BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of a Working Case to Consider Policies to Improve Electric Utility Regulation.	)))	File No. EW-2016-0313

REPLY COMMENTS OF AMEREN MISSOURI

As stated in Ameren Missouri's initial comments, the most serious issue faced by electric utilities in the state of Missouri is the mismatch between 100-year-old statutes that govern electric utilities and the modern challenges presented by regulatory lag. Electric load growth is stagnant or declining, yet electric utilities face the need for massive investment in their generation, transmission and distribution systems over the next 20 years. Those investment needs stem from expenditures over which electric utilities have little control, such as mandatory environmental and renewable energy compliance requirements, as well as the need to replace a large swath of infrastructure reaching the end of its life. And the existing regulatory structure, which was designed to meet the needs of the early 20th century, provides disincentives for electric utilities to proactively address these problems. In the long run, customers will not benefit from a regulatory framework that discourages beneficial investment to meet their expectations for service in the modern era.

Other states have recognized this problem and have already taken steps to address the issue of regulatory lag and are reaping the rewards of increased infrastructure investment. For example, the Arkansas legislature enacted legislation in 2015 which adopted performance based ratemaking, including the incorporation of forward test years and streamlining the cost recovery process to facilitate investment. In other states, public service commissions have approved plans which offer faster recovery of capital investment. For example, the Indiana Utility Regulatory

Commission recently approved a plan to allow Duke Energy to invest $1.4 billion in infrastructure improvements through 2022. These costs are recovered through a rider and earn an allowed return on equity (ROE) of 10%. Iowa is moving forward with favorable regulatory treatment to encourage major wind investments by Alliant Energy and MidAmerican Energy Company. And Exelon Corporation, which operates in 10 states, recently reported plans to invest $18 billion in infrastructure needed to make their grid smarter, more reliable and more resilient by 2020.

This proceeding affords Missouri the opportunity to join the many other states that are reforming their regulatory processes to encourage investment that will modernize the electric grid and enhance electric infrastructure for the long-term benefit of electric customers and the state as a whole. Ameren Missouri believes that the goal should not be to develop infrastructure that provides average service options to customers or average reliability. Today's customers expect and deserve more. States and electric utilities that will succeed over the long run will find ways to provide better than average service to customers—higher levels of reliability and a greater variety of service options—while keeping electric rates reasonable.

Ameren Missouri looks forward to discussing all of the issues raised in the initial comments submitted in this proceeding in the workshops scheduled by the Commission, listening to the perspectives of other parties, and seeing whether common ground can be found with regard to improving electric utility regulation. As a consequence, we do not think that debating all of the points made by the other stakeholders through written comments is all that productive. However, there is one issue presented by a few other stakeholders that we believe merits a written response. Specifically, a few stakeholders have cited the Regulatory Research Associates (RRA) ranking of the Missouri regulatory environment as "A2"—meaning average—

as support for the position that substantive improvements to Missouri's regulation of electric utilities are unnecessary. For example, the Midwest Energy Consumers' Group's (MECG) initial comments state: "Clearly, given this A2 rating, the Missouri Commission is fulfilling its duty to balance the interests of utility shareholders and customers." MECG Initial Comments, p. 13. Similarly, Missouri Industrial Energy Consumers' (MIEC) initial comments state: "This [the A2 rating] is reflective of the balance that the Missouri regulatory process has achieved. Note that the 'average' ranking for Missouri is described as 'constructive regulatory environment from an investor viewpoint.' It is certainly important to recognize that from an investor point of view, Missouri's regulatory process is considered to be constructive." MIEC's Initial Comments, p. 2.

Ameren Missouri believes that this view is based on a misinterpretation of the RRA ranking. First of all, the RRA ranking is based on the regulatory environment in Missouri as applicable to all utilities—electric, gas and water included. As the owner of both an electric and gas utility, Ameren Missouri knows that gas regulation in Missouri provides some benefits not available to the electric industry. In particular:

- The Infrastructure System Replacement Surcharge (ISRS) that is available to gas (and water) utilities greatly reduces regulatory lag for the capital projects to which it applies. No such mechanism is available for electric capital projects;
- The rate design currently in effect for gas utilities ensures that a substantial portion of fixed costs are recovered through fixed charges—either a customer charge or a first block usage charge that nearly all customers' usage exceeds every month. In contrast, almost all fixed costs of electric utilities are recovered through variable charges, making them vulnerable to under-recovery when loads drop.

- The purchased gas adjustment (PGA) charge for gas utilities is set based on some projected data and allows for 100% recovery of prudently incurred gas costs. In contrast, the electric fuel adjustment clause (FAC) is based on historic data and allows for recovery of only 95% of the change in net energy costs between rate cases.
- Rates of return on equity (ROE) for gas utilities have on occasion been set at a high level compared to the national average. For example, in File No. GR-2014-0152 decided in December, 2014, Liberty Utilities was granted an authorized ROE of 10%. In contrast, in their most recent cases, Ameren Missouri and Kansas City Power & Light Company were granted authorized returns of 9.53% and 9.5%, well below the national average for integrated electric utilities, which is generally considered to be a riskier business than the natural gas utility business.

The point is not that Missouri's regulation of gas utilities is perfect or to imply that there should not be improvements to the regulatory structure for natural gas utilities. There are some improvements to gas utility regulation that would be warranted and that Ameren Missouri has supported and will continue to support. But Missouri's gas utilities do not face the same level of difficulty with regulatory lag and unrecovered fixed costs with which Missouri's electric utilities must contend. And RRA takes into account Missouri's more favorable regulatory environment for gas utilities when it ranks Missouri's overall regulatory environment. Moreover, in general Missouri's gas utilities do not face the same kind of bow wave of investment needs because their systems have largely been replaced and upgraded in the past decade or so with the help of the ISRS statute.

Recent comments from RRA bear this out. In its July 21, 2016 publication of State Regulatory Evaluations, RRA stated:

> In addition, RRA is maintaining its Average/2 ranking of the Missouri jurisdiction at this time, but is mindful of the fact that the 2016 legislative session concluded without action being taken on a bill that would have altered the state's ratemaking framework to address "regulatory lag." The issue is of particular concern to Missouri's electric utilities, and the matter is now being considered both by an interim legislative committee and the PSC. Although the utilities are generally supportive of potential changes to the regulatory paradigm, recent comments from the public counsel were dismissive of regulatory lag concerns. *Should the legislature or PSC fail to take action to address these concerns, a reduction in the ranking may be justified.* (emphasis added) (See Appendix A, pp. 1-2)

Clearly the outcome of this proceeding, and the legislative committee hearings are being carefully watched by RRA to see if regulatory lag for electric utilities is addressed.

Investor services companies, better barometers of investor sentiment than RRA, have also recognized the difficult regulatory environment Missouri electric utilities face, and the opportunities for improvement that are offered in this proceeding and in the legislative committee hearings. For example, in a "Sector In-Depth" report published on November 5, 2015, Moody's Investors Service listed Missouri in a category of "less credit-supportive" states that included New Mexico, Kansas, Missouri and Montana. Moody's said that electric utilities in Missouri face greater regulatory lag compared with most electric utilities in most other states that are considered credit-supportive because:

- There are limited opportunities for interim rate adjustments;
- Using a historical test year in rate cases contributes to longer lag times;
- Historically, allowed returns on equity in Missouri are lower than industry average; and

- Other types of utilities in Missouri have shorter lag times.

(See full report attached hereto as Appendix B, p.1.)

Moody's analysis was reflected in its Credit Opinion for Ameren Missouri issued one month later, on December 8, 2015, in which it stated: "We consider Missouri's regulatory environment to be stable but still challenging as it has limited interim base rate recovery mechanisms, resulting in longer regulatory lag, and tends to be more litigious....Examples of the MPSC's limited credit supportiveness include a lack of a forward test year, the inability to include construction work in progress (CWIP) in rate base, and no tracker for capital investments for electric utilities."

(See full report attached hereto as Appendix C, p. 2.)

Other credit ratings agency reports reference similar problems. For example, in a Full Rating Report issued by Fitch Ratings earlier this year, the challenging regulatory environment in Missouri was cited. Fitch stated:

> Regulatory lag due to the use of an historical test year in setting rates, the absence of CWIP in rate base, and an extended review period, remains a credit concern.

(See full report attached hereto as Appendix D, p. 2.)

On a more positive note, investor services companies have recognized that an improvement in the regulation of electric utilities in Missouri is possible. Both Moody's and Fitch recognize that possibility in their reports. In addition, Wolfe Research, a well-respected investor research organization, specifically cited the existence of this proceeding and the Senate Interim Committee on Utility Regulation and Infrastructure Investment meetings as positive signs that improvements to Missouri's regulation of electric utilities could be forthcoming.

The bottom line is that, contrary to the implications in some of the initial comments, RRA and investor services organizations recognize the problems that regulatory lag is causing Missouri's electric utilities and the opportunities that Missouri has to address these issues. Ameren Missouri is hopeful that the upcoming workshops will offer a real opportunity to address these issues to the ultimate long-term benefit of customers and utilities alike.

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Respectfully submitted,

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