**STATE OF ILLINOIS**
**ILLINOIS COMMERCE COMMISSION**

| | | |
|---|---|---|
| Illinois Commerce Commission<br>On Its Own Motion | )<br>) | |
| | ) | 16-NOI-01 |
| Notice of Inquiry regarding the<br>Regulatory Treatment of Cloud-<br>Based Solutions | )<br>)<br>) | |

**AMEREN ILLINOIS COMPANY'S REPLY COMMENTS**
**IN RESPONSE TO NOTICE OF INQUIRY**

COMES NOW Ameren Illinois Company d/b/a Ameren Illinois (Ameren Illinois, AIC or the Company) and respectfully submits the following Reply Comments in response to the initial comments provided by interested parties in this Notice of Inquiry (NOI) on April 29, 2016 to the Illinois Commerce Commission (ICC or Commission) regarding the regulatory treatment of cloud-based solutions.

In these Reply Comments, AIC will address interested parties' responses to the Commission questions concerning Regulatory Barriers, specifically the Ratemaking Treatment of cloud-based solutions. Failure to address a particular item, point or argument raised by another party in their initial comments shall not be construed as to indicate agreement by AIC and AIC reserves the right to respond in kind in subsequent rounds of comments.

## I. REGULATORY BARRIERS

### 1. Ratemaking Treatment:

**Equal Treatment of Cloud-based and Premises-based Computing Systems**

In their initial comments, certain interested parties propose that with respect to cost recovery, the Commission treat cloud-based systems the same as premises-based systems or as the Utility Analytics Institute (UAI) recommended create a "level playing field." (UAI Int. Com., p. 2). Currently, the Generally Accepted Accounting Principles (GAAP) requires software

acquired under a cloud-based arrangement to be expensed or in certain very limited circumstances capitalized. (AIC Int. Com., p. 23). In order for a cloud-based system to be capitalized, the Financial Accounting Standards Board adopted the following criteria: (1) the customer must have the contractual right to take possession of the software and (2) the customer must be able to run the software on its own hardware or contract with another party unrelated to the vendor to hose the software. *Id.* at 24. It should be noted that some Software as a Service (SaaS) providers do not offer on-premises solutions and more and more software companies are moving to this model. This makes it impossible for a utility to capitalize any such cloud offering due to the existing GAAP regulations, causing a disincentive for the use of software tools available to utility companies to bring meaningful value to the customers we serve. The investment required to acquire and implement either a cloud-based or a premises-based system can be equally significant. If the utilities invest in a cloud-based system to replace an equivalent premises-based system, then AIC believes that this investment should be given the same treatment in ratemaking procedures as a premises-based system. In support of this concept, Nicor Gas Company (Nicor) states "there is no reasonable justification to differentiate between utility investments that are similar in nature and provide similar cost and benefit to ratepayers." (Nicor Int. Com., p. 12). The underlying concept, which is two computing systems that serve equivalent or identical purposes should not be treated equally for ratemaking purposes because one is not a premises-based system, is fundamentally flawed. Instead, the two systems should be treated in an equivalent fashion because utilities are implementing these computing systems in order to provide safe, reliable and cost effective service to their customers and existing, new and evolving *financial* accounting standards should not be applied with such rigor as to tilt the *regulatory* scales against a potentially viable option. Although different circumstances will yield

different results as utilities assess prospective IT solutions to specific and unique utility system requirements, the determination of which solution is selected - cloud-based or premises-based - should not be unnecessarily influenced by the ratemaking treatment. That is, utility information systems are as critical today to delivering electricity and natural gas to modern consumers as wires and pipes are, and utilities should not be penalized or incented to use either premises-based or cloud-based systems because of misguided application of general accounting rules or broad categorizations of costs.

**Account 303 Treatment for Cloud-Based Systems**

Ameren Illinois supports the utilities' recommendations of accounting for the costs incurred for investing in cloud-based systems similarly to premises-based systems. Specifically, Ameren Illinois supports Commonwealth Edison's (ComEd) recommendation to utilize FERC Account 303000 – General Intangible Plant and Nicor's and North Shore Gas Company and the Peoples Gas Light and Coke Company (North Shore/Peoples) recommendations to utilize Account 303-Miscellaneous Intangible Plant. These two options would allow utilities to capitalize and amortize associated costs over the useful life of the assets. This would create the "level playing field" because it would treat both cloud-based and premises-based solutions in an equivalent fashion. Ameren Illinois further agrees with North Shore/Peoples that it would eliminate rate bias in favor of a premises-based solution. While Ameren Illinois supports these approaches, as both a gas and an electricity utility, the Company would request that the Commission provide uniform rules for both electric and gas providers. Because AIC is a combination utility there is the possibility that these computing solutions would be used for both gas and electric systems, and equivalent treatment would therefore eliminate any confusion in ratemaking treatment and unnecessary related expenses. For a combination utility, synergies

exist whereby the utility is better able to service its customers more efficiently and cost effectively by selecting systems that assist with the management of both electric and gas meter data for combination customers. It follows therefore, that it is likely a cloud-based system could be allocated for combination utilities between gas and electric customers, and an accounting mismatch could give rise to over or under recovery problems in ratemaking if the two costs are afforded differing regulatory accounting treatment.

**Response to the Attorney General for the State of Illinois**

While Ameren Illinois agrees with the Attorney General for the State of Illinois' (AG) comments with respect to certain general principles of ratemaking, the Company disagrees with the ultimate conclusion the AG reaches. Ameren Illinois believes that the AG should take the analysis one step further, and if it were to do so, would find that good regulatory policy should drive ratemaking accounting for cloud-based systems, rather than broad generalizations and categorizations of capital vs. expense accounting. The AG paints with a broad brush and depicts the issues in this docket to be cost-related and in doing so logically inhibits its analysis from considering the regulatory barriers presented to utilities that might otherwise be amenable to cloud-based technology. Ameren Illinois does agree with the AG that there is an obligation by utility companies to provide safe and reliable service. Ameren Illinois further agrees that utilities must act prudently while incurring costs associated with providing service in order to provide these services at reasonable rates.

However, the AG assumes a ratepayer preference for treating an investment in cloud-based systems as an expense rather than include it in rate base. Ameren Illinois disagrees with this characterization that ratepayers are better off as a matter of course if cloud-based systems are expensed instead of rate-based. Ameren Illinois believes that in order to act prudently a utility must take into account not only the cost and ratemaking treatment of an investment but rather it

must take into account the best fit in terms of both its fiduciary duty to investors and its ability to meet its customers' needs. Moreover, Ameren Illinois must consider multiple factors including but not limited to safety, security, reliability and longevity, in conjunction with cost when determining the best computing system. There are a myriad of technology choices for utilities and those include premises-based, cloud-based, and combination approaches. The *financial* accounting standards and the associated time period over which rate recovery occurs is an important consideration, but not necessarily determinative when it comes to deciding the approach that may be best for a given system requirement. Furthermore, the accounting principles at issue and regulatory context in which those principles apply provide the Commission with a greater degree of flexibility to effectuate sound policy than the AG's analysis would otherwise suggest.

In large part, the focus of the AG's comments concern regulatory accounting principles and how those principles relate to GAAP standards. When an investment is made by a utility the investment must be evaluated against the backdrop of the regulatory process, because the Company must consider regulation of costs - it owes its investors a fiduciary obligation and it owes its customers the benefit of prudent management and decision-making. The AG explained that there are two types of investment or expenditure categories: expenses and rate-based. The AG states that expenses apply to immediate and recurring benefit investments and rate-based treatment applies to long term investments. The AG characterizes expenses recovery as immediate and rate-based treatment as longer and providing less cash in the short run. (AG Int. Com., p.5). As expressed in their comments, the AG argues that the cost of cloud-based systems should be considered as an expense rather than a rate-based investment in most if not all circumstances. However, what the AG does not take into consideration is that an investment in a

cloud-based system is not necessarily a short-term arrangement and may well include substantial up-front transition or start-up related costs. In contrast to the AG's characterizations, when a utility invests in a cloud-based system, it is actually investing in its long-term computing needs – and is not simply undertaking a short-term course of action. The associated costs of setting up the cloud solution, migrating data, and training staff would make it cost prohibitive to switch back and forth between cloud-based and premises-based solutions eliminating any short-term investment.

Also, the AG does not explain how an expense is necessarily better for customers. From a ratemaking standpoint, in theory customers would bear cost responsibility for an expense in one year of rates. In contrast, if a cloud-based system were included in rate base the customer would not feel the full cost of the investment in one year rather that cost would be spread over the life of the investment therefore eliminating spikes in customers' bills. Clearly when included in rate base, cloud-based costs would be spread over many years. Rate base treatment also requires the utility to finance and manage the asset, assuming the risk and responsibility for the management of that asset during its useful life. For example, if an electric utility were to consider utilizing a cloud-based data management system to manage a sophisticated time-of-use or other demand-based incentive rate and the adoption of such a system required initial set-up, testing, and customization of the system for which costs exceed $15 million dollars, *would it make sense to have customers pay those total costs in one single year, even if the system and program were expected to last at least 10 years or more?*

In large part, the AG analysis rests on *assumptions* concerning the nature of rate base investments vs. operating expenses. The AG argues essentially that GAAP generally drives regulatory accounting and policy. *Id.* at 2. This argument does not recognize that there are many

important differences between GAAP accounting for financial reporting purposes and regulatory accounting for ratemaking purposes. While the two should be consistent and reconcilable as a general matter, one must recognize that each accounting process is undertaken for different purposes. GAAP are a series of accounting protocols used in the development of financial statements intended for investors; and regulatory accounting is used to set rates paid by consumers. Consider for example that GAAP requires Goodwill be listed as an asset on a balance sheet, but in ratemaking goodwill (acquisition premium) is an asset generally permitted to be included in rate base only to the extent there are demonstrable benefits or "synergies" to customers. With respect to the appellate case cited by the AG concerning AIC's rate case and deferred tax treatment in ratemaking (Ameren Illinois v. Illinois Commerce Commission, 2013 IL App (4th) 121008, para. 39.), the case does not support the AG's position, as deferred tax reductions to rate base really have nothing to do with the way taxes are accounted for on financial statements of publicly traded entities - deferred taxes are not listed as a reduction to income producing assets when presented to investors on financial statements.

A misunderstanding of the application of the accounting standards in ratemaking drives certain assumptions that underlie the AG's conclusions. The AG argues in error that customers do not pay for a utility's cost of money when it comes to expenses, as follows: "The categorization of costs as investments that are included in rate base determines whether consumers pay the utility a cost for the capital used to fund the investment. By contrast, costs that do not meet the definition of a capital investment and are not included in rate base, are treated as expenses for which the public pays as the cost is incurred." The dichotomy depicted in this statement is simply not true. First, customers do pay for cash working capital as part of rates, which is cash that is held on hand to pay expenses, and utilities do earn a return on that

cash. Generally, the larger the expense, the more cash working capital needs to be on-hand. Second and fundamentally, customers do not pay for capital or for expenses in reality, they pay rates. When a utility uses its financial scale to invest in systems that are intended for long-term use by customers, rates are higher when those investments are expensed and lower when investments are amortized for recovery over the period in which those systems are used. The utility does not get reimbursed for its cost of capital on an absolute or guaranteed basis, but is compensated for assuming the management and financial risk of owning and operating its assets as a business over a long-term period of time; imprudent management can result in disallowances that lower the return a utility pays it shareholders.

Individual consumers clearly benefit from lower rates facilitated by capital investment from investors. The customer base itself and consumption are ever changing and dynamic, and individual customers pay their respective share of the systems costs as they make use of that system. From a ratemaking perspective, expensed items on the other hand are costs that are recovered from present customers as they are incurred, or all at once, and the utility's window of risk (both financial and managerial) associated with expense recovery is narrow. These benefits of investor-supplied capital in energy infrastructure is exactly why utilities exist as investor-owned businesses in the first place - they offer capital to meet customer energy solutions on a scale that permits mass utilization of infrastructure and are willing to assume the risk of offering such systems for public use. Cloud-based utility investments, those of scale, are no different than any other investment in plant and equipment. Thus, it follows thoughtful regulatory policy should drive the categorization of cloud-based investments and how they should be recovered through rates, and a rigid or categorical application of financial accounting practices and

standards that are evolving as technology changes should not pose a barrier to good regulatory policy.

It is noteworthy that the AG does acknowledge that there are some instances "if costs that are properly treated as expenses are unusual and have a benefit that extends beyond a year, regulatory accounting allows for the creating of a "regulatory asset" to match the recovery of the cost with the benefit of the expenditure." *Id.* at 5. The AG cites Account 182 as an option for rate-based treatment. Account 182 requires Commission approval for regulatory assets to be established as an asset subject to amortization. However, the purpose of Account 182 is to defer an expense for future rate recovery - not to permit recovery of investment in an asset. Further, regulatory assets under Account 182 typically are not tangible products or services, are generally short lived, and are fully amortized in less than five years with some exceptions, such as deferred storms costs under IEMA. A five-year period may not match the time period over which cloud-based investments are used and useful in providing service to customers. Also, the value of the asset on the balance sheet declines as it is amortized and is removed entirely from the balance sheet once its value reaches zero even though it is still providing service to customers. In comparison with Account 182, Account 303 is used for tangible products or services such as a premises-based or cloud-based system which provides a benefit to ratepayers. It capitalizes a cost that benefits ratepayers over multiple periods allowing for recovery of rates in real time over the estimated useful life of the asset. An asset that is recorded in Account 303 remains on the balance sheet as an asset until fully replaced or retired. If an asset, for example, is amortized over five years but continues to be used and useful in providing service to ratepayers, the asset stays on the balance sheet at its full gross plant value. While net plant would be $0 after being fully amortized, with no rate base impact (similar to a fully amortized Regulatory Asset),

keeping the asset on the balance sheet while the asset is still being used in utility service provides for a more accurate and relevant balance sheet, as opposed to recording to Account 182, which would remove an asset from the balance sheet once it is fully amortized without consideration of whether that asset is still providing service to customers.

## CONCLUSION

Ameren Illinois appreciates the opportunity to provide comments in response to the Commission's Notice of Inquiry and the comments of interested parties. Ameren Illinois looks forward to continued progress and discussion on these important issues.

Dated: May 26, 2016

Respectfully submitted,

AMEREN ILLINOIS COMPANY
d/b/a Ameren Illinois

Geoffrey F. Grammer
Matthew R. Tomc
AMEREN SERVICES COMPANY
One Ameren Plaza
1901 Chouteau Avenue
PO Box 66149, MC 1310
St. Louis, MO 63166-6149
314-554-3909, *direct dial*
314-554-4014, *facsimile*
ggrammer@ameren.com
mtomc@ameren.com