers. AIC asserts that Nicor’s transmission and distribution networks have a much greater degree of interconnection and integration, offering greater flexibility in moving gas across its entire system than AIC’s. AIC indicates that Nicor’s Chicago area service territory is also home to one of the largest natural gas transmission hubs, which is another material difference between the Nicor and AIC systems. AIC states that Staff witness Sackett agreed taking gas from the Chicago hub presented operational difference for customers taking gas in the Chicago area as compared to downstate customers. Further, AIC opines that Nicor owns and operates eight storage fields with an annual capacity of nearly 135 Bcf while AIC owns and operates 12 fields with a capacity of only 25 Bcf.

In contrast, AIC states that six of its smaller storage fields are largely constrained by
the distribution system to serve only a small subset of its gas customers, while many of AIC’s customers are served by distribution systems with no access to any AIC storage field. Further, AIC states that approximately 80% of its supply is provided by two pipelines, Natural Gas Pipeline ("NGPL") and Panhandle Eastern PipeLine Company ("PEPL"), which places AIC at a significant risk if either of these pipelines fail or have significant capacity restrictions. AIC notes that Mr. Sackett agreed the AIC legacy distribution systems were not planned as one system, that each was built to provide service needs in its service areas only, that the systems are not integrated, and that there are captive systems. AIC states these operational differences hamper AIC’s ability to move gas supplies.

AIC asserts that its proposed Rider TBS banking provisions take into account AIC’s own operational circumstances, while Staff has failed to either (1) demonstrate a comparability between AIC’s operations and Nicor’s, or (2) explain why Nicor provisions should nevertheless be applied to AIC despite the differences.

AIC also recommends the Commission reject Staff’s proposal that Rider TBS should be modified to reflect CD withdrawal rights (2.2% of the transportation customer’s bank limit) set for all transportation customers based on their subscribed storage capacity. AIC recommends the Commission maintain CD withdrawal rights as proposed by AIC, which is the level approved by the Commission in the last two AIC rate proceedings. As Mr. Eggers explained, Staff’s proposal provides transportation customers with greater access to banks on a CD than a normal day, which defeats the purpose of declaring a CD. Further, to provide transportation customers these rights on a CD, AIC asserts it would be forced to purchase additional leased storage and pipeline capacity assets at a significant cost to sales customers, as whatever additional resources designated to be used to serve transportation customers must be replaced to continue to serve its sales customers, who were the previous beneficiaries of the transferred resources. Assuming the additional resources would be contracted on PEPL, one of AIC’s largest interstate pipeline suppliers, AIC claims these additional resources would cost approximately $8 million per year.

AIC notes that Mr. Sackett admits the 2.2% CD withdrawal rights works a perverse outcome when applied to his proposed number of bank days, since on a CD, it would allow the transportation customer to take 32% of its bank (2.2% x 15 days), at a time when the system’s operational integrity is at stake. Under this scenario, the sales customers would have the remaining 68%. AIC states that Mr. Sackett admitted, if transportation customers only took 20% and sales customers took 40%, sales customers would be responsible for the costs associated with the difference, since any portion of that bank that is not utilized by transportation customers, gets picked up by sales customers.

AIC asserts that Staff does not dispute that AIC could be required to incur additional cost, but rather claims that it is unknown whether AIC would have to incur costs to obtain additional resources and AIC would need to re-evaluate its peak day portfolio if the Commission ordered them to offer proportional rights on the peak day. AIC notes that Staff
acknowledges that if AIC did require more assets, sales customers would pay less than they currently do for on-system storage and more for off-system assets, but that the net effect is unknown. AIC claims the uncertainty of the cost impacts of Mr. Sackett’s proposal is, by itself, a reason to reject his proposal, citing Abbott Laboratories, Inc. v. Illinois Commerce Comm’n, 289 Ill. App. 3d 705, 712 (1st Dist. 1997), where the Court held that operational integrity of public utility should not be compromised by forcing utility to incur costs to obtain gas as a result of transportation customer actions.

AIC notes that Staff recommends giving transportation customers proportional maximum storage capacity based on adoption of Nicor tariff provisions, which would raise the BSL from AIC’s proposed level of 5.48 Bcf to 8.22 Bcf. AIC asserts this proposal should be rejected, as the bank service limit under AIC’s method is appropriate because the reason for AIC’s BSL is to allow AIC to fill and cycle its on-system storage resources on a consistent schedule that protects the operational integrity of its fields. AIC states that aquifer storage field operations require inventory minimums, and notes that AIC must follow certain injection and withdrawal parameters to maintain the integrity of the storage fields. AIC claims that the 90% fill requirement in Staff’s proposal provides only a minor incentive for transportation customers to fill its bank, as the only penalty is slightly reduced CD withdrawal rights. Since AIC has not called a system wide CD in over 10 years, AIC opines that a transportation customer would have very little incentive to fill their bank to the levels required to maintain the operational characteristics of its storage fields.

AIC states there are two key issues with the tariff aggregate BSL proposed by Staff, the first of which is a system integrity issue. AIC notes that Staff’s proposal grants transportation customers up to 8.22 Bcf of capacity, and since CD rights are a percentage of bank capacity, this automatically places a much larger aggregate obligation to serve CD bank withdrawals. AIC’s proposed BSL is an important limit to this increase to CD obligations. AIC notes the second issue is a stranded asset issue, which risk stems from the variability of CD rights from year to year that is inherent to Staff’s proposal. AIC argues that Staff’s proposal allows transportation customers to elect from very little to 8.22 Bcf of bank capacity, with AIC expecting in years with very good storage economics the entire capacity to be elected, while in with very poor storage economics, capacity of 2 or 3 Bcf might be elected. AIC notes that since CD rights are directly tied to bank capacity elected, the amount of gas that AIC is obligated to plan for will change year to year, which places AIC at risk of acquiring assets to meet its obligations in years with high bank elections that are then stranded in a following year with low bank elections.

While Staff proposes implementing a fall injection target like that used by Nicor Gas, Peoples and North Shore Gas, AIC avers that having a fall injection target is not enough to protect the integrity of storage fields, particularly if the target has very limited consequences if missed. AIC believes that, for its operations, an injection target is meaningless without a withdrawal target. AIC states it will make up any difference from planned injections and withdrawals that result from the actions or inactions of transportation customers with sales
customer activity. Under AIC’s current tariffs, sales customer gas is used to facilitate the necessary injections and withdrawals to maintain field integrity, and therefore AIC requires no bank fill or empty targets under its proposed BSL.

AIC asserts that its daily balancing service effectively utilizes both capacity (bank size) and deliverability, and this flexibility in AIC’s bank service to cover daily imbalances significantly reduces the amount of gas that a transportation customer might have to cashout. AIC states its bank service allows injections in the winter and withdrawals in the summer and provides a 20% balancing tolerance before cashing out. AIC notes any balancing before cashout should be a base rate recovery issue because it is part of the tariff bank service (base rates) and any balancing done by cashout is a PGA recovery issue. Given the cashout premiums paid by transportation customers, AIC claims it is clear that the balancing provided by AIC offers a tangible benefit to transportation customers, and its proposal appropriately allocates costs to transportation customers based on the service provided to them.

AIC notes Staff also takes the position that if the Commission rejects the proposal to link CD withdrawal rights, annual capacity and storage costs to the peak day through the MDCQ, then in lieu of such a tariff change, the Commission should allocate those costs based on 20% of the average historical peak DCN during the past two years. AIC disagrees and contends transportation customers should be allocated costs based on the contracted service level between it and the customer, the MDCQ. AIC states each transportation customer has the right to 20% of DCN on a CD and each customer can nominate their entire MDCQ, which gives each transportation customer the right to 20% of their MDCQ on a CD. AIC states it must plan for the full utilization of the rights it affords to customers and retain assets accordingly, therefore, AIC’s allocation based on MDCQ is appropriate and should be adopted by the Commission. Further, AIC notes that Mr. Sackett’s concern that AIC’s proposal will “drive customers away” from transportation is completely unsupported by any study or analysis on his part, noting that no quantification of the cost differences has been provided, nor has any analysis been done of the impact of differences in costs on the economics of a customer’s decision to take transportation service.

AIC indicates that IIEC has three concerns with AIC’s banking provisions. AIC states that IIEC does not agree with maintaining the 22 times MDCQ allocation following the corrected bank days calculation, rejects AIC’s proposed 10-day BSL and recommends that each transportation customer be allowed to subscribe to a maximum 15 days of storage, and lastly takes issue with AIC’s proposed cost allocation methodology.

AIC notes that it will accept, a maximum of 15 days times MDCQ for an individual customers’ subscribable bank election as Mr. Gorman suggests, provided the 10 day BSL is not exceeded. For the reasons discussed above with respect to Staff’s position, AIC notes it supports the BSL at 5.482 Bcf which is based on 10 days of bank, and recommends the Commission adopt this position. AIC also recommends that the Commission reject IIEC’s
position on the proposed cost allocation methodology, claiming that AIC’s proposal is reasonable and should be adopted.

AIC indicates that IIEC appears to find this revised proposal more acceptable; however IIEC continues to oppose any aggregate limit on transportation customers’ storage capacity. While IIEC asserts that AIC has not demonstrated or claimed any inability to meet the 15 day limit, AIC contends that it has shown that raising the BSL would pose system integrity and stranded asset concerns. IIEC does not address these concerns.

AIC states that Staff witness Jones recommended that the formula to calculate the Unsubscribed Bank Capacity Charge ("UBCC") and language providing for an annual reconciliation be included in Rider S – System Gas Service. AIC accepted the recommendations to include the formula to calculate the UBCC and language that provides for an annual reconciliation in a section that AIC added to Rider S – System Gas Service regarding its proposed UBCC.

AIC suggests the disputes between Staff, IIEC, and AIC over transportation banking provisions are rooted in complex issues of gas storage operation, transportation customer behavior, and accounting, however, the choice is simply whether the Commission favors increasing the rights of transportation customers at the expense of sales customers. AIC suggests the Commission either agrees that sales customers’ costs and benefits should be at risk or they should not.

AIC indicates that Staff’s Initial Brief acknowledges the policy choice presented between transportation customers and sales customers, noting that the expansion of transportation customer rights would have an impact on sales customers. AIC notes that with respect to CD withdrawal rights, Staff witness Sackett admitted that AIC might have to add more capacity to make that capacity available to transportation customers on a CD, and that sales customers would pick up the tab for any expansions to off-system storage and capacity. AIC suggests that this also raises a cost causation issue, if granting rights to transportation customers is imposing costs on sales customers, why are transportation customers not paying those costs. Given that sales customers include mostly residential and other small customers, it is AIC’s position that the Commission, as a policy matter, should not impose costs on the sales customers when they are not responsible for those costs and where other options are available.

AIC notes that Staff in its Initial Brief asserts AIC has not proven that AIC and Nicor are sufficiently operationally different to make the Nicor method inappropriate to apply to AIC, however AIC asserts it is Staff’s burden on this issue, as proponents of the modifications that would impose Nicor tariff provisions on AIC, citing Citizens Util. Co. of Ill., Docket No. 94-0481, 1995 WL 612576, *16-20 (Sept. 13, 1995). AIC argues Staff has not even attempted to prove comparability between Nicor and AIC, while AIC has shown the differences between the two systems are significant.
While Staff acknowledges that operational differences exist between AIC’s Rate Zones, as they do between AIC and Nicor, Staff notes that AIC has proposed uniform banking provisions across its Rate Zones. AIC indicates that now that AIC has merged, and is moving to operate in an integrated manner, for example by establishing a single PGA, it is appropriate for AIC to have uniform banking provisions. Further, AIC avers that Staff’s assertion does not answer the question why, even if AIC does have operational differences between Rate Zones, Nicor tariff provisions are appropriate for some or all of AIC’s Rate Zones.

While Staff also asserts that AIC is ignoring the concept of gas displacement, AIC contends that Staff’s use of the concept of displacement is wrong and not how the concept is usually applied. AIC states that gas deliveries utilizing the principle of displacement are typically of equal volumes over a short period of time. AIC alleges Staff improperly extends this concept to seasonal withdrawal quantities over many months, applying the displacement concept in its simplest form—10 units in, 10 units out.

In addition, even accepting that sales and transportation gas are mixed in on-system storage due to displacement, AIC opines there is the problem of withdrawing gas from storage fields without transportation customers withdrawing from their banks. AIC notes that its transportation customers will withdraw from their banks when it is economically beneficial to do so, while they will not withdraw when it is not economical. If sales customer’s gas must be used to withdraw when transportation customers do not, AIC indicates the sales customer group will be forced to withdraw gas when uneconomical.

Regarding cost allocation, AIC notes that Staff in its Initial Brief claims, absent any credible evidentiary support, that AIC’s proposal would allocate a significant portion of costs to the first day of bank, which Staff asserts is a problem because it might cause some GDS-4 customers to select no bank or cause some smaller customers to go back to sales service. AIC asserts that Staff does not explain why allocation of costs to the first day of bank is improper if that is in fact reflective of cost causation, while AIC notes it assigns the costs for the first day of bank because it affords peak day access. AIC opines it also incurs costs related to providing balancing provisions afforded by electing a bank, and as there is a cost to make the banking service available that AIC incurs no matter the bank size, allocating costs to the first day of bank is appropriate. While Staff is also critical of what it sees as a mismatch between tariff rights based on DCN and charges based on MDCQ, AIC alleges Staff ignores a fundamental point, which is that charges must be based on MDCQ, even if tariff peak day’s rights are based on DCN. Because there is a cost incurred in simply making the system (in this case in the form of peak day access rights) available, AIC indicates it is appropriate to allocate transportation charges on the basis of MDCQ.

With respect to interim rates, in effect between the conclusion of this case and the effective date of Rider TBS of May 1, 2012, AIC notes it proposes to use the Equitable Method based on existing transportation customer MDCQs on November 1, 2010. Although
Staff believes that interim base rates should be determined in the manner that the Commission ordered in the previous rate case for those three months, AIC views that allocation as inappropriate. AIC states that other rates become effective on the date of the Commission’s orders, therefore AIC recommends its proposed storage cost rates take effect with the order in this case.

AIC notes that IIEC also takes issue with the use of the Equitable Method, claiming this method is primarily used by FERC to allocate costs between pipeline contract storage service customers and transportation customers, and not for the allocation of storage costs between two groups of customers such as Sales and Transportation customers. AIC asserts, however, that the Equitable Method is appropriate for use in the allocation of costs for any storage field, regardless of regulatory domain, and is appropriate here considering the balancing service andelectable capacity offered as part of the proposed banking provisions. Since deliverability and capacity are not functionally tied in AIC’s banking service, AIC claims these two features need to have costs allocated separately. AIC asserts the Equitable Method is an allocation method that appropriately allocates costs to both the deliverability component and the capacity component.

While IIEC also argues the Equitable Method AIC proposes to use overstates both the “maximum” and the “probable” deliverability used by transportation customers on a peak day, AIC asserts that its customers should pay for the service they have available to them. AIC notes that IIEC is incorrect when it claims daily balancing transportation customers cannot withdraw 20% of their MDCQ and monthly balanced Transportation customers cannot withdraw 50% of their MDCQ on a peak day. AIC states that a daily balanced customer can nominate their entire MDCQ, and if they were to use more than their MDCQ, they would have access to up to 20% of their MDCQ from their banks, while monthly balanced customers can use up to 50% of their MDCQ on a CD. In fact, AIC claims it must deliver volumes in excess of the 20% of DCN if the customer elects to under-deliver and purchase gas from the sales customers, so the true physical access to the system on any day is greater than 20% MDCQ for Daily balanced customers and 50% for Monthly balanced customers.

b. Staff Position

Staff notes that AIC’s customers all take service under either Rider S or Rider T, with Rider S customers purchasing gas commodity exclusively from AIC at the PGA price each month and are referred to as sales customers, while Rider T customers purchase gas commodity from suppliers and are referred to as transportation customers. Staff states that transportation customers nominate their pipeline deliveries separately from the utility, which is the agent for sales customers, and can balance their deliveries against their usage by injecting excess deliveries into a “bank” and withdrawing their gas from the bank when deliveries are less than usage.
During AIC’s last two rate cases, Staff indicates that transportation service has taken its current form under Rider T. Staff states that one issue that it raised in the 2009 rate case concerned the level of access that transportation customers had to AIC’s on-system storage. In particular, Staff argued that it should be proportional to system storage capacity, and although the Commission declined to make any changes in that docket, ordered that AIC and Staff participate in a workshop process. Staff states the Commission also required that AIC provide tariffs implementing either the Nicor or Peoples method.

Staff notes that AIC indicated it preferred the Nicor banking provisions rather than those of Peoples and North Shore Gas. Staff claims the Nicor method has three integrated features: subscribable peak day storage withdrawal rights, seasonal storage, and storage costs. Staff states these are based on the proportion of gas that can be delivered from storage on a design day, the most extreme temperature day that the utility plans for, and the expected use on that day of all customers, both sales and transportation. Staff avers transportation customers as a group are able to subscribe to peak day storage withdrawal rights up to the ratio of the sum of their total maximum daily contract quantities to the design day total usage. Staff notes the seasonal storage for a customer is set to provide the same proportion of the total seasonal storage as the proportion of deliverability the customer receives from storage on a peak day, with storage costs recovered through a charge on storage capacity.

Staff states that AIC opposes the premise of proportional storage rights. Staff asserts that AIC has historically opposed any banks for transportation customers, and in 2007 proposed to eliminate the banks of its legacy transportation customers and to implement a transportation service devoid of banks. Staff argues that AIC’s basic view of transportation customers as second-class customers without any inherent rights to storage is evident from AIC’s continued resistance to equitable access to peak day deliverability and seasonal storage capacity.

Staff asserts that AIC currently provides rights that are below the proportional level, and notes the expansion of these rights would have an impact on sales customers. Staff notes the question is whether such impacts are fair and appropriate given the current state of affairs, indicating that AIC’s portfolio is likely going to have to adjust under either the Companies’ or Staff’s proposal based on the amount of maximum storage capacity selected by transportation customers as a group.

While AIC charges that Staff has not established that AIC’s system is “operationally comparable” to that of Nicor Gas, Staff complains that AIC never defines this concept on the record nor proves that the two systems are sufficiently different as to make the Nicor method inappropriate for AIC’s systems. In surrebuttal, Staff states that AIC describes system differences that it believes distinguishes it from Nicor Gas; however Staff notes some of these same differences exist between the three Rate Zones, yet AIC has proposed uniform maximum storage capacity and uniform CD withdrawal rights across the Rate Zones. While
AIC complains that Staff’s proposal to apply the Nicor method to AIC’s system as a “one-size-fits-all” method, Staff argues its proposal to apply the Nicor method to AIC is “AIC-specific.”

Staff states that AIC proposes a uniform average bank level for all three Rate Zones even though the storage in those systems differ considerably. Under AIC’s surrebuttal position, storage of up to 15 days for individual customers is available regardless of where on the system the customer is located, including customers on captive systems, therefore Staff argues that AIC’s own proposal indicates that AIC’s system is more robust than it suggests by arguing it is not operationally comparable with Nicor’s system.

Staff also complains that several of AIC’s arguments ignore the gas operational concept of displacement, which is defined by the American Gas Association (“AGA”) as “Displacement transactions permit the lateral movement of gas through a transportation network. The configuration of many pipelines is such that it may not be apparent whether a given movement of gas is forward or backward from the point of receipt. It can be argued that all transportation service is performed by displacement as the physical delivery of the same molecules of gas is impossible.”

Staff notes that AIC reflects a willingness in its arguments to ignore displacements, including in its treatment of specific gas in specific assets as belonging to a specific class of customers. While AIC claims that devoting 32% of the working capacity of a storage field to a customer group that may choose not to withdraw during the winter season presents significant operational difficulties, Staff suggests AIC implies that transportation customers “control” those assets.

While AIC claims that on-system storage capacity is “devoted” to transportation customers, Staff states this contradicts an earlier statement that only sales gas goes into those fields. Staff asserts that AIC states that it currently fills on-system storage with sales customers’ gas and puts transportation customers’ gas in banks elsewhere within the system, although Staff claims this is just an accounting convention rather than a physical fact, noting that AIC witness Eggers explained that AIC’s current storage resources provide transportation customers the option to bank as they see fit within the 10 day 5.482 Bcf of BSL.

Although AIC avers that the amount of maximum storage capacity that Staff has proposed to allocate to transportation customers as a percentage of on-system assets is large enough that it would create significant operational issues, Staff claims that since transportation customers do not really control gas in on-system assets, this is really not an issue.

Staff states that under the Nicor method, transportation customers are able to select the amount of storage capacity from any level from one times MDCQ to the maximum amount determined. Staff indicates that customers are not able to select no bank, and this
subscribable feature enables transportation customers to choose the amount of storage that best suits their needs.

Staff witness Sackett also explains that charges are based on the total cost of storage per unit of storage capacity, and to determine the storage charges, the total cost of on-system storage is divided by the capacity of that storage. Staff notes that a transportation customer’s charges for storage equal the customer’s Bank Limit multiplied by the storage charge.

Staff states that AIC asserts that such an expansion of rights would force AIC to purchase additional storage capacity, and that Staff’s proposal grants transportation customers more deliverability from storage on a CD than on a non-CD. Staff responded to these arguments by pointing out that AIC’s current tariffs provide sales customers with a disproportionate peak day access to its storage assets, and Staff claims correcting this distortion allows transportation customers their fair share of those assets while requiring them to pay proportionally for them.

Staff avers that AIC can also increase its peak day resources if necessary, noting that AIC originally proposed to eliminate at least one off-system storage asset from its portfolio. Staff notes that AIC has proposed to retain at least some of these assets because of Staff’s proposal to give transportation customers equal rights to storage as sales customers. Since each asset has both maximum storage capacity and peak day deliverability components to it, Staff states AIC was planning on releasing both peak day deliverability and maximum storage capacity.

Staff states that AIC proposes to provide an unbundled storage bank for transportation customers under a new service called Rider TBS, under which AIC proposes to only guarantee 10 days of bank to its customers as a group. Staff notes that AIC indicates that because many transportation customers do not fully utilize their banks (i.e., they do not completely fill their banks), it can offer, but not guarantee, individual customers more than 10 days, using an iterative process to reallocate capacity from transportation customers desiring less than ten days bank to those desiring more than ten days while ensuring that the demand for bank in aggregate does not exceed 10 days.

Staff notes that under AIC’s proposal, daily balanced customers (GDS-4 and GDS-5 customers that are large enough to be on GDS-4) can choose between 0 and 15 days, in whole day increments; monthly balanced customers (GDS-2, GDS-3, and GDS-5 customers that are not large enough to be on GDS-4) can choose from between 5 and 15 days, in whole day increments. Staff states that AIC asserts that monthly balanced customers must, by definition, use storage assets to stay in balance, so they should be required to pay for at least 5 days.

AIC recommends that the restrictions on the ability to inject and withdraw gas from
banks be maintained at the current levels; except that during the summer, customers are able to inject somewhat more gas than previously allowed, and Staff agrees with AIC’s proposal for Rider TBS including a subscribable bank and the increased injection rights during the summer, but disagrees with AIC on the total size of that bank available to transportation customers.

Staff notes that the current peak day withdrawal rights, which are independent of the bank capacity, were determined in AIC’s 2007 rate case, and were originally proposed by Staff in response to AIC’s proposal to eliminate all bank and any associated peak day withdrawal rights. Staff states it did not attempt to make the withdrawal rights proportional to Sales customers’ withdrawal rights at that time. In its 2009 rate case, AIC proposed to recover storage costs from all transportation customers based on the peak-day withdrawal rights of daily-balanced customers, and because AIC did not propose to recover the costs for monthly-balanced customers based on their relatively liberal withdrawal rights, Staff indicates there was no need to correct this discrepancy until the present case.

Staff opines that under the Nicor method, the system peak day deliverability is divided by the Peak Design Day, because if the Local Distribution Company (“LDC”) is able to deliver a certain percentage of its Peak Design Day from its on-system storage, then all the customer groups and individual customers should be able to deliver that same percentage from their portion of that storage. Using the Nicor method, Staff notes AIC’s peak day deliverability of total on-system storage of 558,759 Dth should be divided by its on-system storage capacity of 25,765,200 Dth. This results in CD withdrawal rights of 2.2% of the transportation customer’s Bank Limit, which Staff recommends that the Commission approve in this case.

Staff states that AIC proposes in Rider TBS to limit transportation customers as a group to a BSL, which AIC defines as the MDCQ of all Rider T customers as of November 1, 2010, multiplied by 10, or 5.48 Bcf. Staff notes this level is less than the proportional level determined under the Nicor method. Staff supports the application of the Nicor method to this aspect of operational parameters. This results in the allocation of 15 days of bank to transportation customers.

Staff notes that AIC claims that Staff has not demonstrated that this peak day deliverability allocator is appropriate for dividing maximum storage capacity, because it is not operationally linked to that maximum storage capacity, and suggests other divisors might be more appropriate, such as “actual usage on a peak day divided by total storage capacity,” “the ratio of winter transportation customer throughput over total winter throughput,” and “maximum coincident banked volumes of transportation customers in the winter(s) prior to the proceeding to gauge what they are actually using.” Staff avers that Peoples and North Shore have both proposed to now use the same peak day allocator (peak day demand) in their current rate case (Docket Nos. 11-0281 and 11-0282 (Cons.)), and neither Peoples, North Shore, or Nicor have indicated the need for an “operational link” for their allocator and
have been able to operate their systems competently.

Staff suggests that using relative peak day demand makes sense as it is the only Commission-approved method for proportional capacity allocation, and AIC uses relative peak day demand to allocate banks to individual transportation customers. Since AIC itself has used this method for allocating banks amongst transportation customers for decades, Staff suggests it is only logical to use this divisor to allocate proportional annual capacity.

Consistent with the Nicor approach, Staff proposes that the BSL be set at 8.22 Bcf, which is equivalent to 15 days of bank, as well as a single fall injection target, like the one used by Nicor, as appropriate for AIC’s transportation customers. Staff suggests this target should be set at the average maximum level that AIC has filled its on-system storage for the past five years.

AIC states that if it were to give proportional storage rights, this would require “some measure of cycling requirements,” however Staff suggests that because of displacement, all gas can be cycled from the fields even if transportation customers do not withdraw it from their banks. Staff notes one option to provide AIC with a tool to handle the 15 day bank allocation to transportation customers is to implement a fall target in this docket, and if this target is not effective, AIC has the option of filing a 45-day filing or correcting it in the next rate case.

Even if the total storage capacity of individual customers or transportation customers as a group is limited by the Commission to AIC’s proposed BSL of 5.2 Bcf, Staff argues the storage cost allocation and peak day rights determined under the Nicor method are still relevant, and the Nicor method of tying the peak day withdrawal and total bank capacity level to a lower BSL is still appropriate.

In direct testimony, Staff witness Jones recommended changes to the language in AIC’s proposed Rider TBS predicated on a BSL that could change annually. Staff notes the recommended changes included deleting the size of the BSL from the definition of the BSL and replacing the specific rates in Rider TBS with the formulas for calculating the rates approved by the Commission. AIC clarified that AIC’s position is that the BSL will be fixed between rate proceedings. If the TBS approved by the Commission is structured such that the BSL and its attendant rates remain fixed between rate proceedings, Staff states Ms. Jones’ recommended changes will not be necessary; however, if the Commission approves a TBS such that the BSL and its attendant rates would fluctuate between rate proceedings, Ms. Jones’ recommended changes should also be approved.

To set rates for storage, Staff indicates that AIC proposes what it calls the Equitable Method, which uses one of the FERC approaches to rate-setting for storage services. Staff notes this method assesses 50% of fixed costs to total storage capacity and 50% to peak day delivery rights. AIC states its current cost allocation is based on the percentage
obtained by dividing 20% of the highest daily aggregate nomination of Rider T customers by the peak daily deliverability of AIC’s system storage fields. Staff notes this method is not appropriate when the customer’s maximum storage quantity varies based on the customer’s choice.

While AIC’s proposal for the cost recovery of underground storage costs is an attempt to relate the customer’s storage charges to the amount of bank chosen, Staff asserts that the Nicor method proposed by Staff obviates the need for separate charges for the peak day delivery and maximum seasonal capacity as the two are tied and proportional to each other.

Staff avers that AIC’s method would allocate a significant portion of costs to the first day of bank, which could result in negative impacts. Staff alleges that one possible impact could be to drive at some GDS-4 customers, who had that option, to select no bank in order to avoid the high initial bank charges, noting that AIC has already stated that it does not expect electric generators to purchase banks at all because they seldom use the ones they currently have. Another concern Staff has is that AIC’s cost allocation proposal, when combined with AIC’s proposed requirement for monthly-balanced customers to subscribe to at least 5 days of bank, could drive some of these smaller customers back to sales service, which would reduce the benefits now enjoyed under Transportation service. Staff indicates this migration would be based on the fact that transportation service would no longer be economical. Staff notes that Ameren Ex. 34.1 confirms that AIC’s method allocates at least 50% of the costs to the first day of bank and, therefore, supports Staff’s contention that, all other things being equal, if the amount of the additional storage cost allocated to the peak day component exceeds a customer’s benefit from transportation service, then that customer will exercise the option to return to sales service. Staff opines that storage costs should reflect the cost of services and not the extra benefit received. While AIC claims that it incurs higher costs in balancing monthly-balanced customers, Staff indicates it has not shown that this is the case.

Staff states that in the 2007 rate case, the Commission ordered AIC to institute a system-wide monthly-balanced transportation service directed at smaller volume transportation customers, and since that time, transportation service to GDS-2 and GDS-3 customers has grown from about 1,100 customers to about 2,100 customers currently. Staff asserts this growth reflects the appeal of this monthly-balanced program and its tariff parameters, however the significant increase in the storage costs allocated to monthly-balanced customers may arbitrarily make transportation service uneconomical for smaller customers.

Staff notes that AIC proposes to use two charges instead of a single charge that links deliverability and maximum storage capacity, as is done by all of the other major gas utilities in this state. While AIC sees this Nicor method charge as a charge per therm of maximum storage capacity, Staff avers this single charge is equally a charge per therm of CD deliverability. Staff’s proposal to use the Nicor method, which recognizes the linkage
between seasonal capacity and the ability to deliver a volume of gas on the peak day deliverability, links the two mathematically.

Staff witness Sackett calculated this charge by dividing the on-system storage costs of $32,485,580 by the annual capacity of on-system storage of 25,765,200 Dth, which results in an annual per Dth of Bank Limit charge of $1.26, an annual per therm of Bank Limit charge of $0.126 and a monthly charge of $0.0105 per therm of Bank Limit. Staff asserts that doubling the proposed capacity charge and linking the CD withdrawal right with the storage capacity eliminates the need for a separate capacity-based portion of that charge. Because of the high percentage of storage costs allocated to the first day of bank under AIC’s proposal, if the Commission approves a dual charge for these storage costs, Staff recommends that the rights of monthly-balanced customers would need to be reduced to prevent them from being priced out of transportation service.

Additionally, if the Commission approves a dual charge for these storage costs, Staff recommends that the charges for daily-balanced customers should be based on the CD withdrawal rights which remain at 20% of DCN as opposed to the 20% of MDCQ that AIC proposes. Staff claims the Commission already decided that DCN is the appropriate parameter in AIC’s last rate case because that is the tariffed withdrawal rights.

Staff notes that in its last two rate cases, AIC has sought to charge daily-balanced transportation customers for more than their tariffed peak day withdrawal rights on a CD. Staff suggests if AIC wants to charge storage costs based on MDCQ, then it should rewrite its tariff to allow its daily-balanced customers to withdraw up to 20% of MDCQ. Instead, Staff indicates AIC proposes to allocate costs based on MDCQ but to allocate CD withdrawal rights based on DCN, noting that AIC has provided no more convincing argument in this case than it did in the last and the Commission should reject their proposal again.

Staff states that AIC has provided the data from its historical peak days for the past 5 years, which shows that the average DCN for each historical peak is less than 43%. Staff witness Sackett asserts that this evidence confirms that on noncritical historic peak days, transportation customers as a group have been nominating far less than their MDCQs, and any attempt to allocate costs to them based on MDCQs will over allocate storage costs to them.

If the Commission rejects Staff’s proposal to link CD withdrawal rights, annual capacity, and storage costs to the peak day through the MDCQ, then in lieu of such a tariff change, Staff recommends that the Commission allocate those costs based on 20% of the average historical peak DCN during the past two years, 43% of their MDCQ. Staff states daily-balanced transportation customers historically had access to only 9% of MDCQ, and it would be appropriate to use this amount for the interim period for all transportation customers, and, after Rider TBS becomes effective, for daily-balanced customers.
Additionally, Staff asserts that AIC’s equitable method using the MDCQ should be rejected because it is internally inconsistent. Staff notes that AIC has claimed that it plans for a peak day using the 20% of MDCQ number for daily-balanced customers. Thus, AIC plans for bank withdrawals at 20% of MDCQ, would charge those customers based on 20% of MDCQ, but only gives tariff rights at 20% of DCN, a number that Staff has shown is historically only 9% of MDCQ.

Staff notes it does support AIC’s proposal to require monthly-balanced customers to select at least five days of bank, but believes that this issue should be re-evaluated in the next rate case.

Staff states that AIC plans for Rider TBS to go into effect on May 1, 2012, however prior to that date, the interim base rates that are to go into effect are not determined in the manner that the Commission ordered in Docket Nos. 09-0306 et al. (Cons.). Staff avers that Mr. Eggers addresses interim rates in surrebuttal testimony and claims that AIC applied the “equitable method” for that period using MDCQs instead of DCNs (and presumably a full 10 days of bank).

Staff alleges that interim base rates should be determined in the manner that the Commission ordered in the previous rate case for those three months, i.e. allocate storage costs to all transportation customers based on 20% of DCN. In addition to the reasons stated above, Staff believes that this is also appropriate for those three months until the new rider TBS becomes effective because the tariff rights will not have changed and the Commission’s current ruling is still appropriate. Staff states this ensures that there is no three month gap in which costs spike before more reasonable rates discussed here are implemented. Staff indicates the charges should reflect the storage costs determined in this case, but the method should remain fixed until Rider TBS becomes effective.

While AIC maintains that it is not operationally comparable to Nicor and that Staff did not show that the two are operationally comparable, relying on the Antioch Milling Co. case to argue it is Staff’s burden to show operational comparability, Staff opines that the reliance on this decision ignores the fact that the Commission required AIC and Staff to participate in a workshop process which was to, at a minimum, result in tariffs implementing for AIC the banking provisions currently employed by Nicor, Peoples, or North Shore. Staff argues the Commission has already determined that the operations are comparable, and while the Commission made it clear AIC could raise its concerns about adopting the banking provisions and could propose alternatives, Staff asserts AIC bears the burden of demonstrating what changes to those methods are operationally necessary. To the extent AIC raised concerns about specific operational differences between AIC and Nicor, Staff argues it has demonstrated that they do not affect AIC’s ability to implement Staff’s proposed changes. Staff notes that AIC proposed uniform transportation tariff provisions in its last two rate cases. While AIC asserts there are operational differences between its fields, Staff opines AIC apparently finds these differences insignificant when it wants to work with them.
Although AIC also asserts that Staff is proposing numerous Nicor transportation tariff provisions to be imposed on AIC, Staff claims only two changes are proposed, the linked maximum storage capacity and CD withdrawal method, each adjusted to reflect the physical attributes of AIC’s system.

While AIC argues in its Initial Brief that its proposed Rider TBS banking provisions account for its own operational circumstances, Staff believes AIC cannot take credit for Rider TBS’s proposed maximum storage capacity and peak day deliverability because it is levels for both that the Commission ordered it to provide under Rider T in AIC’s 2007 rate case. Staff notes that AIC customers responded to those provisions and elected to take transportation service, with AIC responding to this migration as needed and experiencing no operational difficulties. Staff asserts that just because the system works with the current levels does not mean that it cannot be expanded and the process repeated.

Staff notes that AIC also objects to having to buy more off-system assets to allow transportation customers proportional storage rights, claiming that this results in significant cost to sales customers. In Staff’s view, the proportional storage rights are appropriate and transportation and sales customers should share the cost. Staff urges the Commission to require AIC to provide transportation customers a proportional amount of the on-system capacity, claiming that sales customers would still pay for and receive a proportional amount (68%) of the on-system deliverability and 100% of the off-system deliverability. While AIC argues that Staff’s proposal will increase costs to sales customers, Staff indicates that such a result is not certain. If transportation customers take less capacity than they have currently, Staff believes AIC may actually be able to reduce their off-system assets under Staff’s proposal because, unlike AIC’s proposal, a decision to reduce banks will result in lower peak day rights.

Further, AIC has made the case that its expectation is that transportation customers as a group will decrease their bank usage relative to current 10-day banks. AIC provided two reasons for this expectation. First, transportation customers’ current maximum inventory is significantly less than the full 10 days. Second, AIC witness Eggers estimated a negative price hedge value for storage. Staff has provided two additional reasons to expect a reduction in transportation customers subscribed bank size. First, since costs under both Staff and AIC’s proposals would be tied directly to the amount of storage, transportation customers are unlikely to keep capacity that they do not use. Second, Staff’s fall injection target would require customers to fill their subscribed storage. Taken together, it is unlikely that transportation customers would subscribe to as much bank as they currently have.

Finally, capacity needed for monthly balanced customers would also be lower under
Staff’s proposal than AIC’s, since peak day withdrawal rights for monthly-balanced customers would be lower. Thus, it is likely that Staff’s proposal will reduce peak day needs for the system.

While AIC claims in its Initial Brief that the uncertainty of cost impacts is a reason to reject Staff’s proposal, Staff avers that AIC is currently over-planning for the peak day because it has secured sufficient deliverability to cover transportation customers’ bank withdrawals at a level in excess of the level allowed by the tariff. As Staff noted in its Initial Brief, over-planning for the peak day raises costs for sales customers. Staff opines that AIC has not demonstrated that Staff’s recommended change to CD withdrawal rights will affect AIC’s operational integrity.

While AIC asserts in its Initial Brief that giving transportation customers a large percentage of on-system assets would be destabilizing to its system, Staff suggests this is incorrect. Staff states that AIC incorrectly states that under Staff’s proposal a transportation customer could take 32% of its bank, however this is not correct. Staff indicates that under its proposal, a transportation customer can take 2.2% of its bank, which is 32% of its MDCQ, therefore the amount calculated by AIC is greatly overstated.

Staff also disagrees with AIC’s claim that other utilities require fall and spring cycling targets, noting that Nicor, Peoples, and North Shore all have a single fall injection target. Staff suggests the Commission specifically rejected a spring target in Peoples and North Shores 2007 rate case, Docket Nos. 07-0241 and 07-0242 (Cons.).

Staff notes that AIC proposes to recover the costs associated with unsubscribed bank capacity from sales customers through a charge called the UBCC in Rider S, as AIC states that a necessary element of the unbundled balancing service is an annual cost allocation to Rider T Customers of only the amount of bank capacity for which they subscribe. AIC contends these costs should be borne by sales customers because they are “the beneficiaries of the unsubscribed bank capacity.”

Staff agrees that a cost mechanism is necessary to support this level of bank flexibility for transportation customers, and notes that the Commission has approved a similar mechanism in Nicor’s Rider 5 – Storage Service Cost Recovery (“SSCR”). Staff therefore recommends that the Commission approve the UBCC. If AIC’s proposed addition of the UBCC to Rider S is allowed by the Commission, Staff witness Jones recommends that a formula to calculate the UBCC and language providing for an annual reconciliation be included in Rider S, as shown in Staff Ex. 6.0 at 12-14. Staff also notes that AIC agrees with this language.
c. IIEC Position

IIEC states that AIC proposes to allocate storage capacity to the "Large Volume Transportation Customers" using what is commonly known as the Nicor method. IIEC indicates that in rebuttal AIC acknowledged that the Nicor method properly applied, resulted in the allocation of 15 days of MDCQ to each transportation customer. IIEC notes this means that transportation customers would be allocated 15 days times their MDCQ of storage capacity under the Nicor method. IIEC accepts the recalculation and recommends that each Transportation customer be permitted to subscribe up to a maximum of 15 days of storage consistent with the Nicor method. IIEC recommended that this limit apply to both individual and aggregate allocations of storage to transportation. In its surrebuttal testimony, IIEC notes AIC accepted the maximum of fifteen times MDCQ for individual transportation customers’ and agreed that any unsubscribed storage capacity would be available for customers desiring more than 15 days of capacity.

However, IIEC indicates AIC still proposes an aggregate limit (the BSL) on transportation storage capacity equal to ten days or 5.482 Bcf, which IIEC notes is substantially less than the proportional share of AIC’s on-systems storage that would be allocated to transportation customers as a whole under the Nicor method. IIEC notes that AIC’s concerns on the aggregate storage limit were not eliminated with the corrected 15-day individual limit. IIEC indicates that under the Nicor method, transportation customers should be allocated 8.22 Bcf of AIC’s on-system storage, which AIC limits 5.48 Bcf, based on its 10 day aggregate limit.

IIEC notes that despite AIC’s proposal to strictly impose the 10-day aggregate limit, AIC indicates that transportation customers are not currently using their existing 10-day bank allowance and are unlikely to subscribe to the aggregate 10-day limit under the proposed program. IIEC indicates AIC has not demonstrated or claimed any inability to meet the 15-day limit. IIEC suggests that AIC’s approach is inconsistent with the Nicor method and has the potential to prevent transportation customers from subscribing to the maximum of 15 days of storage AIC proposes to establish as the individual customer storage limit and has not been shown to be a necessary limitation.

Therefore, while IIEC agrees with the AIC maximum individual customer storage limit of 15 days times MDCQ, and the opportunity for customers to subscribe to more than 15 days of storage if storage capacity is available, it disagrees with the 10-day aggregate storage limit and recommends the Commission reject the same.

IIEC indicates that AIC proposes the use of the so-called Equitable Method to allocate storage costs for Rider TBS between sales and transportation customers. Under that method, 50% of the storage costs are allocated between sales and transportation customers on the basis of deliverability and 50% on the basis of capacity. IIEC states there are several reasons for the Commission to reject the use of the Equitable Method for the allocation of
costs between sales and transportation customers in this case.

IIEC indicates that the Equitable Method is a method that is primarily used by the FERC to allocate costs between pipeline contract storage service customers and transportation customers, and is not used for the allocation of storage costs between two groups of customers such as sales and transportation customers. IIEC alleges it is used for allocation of storage to customer groups with a limited service relationship to the regulated provider. Unlike pipeline contract storage customers, IIEC notes that AIC’s sales and transportation customers have a current and historic end-use customer relationship to AIC in this case, purchasing multiple services from AIC, and have contributed to the rate base for AIC’s gas operations, including its storage assets.

IIEC notes the service purchased by contract storage customers from the pipeline is, in fact, a full storage service providing the customer with all the benefits of storage, such as peak day deliverability, hedging capability, and balancing capability. In this case IIEC alleges AIC is offering transportation customers an unbundled balancing service which does not provide AIC’s transportation customers with all of the benefits of storage.

IIEC states the Equitable Method also fails to reflect the way in which storage capacity itself is allocated to transportation customers by AIC, noting that AIC allocates storage capacity on the basis of the customer’s MDCQ and the associated costs should be allocated accordingly. IIEC indicates that otherwise, the cost allocation will not reflect cost causation. IIEC alleges that use of the Equitable Method results in a departure from cost-based rates because it allocates a portion of costs on assumed levels of peak day deliverability rather than on the MDCQ factor used to allocate the capacity. IIEC indicates the Commission has approved the use of the MDCQ as a means of subscription to storage or allocation of storage for other Illinois utilities, including for Nicor in Docket No. 08-0363.

IIEC argues that for these reasons, the Equitable Method should be rejected for use in allocating storage costs to Sales and Transportation customers in this case. In addition, IIEC urges the Commission to not use the AIC version of the Equitable Method in any case because it overstates both the “maximum” and the “probable” deliverability used by Transportation customers on a peak day, noting that the AIC calculation of the deliverability allocation uses 50% of all monthly balanced customers’ MDCQ and 20% of all daily balanced customers’ MDCQ.

IIEC asserts that the AIC version of the Equitable Method incorrectly calculates the “maximum” because daily balancing Transportation customers cannot withdraw 20% of their MDCQ and monthly balanced Transportation customers cannot withdraw 50% of their MDCQ on a peak day, as assumed by AIC. Furthermore, once a daily balanced customer has used the amount of gas specified in its daily nomination, IIEC indicates the next 20% of its usage will be considered a withdrawal from storage. IIEC states additional usage beyond the 20% is cashed out according to AIC’s cash-out schedule. IIEC opines that a customer’s
maximum possible storage deliverability is 20% of the customer’s peak day DCN (which cannot exceed, and is typically much less than, the customer’s MDCQ), noting the same problem arises for monthly balanced customers.

IIEC alleges that AIC has overstated the probable deliverability from storage used by Transportation customers, noting that there are important differences in FERC’s application of the Equitable Method and the AIC application. Under the FERC application, IIEC states the contract user acquires all the benefits of storage through its purchase of storage capacity from the pipeline. Therefore, IIEC indicates it is probable that such a customer’s maximum use on a peak day will be the maximum use allowed under the contract.

However, IIEC states a transportation customer on the AIC system is purchasing a balancing service. IIEC argues the customer’s peak day storage deliverability will be a function of the customer’s imbalance on that day, and it is not a function of the customer’s desire to use storage gas, in lieu of flowing gas supplies, to avoid high cost gas purchases. Under such circumstances, IIEC asserts the appropriate measure of deliverability is not simply the sum of every customer’s maximum peak day withdrawals, but rather the probable maximum withdrawals on peak days.

In making such a calculation of probable deliverability, IIEC claims one must consider transportation customer diversity, in that consideration should be given to the fact that some customers may over-deliver gas and thus may actually be injecting gas into storage, while other customers may under-deliver gas and thus be making withdrawals from storage. Since under-deliveries may be offset by over-deliveries, IIEC notes the calculation of probable peak day deliverability is an empirical question, not just a matter of calculating the maximum possible withdrawals that could possibly occur, however AIC has not made such an empirical calculation in this case.

Because AIC has overstated both the probable and maximum deliverability used by Transportation customers, IIEC states the results of its calculations do not support use of the Equitable Method. IIEC recommends the Commission reject the use of the Equitable Method and instead allocate storage costs to Transportation customers on the basis of capacity. IIEC has calculated the appropriate storage costs and unbundled bank charges using a capacity allocation of storage costs. Specifically, IIEC divided the total annual on-systems storage costs of 32.5 million by the total on-systems storage capacity of 25.8 million Dth, deriving an annual cost per Dth of storage capacity of about $1.26. IIEC states this translates to 10.5¢ per therm of subscribed storage capacity on a monthly basis or 1.05¢ per therm of unsubscribed storage capacity. IIEC notes that Staff witness Sackett came up with almost exactly the same cost per Dth of storage capacity using essentially the same method. Therefore, the Commission should adopt IIEC’s recommended allocation of storage costs between Sales and Transportation customers and the associated charges.

d. Commission Conclusion
The Commission notes that in AIC’s last rate case, the Commission required AIC to submit a tariff implementing the Nicor method for determining bank size, however, the Commission further allowed AIC to offer an alternative, preserving the flexibility to determine the most appropriate banking provisions under Rider T for AIC. In accordance with the Order, the Commission recognizes that AIC held workshops to gather input for its proposed tariff. Reflecting concerns AIC addressed in the workshops, and as authorized by the Commission in Docket Nos. 09-0306 et al. (Cons.), AIC submitted alternative tariffs setting forth unbundled, subscribable banking service, identified as Rider TBS. AIC’s proposal also provides for the allocation of on-system storage costs to Rider T customers, unsubscribed bank cost recovery language in Rider S, an election process that allows Rider T customers to subscribe to their preferred bank size up to a 15 day times MDCQ limit, and other implementation and service management provisions.

The Commission notes that Staff has proposed various other modifications to AIC’s proposed Rider TBS by replacing certain portions of the tariff with Nicor banking provisions. It appears to the Commission that Staff proposes to modify various portions of the tariff including the MDCQ, system peak day deliverability, to adopt the Nicor BSL, and a single fall injection target. The Commission notes that AIC argues against many of Staff’s recommended changes by asserting that there are significant operational differences between AIC’s gas distribution system and that of Nicor.

During the course of this proceeding, it appears to the Commission that Staff has proposed certain changes or additions to Rider TBS, based on Staff’s belief, as expressed in Staff’s Reply Brief, that the Commission had settled the question of whether there were operational differences between AIC and Nicor. While Staff asserts that the Commission had determined there were no operational differences between AIC and Nicor, the Commission disagrees with that assessment. The Commission notes that in Docket Nos. 09-0306 et al. (Cons.), under the section of the Order regarding this issue the Commission found as follows:

As for the subject of the workshops, which should be open to all those interested, the Commission notes less agreement by the parties. While Staff proposes that specific methods employed by other Illinois gas utilities be considered and modified for use by AIU, AIU urges the Commission to refrain from limiting discussion in any way. The Commission finds merit in Staff’s proposal since it concerns methods which it is familiar with and would promote consistency among the gas utilities operating in Illinois. Customers with facilities served by differing gas utilities are apt to find such consistency attractive. AIU’s view, however, deserves consideration as well. By directing that the workshop participants develop tariffs implementing the same banking provisions of Nicor, Peoples, and North Shore, the Commission fears that it would be making a decision before having all of the facts. Order at 283, emphasis added.
As it appears the Commission had not determined that there were no operational differences between AIC and Nicor, the Commission finds the burden would be on Staff to support the changes it has proposed to Rider TBS. The Commission finds that Staff has not met that burden, and believes the evidence is clear that there are significant operational differences between AIC and Nicor’s gas distribution systems.

The Commission also notes that it appears that AIC is proposing to recover 50% of its storage costs through a Deliverability Charge, and the other 50% through a Capacity Charge, applying what it calls the "Equitable Method." Staff suggests that this method would allocate a significant portion of costs to the first day of bank, which would result in negative impacts to customers. Staff argues in favor of the Nicor method for allocation of storage costs. IIEC also argues against AIC’s use of the Equitable Method, and suggests instead calculating the appropriate storage costs and unbundled bank charges using a capacity allocation of storage costs. The Commission is concerned with the suggestion that AIC’s method may result in negative impacts, such as to cause some customers to select no bank so as to avoid high initial bank charges. Based on the evidence presented, the Commission is of the opinion that the method endorsed by IIEC is more appropriate for determining storage costs.

The Commission recognizes that the dispute between Staff, AIC, and IIEC over transportation banking provisions is rooted in complex issues of gas storage operation, transportation customer behavior, and accounting. As a result, the Commission believes that it must exercise caution in picking and choosing among the various aspects of the parties’ proposals. The Commission is particularly concerned that certain aspects of Staff’s proposals would increase the rights of transport customers at the expense of sales customers, which the Commission feels it cannot support based on the record in this proceeding. The Commission also finds that Staff has failed to demonstrate that there is sufficient operational comparability between AIC and Nicor that would provide a basis for applying many aspects of Nicor’s tariffs to AIC. The Commission therefore finds the proposed Rider TBS and changes to Rider T tariffs proposed by AIC, except with regard to the Equitable Method discussed above, are the more reasonable and should be approved.

2. Rider T – Cashout Provisions

a. AIC Position

AIC indicates it has proposed to modify the current cashout provisions in Rider T-Transportation Service in order to provide better protections to its sales customers and incentivize transportation customers to better manage their accounts. AIC indicates that cashout provisions are tariff provisions that require transport customers to settle imbalances by purchasing or selling gas from sales customers. AIC states the proposed cashout
provisions are enhanced to provide recovery of costs related to managing imbalances caused by transportation customers for over or under delivering. Currently, AIC notes that cashouts are charged at a market price, and the cashout volume is either purchased from (for under deliveries), or sold to, sales customers (for overages). Under AIC’s proposal, the transportation customer will be charged the market or PGA cost, whichever is higher, to buy gas from sales customers in the case of under deliveries, and in turn, the transportation customer can sell excess deliveries at the lower of the market price or PGA. AIC asserts that this price proposal represents a common sense measure to ensure that transportation customers pay the highest price amounts when they under-deliver gas and AIC pays the lowest price when transport customers over-deliver.

AIC notes that the Commission has recently recognized the concern with adverse impacts on sales customer of cashout provisions that may allow arbitrage opportunities by transport customers. In Mid-American Energy Co.’s latest rate case, AIC states the Commission found that “sales customers have, at times, shouldered financial responsibility for the consequences of that arbitrage.” Docket No. 09-0312, Order (Mar. 24, 2010) at 40-41. AIC indicates the Commission went on to approve a cashout pricing proposal that charges transportation customers the highest daily price among the three indices to cover their delivery shortfalls, and that uses the lowest daily price among the indices to buy excess delivered gas, finding that the utility’s proposed high/low cash-out solution was properly aimed at curtailing arbitrage, and any associated subsidy.

AIC states it has proposed a similar “high/low” solution here, noting the Commission has approved similar cashout language to AIC’s proposal in the tariff of legacy utility AmerenCILCO and in Nicor’s tariff. AIC argues the evidence provided in this proceeding shows that AIC’s current cashout mechanism is failing to perform its intended purpose to “protect sales customers,” as Staff averred they should when Rider T was authorized in Docket Nos. 07-0585 et al. (Cons.).

AIC indicates that the total cost for the services required to cover daily balanced customer imbalances is $2.3 million annually, noting that imbalances are managed in real time, using adjustments to on-system storage, leased storage, pipeline deliveries and linepack. When imbalances occur, AIC states its system is impacted through adjusted injections or withdrawals from on-system storage and leased storage, changes in linepack, and gas loaned to or borrowed from pipelines. AIC notes sales customers incur a cost from all of these, except linepack. AIC avers that charges under the balancing agreements with the pipelines are paid only by sales, not transportation customers, and any extra withdrawals or injections incur fuel charges from the pipelines that are paid for by the sales customers. AIC opines that any no-notice storage fees are also paid for by the sales customer. AIC argues where such costs are incurred by sales customers, appropriate penalties should be adopted, citing Abbott Laboratories, Inc. v. Illinois Commerce Commission, 289 Ill. App. 3d 705, 712 (1st Dist. 1997). Furthermore, AIC alleges managing transportation customer imbalances with adjustments to on-system storage injection and withdrawal plans affect the
ability to store or withdraw the desired amount of supply for sales customers.

AIC argues that Staff incorrectly assumes that the penalty revenues from transportation customer cashouts adequately cover these costs. AIC notes however, the $2.3 million in costs are far in excess of the $583,000 average in premiums paid by transportation customers, through the cashout mechanism, and AIC’s cashout proposal is designed to bring cashout premiums more in line with balancing costs.

Currently, AIC notes its transportation customers pay for banking rights, but pay nothing for on-system and off-system storage used to manage cashout imbalances. AIC indicates that these imbalances rely upon system supply resources which are paid for by the sales customers. AIC states its banking service allows transportation customers to access up to 20% of their nominations from their bank to cover any differences between their deliveries and usage at no cost premium. Under AIC’s current tariff, after a transportation customer utilizes its bank, it can then cashout up to an additional 20% of its nomination without penalty. AIC asserts this additional 20% cashout acts like overdraft protection for transportation customers, in that if the banking service does not provide enough gas to cover an under-delivery, they can access a savings account (sales customers) to cover the spread and are not charged a fee up to 20% of their nomination. AIC argues its proposal mitigates these impacts on sales customers, while cashout revenues would continue to be credited to the sales customers through the PGA mechanism to offset the costs incurred to maintain cashout imbalances.

AIC notes a negative cost consequence to sales customers can occur under the current cashout provisions when, for example, a transport customer under delivers. AIC states the shortfall is made up with sales customer gas (ie, PGA gas), and AIC pays the transport customer a market price which is lower than the PGA price. AIC provided evidence of such negative cost consequences to sales customers from 2009 and 2010 where the cashout revenue was insufficient to avoid a negative cost consequence. Therefore, AIC argues its proposed pricing mechanism, by using of the PGA prices as a baseline, is more reasonable than market price, which is the current baseline.

AIC indicates Staff’s opposition to AIC’s cashout mechanism is based on at least two flawed assumptions. First, Staff incorrectly assumes AIC can simply buy market priced gas to make up cashout imbalances, as AIC notes every purchase flows through the PGA with all supplies AIC provides to its distribution system priced at the PGA price. When buying gas from transportation customers, AIC urges that sales customers should never have to buy it at a price greater than their supply, the PGA, as a result of transportation customer activity.

AIC states that Staff believes net purchases are realized during the gas day by a drop in system pressure and AIC responding by buying more gas - at the market price, not the PGA. AIC indicates however that it does not respond to a drop in pressure by buying gas,
noting that flexible storage resources are most often used. AIC indicates it can only
purchase and nominate gas for the first 8 hours of a gas day due to North American Energy
Standards Board rules for nominations on the interstate pipeline system, leaving insufficient
time to respond to pressure drops with gas purchases. Even if AIC could purchase gas
beyond the first eight hours of a day, AIC notes it would still be purchased through the PGA,
therefore Staff’s concerns are unfounded and should be rejected.

AIC asserts that its proposed cashout mechanism provides an incentive for
transportation customers to better align nominations to load. AIC notes that IIEC witness
Gorman accurately concludes that PGA prices still routinely exceed market clearing prices,
at levels as high as 206% of the market price. As transportation customers have a 20% free
margin of error on their nominations, AIC contends that such wide latitude does not provide
any incentive for a transportation customer to better maintain their accounts if they can
continue to buy and sell at market price and take advantage of any price differences. AIC
argues its cashout proposals will provide the incentive to transportation customers to
minimize or eliminate their cashout imbalances.

AIC also notes that its current cashout provisions do not deter transportation
customer behavior that might impair the system. AIC indicates the 20% of the DCN
permitted to be cashed out at the Chicago market price can often be less than the
transportation customer is paying for their gas supply, so a transportation customer would be
incented to under-deliver and purchase from AIC’s sales customers at the market price. AIC
states the 10% penalty imposed on imbalances greater than 20% DCN after banking offers
little deterrent for transportation customers to minimize imbalances. AIC asserts that
evidence showing that the current cashouts are not minimizing imbalances is evident since
transport customers consistently under-deliver, noting there is a net of approximately 20,000
therms of average daily under-delivery on the total system. AIC contends this imposes costs
on sales customers every day, while AIC’s proposed cashout provisions will provide
incentives to reduce these imbalances.

AIC indicates that Staff concedes therefore that there is an under delivery issue that
should be addressed, with Staff now suggesting there may be reasonable alternatives to
AIC’s proposal, such as to add a basis to the cashout price. AIC notes, however, that Staff
has not provided any explanation or detail supporting their proposal. While AIC is not
opposed to discussing alternatives to its cashout mechanism with the goal of minimizing
balances on the record evidence in this case, AIC asserts its proposal is the most
reasonable and therefore should be adopted.

AIC asserts that Staff’s Initial Brief contains two significant incorrect assertions: that
AIC has provided no evidence regarding negative cost consequences to PGA customers is
false; and that AIC has provided no evidence that the current cashout provisions are
inadequate. AIC submits it has provided substantial evidence that current cashout
provisions are not adequate, including: (1) data showing negative costs consequences to
sales customers, (2) balancing costs of $2.3 million far exceeding cashout premiums of $583,000, and (3) a pattern of under-delivery by transportation customers.

AIC argues in its Reply Brief that the evidence shows that there were negative cost consequences to sales customers from 2009 and 2010 where the cashout revenue was insufficient to avoid a negative cost consequence. AIC asserts that there was a $2.3 million annual cost for the services required to cover daily balanced customer imbalances, which exceeds the $583,000 average in premiums paid by transportation customers through the cashout mechanism. AIC suggests this means the costs to cover these imbalances is almost four times what transportation customers pay, and notes that Staff acknowledges that there is a problem with under-delivery.

AIC opines that Staff’s Initial Brief shows a continued misunderstanding of the source and price of gas supplies used to balance the system. AIC states that making up for cashout imbalances is not as simple as AIC buying more market priced gas, noting that imbalances are corrected using distribution system supplies, i.e., sales customer gas – which are priced at the PGA price. AIC asserts that when buying gas from transportation customers, the sales customers should never have to buy it at a price greater than their supply, the PGA, because that exposes them to higher prices than they would have otherwise experienced as a result of transportation customer activity.

Although Staff claims in its Initial Brief that imbalances can be offset by market purchases for which the daily market price compensates the PGA for the gas purchased, AIC avers that it does not respond to imbalances by buying gas – flexible storage resources are most often used. Because imbalances are corrected using distribution system supplies which are priced at the PGA, AIC suggests it is logical that the transportation customer’s cashout mechanism use PGA prices as a baseline. IIEC does not agree that cashout volumes are necessarily purchased from or sold to PGA customers, but argues that AIC cures imbalances at the marginal or market price. While IIEC also argues that using PGA prices rather than market clearing prices produces a margin, which benefits the sales customers, AIC contends that any margin serves to offset the costs incurred by the sales customers when transportation customers cannot adequately match nominations to usage. AIC states it has shown that cashout premiums are inadequate to recover the full amount of balancing costs imposed on AIC’s sales customers and these imbalances are corrected through the PGA. AIC argues that its cashout proposals will provide the incentive to transportation customers to minimize or eliminate their cashout imbalances.

b. Staff Position

Staff notes that AIC proposes to change its Rider T cashouts so that AIC will charge the Rider T customer the higher of the PGA price for the month in which the cashout occurs or the market price when the customer has inadequate deliveries and pay the customer the
lower of the PGA price or the market price in month in which a cashout occurs. Staff indicates that AIC has also proposed an identical cashout in the new Rider TBS. Staff states that AIC made this same proposal in its 2007 rate case, which Staff opposed in that docket.

Staff argues that AIC has provided no evidence regarding the negative cost consequences to PGA customers under the current system, and Staff indicates the cashout provisions are already designed to deter transportation customer behavior that might impair the system. Staff argues there is no evidence that the current provisions are inadequate, although AIC argues that the PGA is more appropriate because it is the price paid by sales customers in that month for gas.

Staff witness Sackett explains how diversity keeps the impact of transportation customers as a group minimal, and in fact, claims transportation customer imbalances may benefit sales customers. Staff asserts that due to diversity, AIC does not balance each customer individually each day, but rather balances the entire system. Staff avers the imbalance of transportation customers may be off set by unplanned for imbalances of sales customers. Where transportation customers contribute to net imbalances, Staff indicates that imbalances can be offset by market purchases for which the daily market price compensates the PGA for the gas purchased. The daily market price, Staff opines, not the PGA is the appropriate price to use for transportation customer imbalances. Even if AIC were not able to make its purchases by the end of the day, Staff argues AIC could increase its purchases the next morning, which most likely would have an opening price very close to the closing price from the day prior. Staff notes AIC concedes that it is able to purchase gas the next gas day once imbalances are noted and that the prices it faces that next day are generally close to the closing price from the day prior.

Staff asserts that the evidence shows that since October 1, 2008, transportation customers have paid almost $600,000 annually in premiums to the Chicago Citygate Price (“CCP”) by paying 10% more for gas outside the 20% deadband and receiving 10% less than the market price for gas delivered in excess of the 20% deadband. Staff states there is no evidence that the 33,289 therms daily average harms the system. Staff avers that this tendency to under deliver will totally disappear if a CD is declared due to a $6 per therm penalty. Staff notes that AIC acknowledges that these under-deliveries do not destabilize the system.

While AIC argues that these imbalances may be inconsequential when compared to a peak day volume but nevertheless harm the sales customers economically, Staff opines that the evidence provided does not demonstrate that this is the case. Although AIC claims that the cost for all gas on AIC’s system is the PGA price and there is no separate market priced gas waiting to handle cashout imbalances, Staff notes AIC admits there have been no actual purchases of any gas at the PGA rate.

In addition, despite assurances that AIC cannot buy gas at the daily price, Staff states
AIC witness Eggers acknowledged under cross-examination that AIC makes daily gas purchases at its city gate at the CCP, the exact same cashout price charged to daily-balanced customers. Thus, Staff claims the use of the PGA is not appropriate, and the current tariffed price is reasonable.

Staff asserts there are other market-based ways to address under-delivery rather than abandoning the market in favor of penal PGA cashouts. Staff indicates a reasonable alternative that would correct the under-deliveries would be to add a basis to the cashout price. Staff argues that more reasonable measures such as this should be considered first, however if the Commission is inclined to seek a corrective path to this under-delivery issue, it should encourage AIC to work with Staff to find a less draconian means of addressing the issue through an appropriate tariff modification.

Staff notes that AIC has offered two data sets to support its cashout proposal, the first being data from a two week period in the winter of 2009-2010 which AIC alleges shows evidence of negative cost consequences to sales customers because the cashout revenue was insufficient. Staff argues however, this data “from 2009-2010” is not two years of data but rather two weeks of data, and is an anomaly because the CCP price is equal to or greater than the PGA during this period. Staff asserts that IIEC Ex. 8.1 demonstrates that on average, AIC’s PGA is 147% of the market price, and that this two week period was from the only month where the PGA was less than the average CCP. Staff opines that AIC chose the only period where such a price relationship occurred in any Rate Zone for 2010 to support its position.

Staff avers that even AIC’s alleged cost consequence to sales customers from that period is actually a benefit when netted against the cashouts premiums transportation customers paid. Staff asserts there are in fact no net negative cost consequences from this time period and AIC has provided no other evidence of any alleged cost consequences.

Staff claims the second data set that AIC provides is Ameren Ex. 34.5, which shows under-deliveries, which calculates under-delivery for the system in the period since the current cashout provisions went into effect. Staff claims it calculates the system net under-deliveries equal to an average of 33,289 therms daily, which is less than 0.2% of AIC’s peak design day. Staff opines the average annual amount of the under-delivery is also less than 2% of transportation throughput, less than 1.5% of sales throughput and less than 1% of AIC’s total throughput. Staff avers this magnitude of under-delivery is insignificant and insufficient to justify AIC’s proposed change in the cashout provisions.

Staff notes that AIC in its Initial Brief wrongly projects an assumption on Staff’s part that AIC can simply purchase market priced gas to make up cashout imbalances, stating that
Staff’s assumption is incorrect. Staff opines that AIC implies that the PGA is the cost of incremental gas purchases, however Staff indicates it has established that the market price is unlikely to exceed the PGA. Staff avers that AIC’s conclusion that the PGA value serves as a good estimate of incremental cost is unfounded.

Staff asserts that in its Initial Brief, AIC justifies its cashout proposal by pointing to a Commission decision in Mid-American Energy Co.’s most recent rate case, Docket No. 09-0312. Staff notes that AIC maintains that its proposal provides an incentive for transportation customers to better align nominations with load, and claiming that the Commission’s decision in Docket No. 09-0312 recognizes that high/low cashout proposals create an incentive for transportation customers to accurately balance their daily supply and demand. Staff argues this quote does not fully summarize the approved tariff in Docket No. 09-0312, and a fair reading of the Order in Docket No. 09-0312 and the MidAmerican tariff argue for the adoption of Staff’s position on this issue.

While AIC also claims that the Commission has approved similar cashout language to AIC’s proposal in the tariffs of AmerenCILCO and Nicor, Staff asserts that the referenced Commission approval is overstated and irrelevant to AIC’s daily proposal.

c. IIEC Position

IIEC notes that AIC has proposed that the pricing mechanism in the cashout provisions contained in Rider T be modified, by proposing that a transportation customer must buy gas from AIC at the higher of the market price or PGA cost when it under-delivers gas to the system and sell gas to AIC at the lower of the market price or PGA cost when it over-delivers gas to the system. IIEC indicates that AIC argues this approach protects sales customers from any negative cost consequences of the cashouts.

IIEC does not agree that cashout volumes are necessarily purchased from or sold to PGA customers, and notes that an appropriate analysis assumes that AIC’s portfolio for sales customers is the proper size for those customers and that marginal unplanned purchases or sales to cure customer imbalances are made by AIC at the marginal or market price. IIEC notes that under AIC’s proposal, cashout purchases from transportation customers would be made at the lower of either 90% of the market price or the PGA price and cashout sales to transportation customers would be made at the higher of 110% of the market price or the PGA price. IIEC indicates there is a margin produced from these cashout transactions and sales customers will receive the benefit of that margin.

IIEC suggests that introducing the PGA as a cashout transaction price, exposes transportation customers to significant out-of-market costs for these cashout transactions.
because PGA prices have been well above market. Comparison of market prices and the AIC PGA prices for the year 2010 show that on an annual average basis, transportation customers with negative imbalances in the AmerenCILCO zone (Rate Zone 1) would be forced to pay 142% of the market price for gas, customers in the AmerenCIPS zone (Rate Zone 2) 157% of the market price for gas, and customers in the AmerenIP zone (Rate Zone 3) would pay 143% of the market price for gas, under the AIC modified cashout proposal. In fact, in November of 2010, AmerenCIPS transportation customers would have been forced to pay more than 206% of the market price for gas.

IIEC claims that AIC did not present testimony in its direct case which demonstrated that sales customers had been economically harmed under the existing cashout protocol. IIIEC notes that in rebuttal AIC did present a comparison of the PGA to revenues from imbalance charges for a period of only 14 days from Rate Zone 2, claiming that this data showed that negative consequences occur under the current cashout protocol. IIIEC states the limited data provided shows that on nine of 14 days the PGA cost was greater than imbalance revenues by a small amount, and suggest that even if AIC is correct in its characterization of this data, the shortfalls between PGA revenues and cashout revenues can be corrected without modifying the cashout protocol as proposed by AIC. IIIEC opines this can be accomplished, by reducing the PGA through lower cost purchases. IIIEC avers the current calculation of imbalance charges provides an incentive for AIC to reduce its purchased gas costs to the benefit of sales customers, without imposing additional harmful penalties on transportation customers, therefore the present cashout benefits both sales and transportation customers.

IIIEC argues that the purchase or sale of customer-owned gas should be looked at as marginal purchases that add or reduce costs at a unit rate of the market price for the given day. IIIEC asserts that AIC’s analysis does not necessarily demonstrate the existence of negative consequences from the current cashout protocol, and even if such discrete consequences did exist on particular days, IIIEC claims it is a far cry from showing that in the aggregate, sales customers experience negative consequences. IIIEC avers that the AIC proposal would harm transportation customers in order to correct a problem that has not been shown to exist, therefore the AIC proposal should be rejected and the cashout mechanism should remain as currently outlined in Rider T.

d. Commission Conclusion

The Commission notes that AIC has proposed to modify its current cashout provisions in Rider T-Transportation Service to charge transportation customers the higher of market or PGA cost to buy gas to cover under-deliveries, and in turn, to charge the lower of the market price or PGA when selling gas from over-deliveries. AIC believes this change is warranted because current cashout provisions do not allow AIC to recover the costs of managing imbalances and do not adequately protect sales customers, while the modified cashout
provisions provide better incentives for better account management. AIC claims that the evidence in this case shows that current cashout provisions are not adequate, and that there is a pattern of under-delivery by transportation customers. AIC also claims that its evidence shows that the cost for balancing transportation customer imbalances far exceeds the cashout premiums those customers pay.

The Commission notes that both Staff and IIEC oppose AIC’s proposed change to its cashout provisions currently in place, suggesting that the imbalances are not as severe as AIC suggests, and that AIC’s analysis does not demonstrate negative consequences form the current cashout proposal. Staff and IIEC also note that AIC’s comparison of the PGA to revenues from imbalance charge was only for a period of 14 days in Rate Zone 2.

The Commission finds there has been insufficient evidence to demonstrate the negative consequences alleged by AIC due to the current cashout provisions. The Commission invites AIC to revisit this issue in future rate cases, however the Commission expects a more extensive analysis of the issue, and would appreciate comparisons from each of the three Rate Zones. The Commission finds that current cashout provisions of Rider T are sufficient at this time and AIC’s proposed changes are rejected.

XI. PROPOSED SMALL VOLUME TRANSPORTATION PROGRAM

A. AIC Position

AIC states that RGS recommends that the Commission direct AIC to develop a natural gas choice program in AIC’s service territory for residential and small commercial customers. AIC indicates it does not oppose a residential gas customer choice program subject to the following criteria: (1) there are identifiable customer benefits; (2) the cost of implementing such a program is reasonable; and (3) should the Commission approve such a program, AIC would be entitled to recover all prudently incurred costs in a timely manner.

In response, RGS recommends that within one month of the entry of the order in this docket, Staff and interested parties begin a six-month workshop process by which the parameters of a gas choice program would be developed as well as the related tariffs for Commission approval. AIC notes the results of the workshop would be presented in a separate proceeding and not necessarily in AIC’s next gas rate case.

AIC indicates it is not opposed to workshops per se, although AIC witness Seckler noted some concerns with such a process. However, as is noted by Staff witness Rearden, the ORMD is statutorily obliged to prepare a report that investigates the state of retail gas
competition in Illinois, the barriers to development of retail competition, and other relevant information, under Section 19-130 of the Act. As part of this process requires gathering input from all interested parties for the report, Dr. Rearden testified the ORMD process presented a better opportunity for RGS to advance its recommendations, rather than in the instant rate case.

What AIC does not want is an obligation to conduct workshops, only to then have to repeat the process in the context of the ORMD process discussed above. AIC suggests it may be premature to assume that a workshop process could adequately address all the issues prescribed by law for review in the ORMD process. Further, at least in the judgment of AIC and Staff, as a practical matter, rate cases are not the best vehicles by which to design new and different services. Ms. Seckler testifies there is not sufficient information to design and implement a program based on the record evidence in this proceeding, nor as to what the cost of such a program would be.

In 2009, AIC indicates it prepared a high level analysis of the cost of modifying information technology ("IT") systems supporting the billing and customer information processes for a gas choice program. AIC estimated that the minimum cost to modify AIC’s IT systems alone for a gas residential choice program would be $2.7 million; however, billing is only one aspect of a full program design and implementation effort. AIC states that cost data associated with customer communications, customer switching protocols, and RGS interface with AIC, are just a few of the program design features to be analyzed.

AIC alleges the issue is whether AIC should be required to complete a workshop process, when a similar process that would involve all Illinois stakeholders is still required under the specific requirements of the ORMD process statute. AIC suggests that Commission and stakeholder resources should be taken into consideration in deciding if now is the right time, based on the record evidence, to proceed to a mass market gas choice program. Based on the record in this proceeding, AIC suggests that RGS’ proposal is premature and redundant, and should be denied.

AIC notes it does not have a per se objection to workshops, however, AIC would oppose workshops unless a Gas Residential Choice Program was mandated by legislation or ordered by the Commission. Furthermore, AIC agrees with the position of Dr. Rearden, who pointed to the recent amendment to the Act whereby the ORMD is obliged to prepare a report that investigates the state of the retail gas competition in Illinois, identify barriers or obstacles to a retail gas choice program, and consider other relevant information and gather such information from stakeholders. AIC concurs with Dr. Rearden that awaiting the ORMD process is the better means by which RGS could advance its recommendations, rather than the current rate case.

AIC does disagree with RGS characterization that the parties agree that following a Commission order endorsing the expansion of customer choice to AIC’s natural gas
customers, the next step would be for the Commission to initiate workshops to develop the
details for the program. In response, AIC notes both it and Staff have taken reserved
positions and CUB has expressed doubt as to any customer benefits. While RGS asserts
the ORMD report should not be a reason to delay workshops, AIC notes there is nothing in
the legislation that speaks directly to the propriety of workshops under any circumstance,
other than whatever might occur in the context of the ORMD process.

AIC indicates that it basically agrees with RGS’ recommendations that, in the event
workshops are required, the RGS proposal serves as a starting point for discussions. While
the RGS proposal should be introduced in the course of workshops, AIC alleges it should not
be given any more weight than any other proposal. AIC suggests the rate case is not the
best means by which to adjudicate the design and implementation of a retail gas choice
program, to which ICEA and Staff agree. AIC notes that no party, except perhaps RGS, has
even attempted to try to define the parameters of such a program, which would include
customer switching details billing mechanics, electronic data interface elements, IT
transitions, customer education, community outreach, and the rate parameters for cost
recovery.

If, however, AIC is required to implement a retail gas choice program, AIC asserts it
should be able to recover all its prudently incurred costs. AIC states this would hold true
even in the event the Commission would order workshops, and as a result of those
workshops, order AIC to make a tariff filing providing for a retail gas choice service. As the
design and implementation of a retail gas choice program could take affect when there is no
rate case pending or no opportunity to recover the costs in a rate case, AIC urges the
Commission to permit the utility to defer the costs as a regulatory asset and permit their
recovery in the next gas rate case.

B. Staff Position

Staff notes that RGS proposed that the Commission order AIC to begin a small-
volume transportation (“SVT”) program that would enable small volume residential and
commercial customers to purchase their own gas supplies, rather than buying their
commodity gas only from AIC. Staff indicates RGS also recommended that the SVT
program include a Purchase of Receivables (“POR”) for program suppliers and that a price-
to-compare be calculated.

Staff recommends that the Commission not order an SVT program for AIC in this rate
case. Staff suggests that RGS failed to show that customers are better off with a SVT
program, and did not offer details sufficient to enable such a program to be implemented.
Staff argues a general rate case like this docket does not allow for the comprehensive
exchange of information needed to produce an entirely new service offering in AIC’s tariff.
Staff also notes that under the recently amended Section 19-130 of the Act, the ORMD must
compile a report that investigates the state of retail gas competition in Illinois, the barriers to development of competition and any other relevant information. Staff states that in compiling this report, the ORMD is directed to gather input from all interested parties, therefore the compilation of the ORMD report will provide an opportunity for ARGs to promote their ideas to improve retail gas markets to the Commission.

In Staff’s view, the record in this proceeding does not support a finding regarding the benefits of a SVT program, while the ORMD report will provide the Commission with an investigation of retail gas competition in Illinois. Staff suggests the Commission should consider the ORMD report when it decides upon the best way to promote the public interest rather than decide these issues in this case. Staff notes the Commission will then have a more developed and comprehensive picture of the costs and benefits of a small volume gas transportation program, along with the characteristics that the program should have, than this rate case allows.

Staff notes that to date, the Commission has not mandated SVT tariffs for a utility that did not first file to implement one. Staff suggests the decision of whether AIC should have one should not be based upon whether the other large utilities in Illinois have one; rather the decision should be based on whether there are net benefits to customers from an SVT. Staff asserts that RGS has not provided empirical support for a finding that the program would benefit customers.

Staff states that RGS’ assertion that there is no evidence concerning how the ORMD report will be compiled is equally applicable to the workshops RGS is advocating. Staff suggests the Commission wait for the report to the legislature mandated by the Act before ordering AIC to begin small volume transportation. While the process may be time consuming, Staff notes that workshops would also require time. Staff states the ORMD report is required to consider input from all interested parties, and should provide an opportunity for a broad range of entities to provide input. Staff asserts that AIC would ultimately have to file tariffs to implement an SVT program, which could result in a litigated docket that could take an additional eleven months. Staff urges the Commission to choose the method which would provide the most efficient and comprehensive basis for making a determination about SVT tariffs, which would be to wait until it can utilize the report from ORMD.

C. CUB Position

CUB notes that RGS initially proposed that the Commission and AIC make the development of a competitive natural gas mass market in the AIC service territory a significant priority. CUB initially objected to RGS’ recommendation, citing its varied experiences with the small customer gas choice programs operated by Peoples and Nicor. CUB indicates that in rebuttal testimony, RGS witness Crist refined his proposal and
recommended that the Commission order the parties to begin a six-month workshop process, which would begin no later than one month after the order in this docket, with recommendations to be made to the Commission about market design at the end of the six months. CUB notes that RGS suggested that the end result of the workshop process would be a tariff filing by AIC. CUB indicates it was able to present its response to this suggestion in its response to RGS-CUB 4.01, in which CUB stated that it would not oppose the development of a mass market gas choice program in the AIC service territory if the appropriate consumer protections, consumer education, and utility cost recovery provisions were in place.

CUB agrees with RGS that a properly designed choice program benefits all stakeholders; however CUB notes that what each party believes is a properly designed program may be different. CUB agrees that these issues could be further explored in a workshop process, should the Commission see fit to order one. As a result, if the Commission were to agree with RGS that a choice program should be made a priority in AIC’s territory, CUB would agree that a workshop process would be beneficial to the parties to vet the many issues that require resolution before a choice program is instituted. If the Commission does direct the parties to commence workshops, CUB suggests that the participants first develop a comprehensive issues list which, at a minimum, should address necessary consumer protections and customer education programs in AIC’s service territory, as well as utility cost recovery for implementation expenses. While CUB does not oppose the recommendation that the Commission initiate workshops for the purpose of exploring the implementation of mass market natural gas customer choice in AIC’s service territory, CUB does not agree that the Commission should direct AIC to automatically file tariffs at the conclusion of the workshops.

D. RGS Position

RGS states it has presented substantial evidence concerning the elements comprising a well-functioning mass market retail natural gas competitive program and the process for formulating a detailed plan for final Commission approval. RGS witness Crist discussed the benefits of competition to all stakeholders, including consumers and AIC. Mr. Crist detailed four elements necessary for successful competitive markets: utility support; POR; fair allocation of commodity-related costs; and a properly-adjusted price-to-compare.

RGS suggests that the record evidence supports a Commission Order that paves the way for implementation of a mass market choice program and sets up a workshop process that fills in the details around the requirements for a successful competitive market and produces a tariff for Commission approval. RGS asserts the workshop process, which should last no more than six months, should begin using the detailed choice program outline documents provided by Mr. Crist with his testimony, should include all interested stakeholders, and should conclude with AIC’s filing a tariff regarding the choice program with
the Commission. RGS states parties will have ample time in that workshop context to work through operational issues, consumer protection and education issues, and cost allocation matters, as well as any other issues of concern to parties. RGS argues the goal of the workshop should be a mutually acceptable tariff that sets forth the details of the program, although should the workshop participants fail to reach full consensus on all tariff terms, parties will have a potential opportunity to further address them before the Commission during any review of the tariff after it is presented to the Commission. RGS argues this proposal represents a fair and appropriate plan that advances the Commission’s policy favoring competition and the ability of AIC residential natural gas customers to gain the same ability to choose as other major energy utility customers in an efficient and timely manner on one hand, while protecting the rights of stakeholders to express views about any particular issues associated with the choice program as it is developed.

It appears to RGS that the parties agree that following a Commission Order endorsing the expansion of customer choice to AIC’s natural gas customers, the appropriate next step would be for the Commission to initiate workshops to develop the details for the program. In light of the mass of evidence detailing the benefits of competition for AIC’s residential natural gas customers and the fact that no party provided an alternative structure for a mass market natural gas choice program, RGS recommends that the Commission initiate a workshop process within a month of the Order to last no longer than six months. RGS suggests that the end product from the collaborative workshop process be a tariff, submitted to the Commission by AIC for approval under normal Commission procedures. RGS opines that although a collaborative process should cover operational and program design issues, the Commission should state clearly in this docket its support for the competitive market.

RGS notes that AIC has agreed that the issues identified in Ms. Seckler’s testimony regarding developing tariffs supporting mass market retail natural gas competition are appropriate for discussion in workshops and should be addressed, while CUB has stated that it does not oppose a workshop process to formulate a choice program and address issues of concern.

RGS claims there are several elements of RGS’ mass market natural gas competition proposal that parties have either agreed to, or at least not disputed during testimony or evidentiary hearings, and thus should not have to be discussed during workshops. RGS indicates that these agreed elements include utility support for the competitive market, full utility cost recovery for the utility, and a properly adjusted price-to-compare. RGS also considers the fair allocation of commodity-related costs an issue to be included, although the parties did not reach agreement about the best method to allocate assets and the assets’ costs, RGS states no party disputed that the assets should be allocated in a manner that avoids subsidies and reflects cost causation. Although the parties appear to agree on significant portions of the content of a mass market retail natural gas choice program, RGS indicates the parties still have a number of issues to resolve in the workshop process, although the parties appear open to discussing all open issues in workshops, should they be
ordered.

Because no other party has presented evidence promoting different necessary components of a well-designed mass market retail natural gas choice program, RGS urges the Commission to adopt RGS’ proposal as the starting point of discussions in its Order, noting that the Commission has used this approach to workshops before to resolve mass market natural gas competitive issues in Peoples and North Shore’s 2009 rate case. RGS suggests that this targeted focus on its proposal still allows parties to discuss all relevant issues, but avoids the inefficiency of starting from scratch when the parties could have raised alternative proposals in the present docket.

RGS indicates that no party, other than Staff, appears to oppose the initiation of workshops within one month of the Order in this matter. RGS notes that Staff recommends that the Commission wait until the ORMD releases its report on the natural gas market pursuant to Section 19-130 of the Act. RGS notes that Staff raises three concerns in support of its position, that there is insufficient evidence of empirical benefit of competition in the record, RGS’ proposals lack detail, and the ORMD report is pending. RGS submits, however, there is no need for the Commission to postpone the initiation of the workshop process, because all of Staff’s concerns are either already addressed by the record in this docket or can be resolved in the workshop process.

While Staff is concerned there is insufficient evidence of the benefits of natural gas choice, RGS submits its witness Mr. Crist has provided or cited to a substantial volume of evidence about the value and benefits of mass market natural gas choice. Notably, Mr. Crist cited to both the Commission’s 2007 and 2005 reports on the state of the retail natural gas competitive market, which consisted of empirical observations about the Illinois market, as well as empirical observations from other states in the form of Energy Information Agency and Ohio’s experience.

While RGS acknowledges it is impossible to predict the utilities’ PGA rate which makes it difficult to quantify dollars and cents customer savings, RGS submits there is value in a choice program that permits customers to have access to a variety of risk-reducing products whose benefits cannot be measured by price differential in any given time period. RGS also disputes that it did not provide sufficient detail for its plan to enact a mass market natural gas choice program. While Staff takes the position that a general rate case does not allow for the comprehensive exchange of information needed to produce a new tariffed service offering, RGS submits this argument underscores the value of the workshop process that RGS recommends. Because the parties have expressed willingness to participate in the workshop process, RGS believes the workshop process would facilitate the necessary exchange of ideas and proposals to create a tariff that benefits all mass market customers. RGS opines that workshops are an appropriate venue for finalizing details for all open issues, which would resolve any lack of detail present in Mr. Crist’s testimony.
RGS also suggests that the fact that the ORMD has been directed by the General Assembly to develop a natural gas choice report is not a valid reason for delaying the workshops. RGS notes there is nothing in the legislation that suggests the Commission should defer this decision until the ORMD submits its report; rather, the legislation is entirely consistent with the Commission directing workshops to commence immediately. RGS also notes that the process and timing for the ORMD to develop this report is entirely unknown. RGS indicates that Staff concedes that Section 19-130 does not prevent the Commission from ordering workshops or approving tariffs for a mass market natural gas competition program, but it appears that this would be Staff’s preference. As Section 19-130 requires identification and removal of barriers to competition, RGS believes that the ORMD’s development of its report would be facilitated by the Commission initiating workshops at the conclusion of the instant proceeding to develop AIC’s mass market customer choice program.

RGS submits that Section 19-130 also indicates the General Assembly’s expectation that there should be competitive natural gas markets in Illinois. RGS notes the statute repeatedly calls for the ORMD report to identify barriers to the development of competitive gas markets in Illinois, and also calls for the ORMD to identify solutions to those barriers. RGS alleges that the language of Section 19-130 communicates a clear expectation that there should be a competitive market now, and nothing in Section 19-130 suggests any intention by the General Assembly to constrict the development of the competitive market in any respect, and certainly nothing communicates an intention to wait for the issuance of the ORMD report before implementation of choice. RGS suggests that a fair reading of Section 19-130 indicates it is not intended to slow the process, and a recommendation to read it in that manner is unpersuasive and inaccurate.

RGS further notes that no evidence has been presented by Staff of how the process for developing and drafting the ORMD report will work, and Staff witness Rearden acknowledged that he has no idea what the scope, content, or timing will be of the ORMD report. Indeed, RGS notes that Dr. Rearden identified a further fundamental problem with reliance on the ORMD Report process – the date by which the ORMD Report is due is unclear even to Staff, and may not occur until July 2013. RGS suggests that in light of the scope of Section 19-130, it would not make sense to delay the workshop process or the filing of a tariff resulting from that workshop process when Staff cannot articulate a benefit from further delay. RGS recommends that the Commission approve a workshop process on the issue of a SVT program for AIC, to commence within one month of the final order, and to last no longer than six months.

E. ICEA Position

As ICEA understands the record in this proceeding, AIC is not opposed in concept to a retail market gas choice program, yet the ICEA notes the record also shows that AIC and
others have expressed some reservations regarding the development of a gas choice program. ICEA asserts these reservations include past complaints brought against certain retail natural gas suppliers, a seeming lack of interest by consumers for such a program, and a desire to see an analysis of the savings such a program could bring. ICEA alleges these concerns have been fully addressed in RGS witness Crist’s testimony, therefore ICEA concurs with RGS that the time is right to provide consumers gas choice in the AIC service territory.

ICEA agrees with RGS that a lack of customers requesting a gas choice program is not evidence that a program should not be implemented. ICEA maintains that, just the same as opportunities have been available in utility service territories in northern Illinois, consumers in AIC service territory should be given the same opportunity to benefit from the choices and rate offerings that flow from a properly and well-developed retail gas choice program.

While AG/CUB witness Thomas discusses certain issues regarding existing choice programs in Illinois, ICEA argues his testimony does not reference the 2009 change to the Act. ICEA suggests that it appears from the record that there is support for a retail gas choice program provided that both customer protections and consumer education initiatives are viable components of such a program and that utility cost recovery is appropriate. ICEA agrees with the importance of these matters and the prominence they should take in the workshop discussions.

ICEA notes that AIC indicates it is not planning to develop a residential gas choice program unless mandated by legislation or ordered by the Commission. Given that it would take a Commission Order to move AIC to a choice program, ICEA urges the Commission to include just such a directive in its Order for this proceeding to guarantee a retail gas choice program is put in place. ICEA also recognizes that a hastily-fashioned program is neither in the best interest of customers nor any of the parties, and for this reason, ICEA supports a collaborative approach such as that proposed by RGS, which would allow input from all parties and ensure a wide and full exchange of ideas and specifics. ICEA suggests this type of process would also ensure that the program developed would have the broadest support of all parties involved.

In ICEA’s view, developing a gas choice program requires full discussions on program costs with proper allocation and payment for assets; financial security, billing and rate options; capacity; and, dutiful regard for consumer protection and consumer education. ICEA avers that while none of these items are quickly addressed, workshop discussions with no intended end-date may be wasteful of time and encourage delay. As such, ICEA asks that the Commission’s order clearly set out both a start date and an end date for the workshops with an ultimate goal to have all parties agree on a functioning gas choice program and with the understanding that any items not agreed-upon will be decided by the Commission. ICEA indicates that CUB and AIC have both indicated that they would be open
to a collaborative approach.

F. Commission Conclusion

The Commission notes that it has long had a policy favoring competition in energy markets, and the Commission believes that customers will generally benefit from being given the opportunity to participate in a well-designed competitive market. The Commission also recognizes that the Act also generally supports competition in the market, and that the Commission has consistently advanced this view. In this proceeding, the Commission is presented with RGS and ICEA urging it to continue further down the road toward competitive markets by bringing customer choice to AIC’s residential and small commercial customers, while Staff, CUB, and AIC suggest the Commission take a slower approach and await the report from the ORMD, which will apprise the Commission on the state of competition in Illinois’ gas and electric markets, as well as barriers to retail competition.

The Commission is troubled, however, when some of the parties suggest that this issue not proceed any further in this docket, and that this issue be addressed following the filing of the ORMD report. The Commission notes that the evidence presented in this docket on the ORMD process appears minimal, with a suggestion by Staff witness Rearden that the report may not be concluded until the middle of 2013, and his indication that he is not sure that Staff will even participate.

The Commission does not agree with the argument that the report from ORMD pursuant to Section 19-130 of the Act should be a prerequisite for development of a mass market natural gas choice program. The Commission finds the language of Section 19-130 to be pro-competition, noting that Section 19-130 appears to presume that there should be competitive markets in Illinois, with an apparent mandate to the ORMD to identify barriers to the development of those competitive markets and propose solutions to eliminate those barriers. The Commission believes it would be contrary to both the letter and the spirit of Section 19-130 to use that section as a reason not to advance competition in Illinois, and we decline to read the section in that manner. In the Commission’s view, initiation of a workshop process to develop and implement a mass market natural gas choice program is entirely consistent with Section 19-130, and in no way conflicts with its intent or impinges upon the ORMD report process that it envisions.

While the Commission recognizes that any process, including a workshop, will take time, the Commission believes that this issue would best be addressed by commencing the workshops sooner, rather than later. The Commission acknowledges that there may be some overlap between the conducting of the workshops and the preparation of the ORMD report; however, the Commission suggests the parties may find some synergies available between the two.
The Commission finds it appropriate therefore, to direct Staff to host workshops on the issue of whether an SVT is appropriate for the AIC service territories, with the issues to be covered including those addressed by the parties, which appear to include: whether there would be any benefit to customers from such a program; whether the costs of implementing such a program would be reasonable; whether there is utility support for the competitive market; will there be full utility cost recovery for the utility; and a properly adjusted price-to-compare. The Commission recognizes that there will most certainly be other issues that arise during the workshop process, and the Commission encourages the parties to fully explore these issues. This workshop process is open to all interested stakeholders and should include participation by Staff, including the ORMD.

The Commission recognizes that it has used a workshop process in numerous other instances involving both choice issues as well as other more complex issues. The Commission is of the opinion that a workshop process provides flexibility and open access to all stakeholders to work out development and operational details for a choice program, to consider other examples of choice programs, and to debate and formulate a workable process to implement mass market choice for AIC customers. The Commission expects all parties to work in good faith during the workshop process, and believes that each party involved in this proceeding has expressed just such intent.

With regard to the timing of the workshops, the Commission finds that it would be appropriate for the workshop process to commence within sixty days of the date of this Order. The Commission also finds that a workshop of six months duration should be adequate. The Commission believes this will give all parties a sufficient opportunity to identify and debate any operational issues presented by an SVT; and as CUB notes, to address any needed consumer protections. The Commission hopes that the workshops will allow the parties to have a full opportunity to identify potential issues and reach consensus (to the extent possible). The Commission therefore directs Staff to convene a workshop process within sixty days of this Order, with the workshop open to all interested stakeholders. The workshops should have the goal of developing a consensus on this issue, and the workshops shall conclude with AIC filing a petition within 60 days of the conclusion of the workshops, which petition should include as an exhibit suggested SVT tariffs based on discussions at the workshops. Should the workshop process be unable to develop any consensus as to suggested SVT tariffs, rather than AIC filing a petition, Staff is directed to prepare a report to the Commission detailing the workshop process and the issues and discussions presented by the parties.

By the Commission’s action in this Order, the Commission does not intend to prejudge whether and to what extent a natural gas retail choice program may be appropriate for AIC. 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 the program is being developed, rather than to address them when a program might already be in place. The Commission recognizes that a poorly-executed SVT
program could do harm to market entrants and market participants, and might slow the development of a robust natural gas market.

XII. OTHER

A. Rate Zone Schedules in Future Rate Filings

Through the time of hearing, AIC and the Staff disagreed as to whether the order in this case should expressly require AIC to provide cost of service data by Rate Zone in future rate filings. Since the hearing, AIC and Staff have agreed that the order should reflect the following finding:

The Commission notes AIC’s acknowledgment that AIC is required to provide separate rate base schedules, operating income schedules, and embedded cost of service studies for each of the separate Rate Zones with its rate case filings as long a separate Rate Zone pricing exists. The Commission further notes AIC’s commitment to do so in future rate cases.

The Commission finds this provision to be appropriate and it is hereby incorporated herein.

B. Original Cost Determination

AIC sought original cost determinations because certain requirements for preservation of records are associated with or related to an original cost determination. AIC recommends the Commission conclude and make a finding in the Order in this proceeding that AIC’s plant balances as of December 31, 2009 reflected on AIC Gas Schedule B-5 are approved for purposes of an original cost determination. On rebuttal, Staff agreed that AIC plant balances as of December 31, 2009 should be used, but suggested making the determinations separately by Rate Zone. AIC witness Stafford recalculated Staff’s adjustment to adjust amounts to the correct line number on Gas Rate Zone 3. This issue is now resolved and Staff recommends that the order in this proceeding contain the following language in the Findings and Ordering Paragraphs:

(x) the Commission, based on AIC’s gas Rate Zone 1 original cost of plant in service as of December 31, 2009, before adjustments, of $375,245,000, and reflecting the Commission’s determination adjusting that figure, approves $374,930,000 as the original cost of plant for AIC’s gas Rate Zone 1 as of said date;
the Commission, based on AIC’s gas Rate Zone 2 original cost of plant in service as of December 31, 2009, before adjustments, of $520,095,000, and reflecting the Commission’s determination adjusting that figure, approves $519,714,000 as the original cost of plant for AIC’s gas Rate Zone 2 as of said date; and

the Commission, based on AIC’s gas Rate Zone 3 original cost of plant in service as of December 31, 2009, before adjustments, of $954,029,000, and reflecting the Commission’s determination adjusting that figure, approves $938,504,000 as the original cost of plant for AIC’s gas Rate Zone 3 as of said date.

The Commission finds the suggested original cost determinations to be appropriate, and they will be adopted for use in this proceeding.

C. Depreciation Rate Study

Staff recommends that the Commission order AIC to prepare depreciation studies and file the studies with the Commission within six months of the date of the Order in this proceeding consistent with the Rate Zones established by the Commission in setting rates in this case. Staff proposed the depreciation studies should be conducted prior to AIC’s next rate case. AIC indicates that the Commission last established depreciation rates for the former operating utilities in Docket Nos. 07-0585 et al. (Cons.) based upon depreciation studies for individual plant accounts within each of the legacy companies. AIC states that these rates were not necessarily uniform for the same account across each operating utility. AIC notes that prior to the merger, it filed a petition on August 23, 2010 for approval to change to combined, weighted average rates for the combined entity’s gas operations. AIC concurs with Staff that new gas depreciation studies are needed, and has reached agreement with Staff that AIC be allowed nine months from the date of the order in this case to conduct and file the studies with the Commission. Nine months from the date of the Order in this proceeding is needed to allow AIC sufficient time to compile and review study data based on AIC utility plant and depreciation reserve balances and related retirement and net salvage experience through year end 2011 utilized in the determination of new depreciation rates. Furthermore, the AIC gas depreciation studies will establish depreciation rates by Commission account or subaccount that will allow for calculation of depreciation expense and allocation of expense to Rate Zones in a manner very similar to the approach used by AIC and Staff in the current rate case.

The Commission agrees with this recommendation, and will direct that AIC prepare new depreciation studies within nine months of the date of this Order, in conformity with the parties agreement.
XIII. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having given due consideration to the entire record herein and being fully advised in the premises, is of the opinion and finds that:

(1) AIC is an Illinois corporation engaged in the distribution and sale of electricity and natural gas to the public in Illinois, and is a public utility as defined in Section 3-105 of the Act;

(2) the Commission has jurisdiction over the parties hereto and the subject matter herein;

(3) the recitals of fact and conclusions of law reached in the prefatory portion of this Order are supported by the evidence of record, and are hereby adopted as findings of fact and conclusions of law; Appendices A, B, and C attached hereto provide supporting calculations for those portions of this Order concerning gas operations in Rate Zones 1, 2, and 3, respectively.

(4) the test year for the determination of the rates herein found to be just and reasonable should be the 12 months ending December 31, 2012, as adjusted; such test year is appropriate for purposes of this proceeding;

(5) for purposes of this proceeding, based on AIC’s gas Rate Zone 1 original cost of plant in service as of December 31, 2009, before adjustments, of $375,245,000, and reflecting the Commission’s determination adjusting that figure, the net original cost rate base for gas delivery service operations in Rate Zone 1 as of said date is $374,930,000;

(6) for purposes of this proceeding, based on AIC’s gas Rate Zone 2 original cost of plant in service as of December 31, 2009, before adjustments, of $520,095,000, and reflecting the Commission’s determination adjusting that figure, the net original cost rate base for gas delivery service operations in Rate Zone 2 as of said date is $519,714,000;

(7) for purposes of this proceeding, based on AIC’s gas Rate Zone 3 original cost of plant in service as of December 31, 2009, before adjustments, of $954,029,000, and reflecting the Commission’s determination adjusting that
figure, the net original cost rate base for gas delivery service operations in Rate Zone 3 as of said date is $938,504,000;

(8) a just and reasonable return which AIC should be allowed to earn on its net original cost gas delivery service rate base is 8.33%; this ROR incorporates a ROE of 9.06%;

(9) the ROR for Rate Zone 1 set forth in Finding (8) results in base rate gas delivery service operating revenues of $77,317,000 and net annual operating income of $18,637,000 based on the test year approved herein;

(10) the ROR for Rate Zone 2 set forth in Finding (8) results in base rate gas delivery service operating revenues of $78,910,000 and net annual operating income of $15,134,000 based on the test year approved herein;

(11) the ROR for Rate Zone 3 set forth in Finding (8) results in base rate gas delivery service operating revenues of $175,844,000 and net annual operating income of $45,637,000 based on the test year approved herein;

(12) AIC’s gas delivery service rates which are presently in effect are insufficient to generate the operating income necessary to permit it the opportunity to earn a fair and reasonable return on net original cost rate base; these rates should be permanently canceled and annulled;

(13) the specific rates proposed by AIC in its initial filings do not reflect various determinations made in this Order regarding revenue requirement, cost of service allocations, and rate design; the proposed rates should be permanently canceled and annulled consistent with the findings herein;

(14) AIC should be authorized to place into effect tariff sheets for Rate Zone 1 designed to produce annual base rate gas delivery service revenues of $77,317,000, which represents an increase of $6,791,000 or 9.63%; such revenues, in addition to other tariffed revenues, will provide AIC with an opportunity to earn the ROR set forth in Finding (8) above; based on the record in this proceeding, this return is fair and reasonable for Rate Zone 1;
(15) AIC should be authorized to place into effect tariff sheets for Rate Zone 2 designed to produce annual base rate gas delivery service revenues of $78,910,000, which represents an increase of $10,657,000 or 15.61%; such revenues, in addition to other tariffed revenues, will provide AIC with an opportunity to earn the ROR set forth in Finding (8) above; based on the record in this proceeding, this return is fair and reasonable for Rate Zone 2;

(16) AIC should be authorized to place into effect tariff sheets for Rate Zone 3 designed to produce annual base rate gas delivery service revenues of $175,844,000, which represents an increase of $14,772,000 or 9.17%; such revenues, in addition to other tariffed revenues, will provide AIC with an opportunity to earn the ROR set forth in Finding (8) above; based on the record in this proceeding, this return is fair and reasonable for Rate Zone 3;

(17) determinations regarding cost of service, interclass revenue allocations, rate design, and tariff terms and conditions, as are contained in the prefatory portion of this Order, are reasonable for purposes of this proceeding; the tariffs filed by AIC should incorporate the rates and rate design set forth and referred to herein;

(18) the new tariff sheets authorized to be filed by this Order shall reflect an effective date not less than five working days after the date of filing, with the tariff sheets to be corrected within that time period if necessary, except as is otherwise required by Section 9-201(b) of the Act as amended;

(19) all motions, petitions, objections, and other matters in this proceeding which remain unresolved should be disposed of consistent with the conclusions herein.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the tariff sheets at issue in these dockets and presently in effect for gas delivery service rendered by Ameren Illinois Company d/b/a Ameren Illinois are hereby permanently canceled and annulled effective at such time as the new gas delivery service tariff sheets approved herein become effective by virtue of this Order.

IT IS FURTHER ORDERED that the proposed tariffs seeking a general increase in gas delivery service rates, filed by Ameren Illinois Company d/b/a Ameren Illinois on February 18, 2011, are permanently canceled and annulled.
IT IS FURTHER ORDERED that Ameren Illinois Company d/b/a Ameren Illinois is authorized to file new tariff sheets with supporting workpapers in accordance with Findings (14), (15), (16), (17), and (18) of this Order, applicable to gas delivery service furnished on and after the effective date of said tariff sheets.

IT IS FURTHER ORDERED that all motions, petitions, objections, and other matters in this proceeding which remain unresolved are disposed of consistent with the conclusions herein.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this 10th day of January, 2012.

(SIGNED) DOUGLAS P. SCOTT
Chairman

[1] AMS is the service company subsidiary of Ameren and provides various services to its affiliates, including AIC.
[2] The numbers contained in the table reflect only proposed delivery service revenues since it is only those revenues at issue in this proceeding.