BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area	))))	**Case No. ER-2007-0002**

STAFF'S POST-HEARING BRIEF

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INTRODUCTION

The Staff will commence its Posthearing Brief with a short introduction noting the disdain with which Union Electric Company, d/b/a AmerenUE (AmerenUE) and Ameren Corporation (Ameren) continue to show to regulation by the Missouri Public Service Commission in a number of areas. AmerenUE's approach throughout this case has been as an overview to compare its rates to the rates of electric utilities elsewhere in the United States. Long ago this Commission indicated that industry comparisons are not an adequate standard of review: "The Commission reiterates its position set out in Re: Union Electric Company, 27 Mo.P.S.C.(N.S.)183 (1985). Industry comparisons do not establish a standard of prudence. . . ." *Kansas City Power & Light Company*, Case Nos. EO-85-185 and EO-85-225, 28 Mo.P.S.C. (N.S.) 228, 281 (1986).

Although the Staff has settled with AmerenUE all issues relating to storm damage costs, on the last day of the evidentiary hearings Counsel for AmerenUE attempted to foist onto the Staff responsibility for the AmerenUE system's infamous history respecting storms in Metropolitan St. Louis for the period after the Staff's excess earnings-revenues complaint case against AmerenUE in 2001-2002.

> Q. [Byrne] Okay. Commissioner Gaw asked some questions about recommendations the Staff has made on tree trimming, and I know you've supported the $45 million in this case --
>
> A. [Wood] Yes.
>
> Q. -- and which we've agreed too. But in 2002 the Staff in -- in the EC-2002-1 rate case, didn't the Staff file testimony that reduced the amount of tree trimming expenses for the company?
>
> A. There was a dollar amount in that account as the over -- as a portion of the overall settlement. It was not an obligation or a commitment or a limitation in terms of spending.

Q. Right. But I mean just in terms of the recommendations filed by the Staff, my recollection was it was like a four-year average and that was less than we had spent in the test year in that case; is that correct?

(Vol. 38, Tr. 4385, line 23 – Tr. 4386, line 15).

Q. [Commissioner Gaw] Mr. Wood, what was the testimony that was being referred to earlier? Was that in the complaint case for Ameren's overearnings?

A. [Wood] That would have been -- yes, the EC-2002-1 complaint case.

Q. Was the -- was there a level of tree trimming expense that was set in that settlement on that complaint case?

A. No.

Q. Do you know whether or not the Staff's position regarding that expenditure on tree trimming in the testimony that was supposedly prepared or was prepared for that case was based upon an issue regarding the test year variation from what had been the case on expenditures from Ameren in other years?

A. I'm sorry. I didn't follow your question.

Q. All right. Do you know whether or not the Staff's adjustment proposal on the test year expenditure for vegetation management was as a result of that test year varying what from the expenditures that Ameren had been -- had been giving or expending on tree trimming in other years?

A. Okay. Thank you for stating it again, and the answer is yes.

Q. All right. So in other words, was that -- was that an accounting adjustment proposal from Staff?

A. It was, along with many other accounting adjustments.

Q. All right. And had, in fact, Ameren been spending less money in the years previous to the test year on tree trimming in that -- in the test year for the '02 case?

A. I believe so.

Q. Now, did Staff subsequently discover that Ameren was not maintaining its four-year/six-year cycle?

A. Yes.

(Vol. 38, Tr. 4387, line 1 – Tr. 4388, line 14).

The UE Joint Bargaining Committee, consisting of the International Brotherhood of Electrical Workers (IBEW) Local 2, IBEW Local 309, IBEW Local 649, IBEW Local 702, IBEW Local 1439, IBEW Local 1455 and Operating Engineers Union Local 148 filed on August 31, 2006 an application for leave to intervene out of time stating that the UE Joint Bargaining Committee's interest in this matter relates to the impact of AmerenUE's proposed rates on their members and the impact tariffed rules for the provision of service may have on the health, welfare or safety of AmerenUE employees. In a supplement to its application for leave to intervene out of time filed on September 14, 2006, the UE Joint Bargaining Committee stated that it represents AmerenUE employees who maintain the transmission lines and infrastructure necessary for delivering power to AmerenUE customers. On September 26, 2006, the Commission issued an Order Granting Application To Intervene in which it granted UE Joint Bargaining Committee's Application For Leave To Intervene Out Of Time.

UE Joint Bargaining Committee did not file the testimony of any witness in this proceeding, but AmerenUE filed the Rebuttal Testimonies of Leo A. Beishir of IBEW Local 1439, David Desmond of IBEW Local 2 and Michael A. Datillo of Local No. 1455. The Rebuttal Testimonies of each of these three (3) AmerenUE witnesses contained the following identical statements about the Staff's, the Office of Administration's - Department of Economic Development's (State of Missouri's), Public Counsel's and others' rate reduction cases:

> Such huge rate cuts would be a strange way to reward all of us who have made AmerenUE such a successful, efficient supplier of electricity. Also, we are concerned that reductions of this magnitude will jeopardize AmerenUE's ability to provide quality service to its electric retail customers in Missouri. We are concerned that such a dramatic rate reduction would not provide the Company with sufficient funds to invest in much needed infrastructure improvements in generation, transmission and distribution.

(Ex. 7, Beishir Rebuttal, p. 3, lines 7-13; Ex. 8, Desmond Rebuttal, p. 3, line 8-13; Ex. 84, Datillo Rebuttal, p. 2, lines 16-22). Messrs. Beishir and Desmond appeared before the Commission and stated that they had not conducted any independent evaluation of the appropriate level of rate increase or decrease for AmerenUE. (Vol. 38, Tr. 4188, lines 19-23; Tr. 4195, lines 21-24.) Neither Mr. Beishir nor Mr. Desmond had read any of the testimony filed by the Staff in this proceeding. (*Id.* at 4190, lines 14-18; Tr. 4197, lines 14-16). It should be remembered that for the period that Messrs. Beishir, Desmond and Datillo are touting AmerenUE as being a successful, efficient supplier of electricity, AmerenUE was agreeing to rate reductions as a result of Staff audits.

In response to a question from Chairman Davis, whether he was concerned that whatever amount of ratepayer funding for vegetation management is set by the Commission for vegetation management, would it be spent by AmerenUE, Mr. Desmond responded as follows:

> No. I feel that talking to the contractors that are hiring these trimmers and that, they're telling us that they are supposed to put more on throughout the years to compensate the lack of trimming in the past.

(Vol. 38, Tr. 4202, lines 21-25).

AmerenUE and Ameren Corporation have made inconsistent arguments before this Commission and the Federal Energy Regulatory Commission (FERC) regarding whether this Commission has jurisdiction over the prudence of AmerenUE's actions or lack of action respecting the end of AmerenUE's cost based power supply agreement with Electric Energy Inc. (EEInc.). AmerenUE in its Prehearing Brief, at pages 26-30, filed March 6, 2007, argues that this Commission is preempted by the Federal Power Act (FPA) from making any of the proposed EEInc. adjustments, which AmerenUE also asserts would violate the Commerce Clause. Maybe AmerenUE's and Ameren's explanation for the unseemly inconsistency in their arguments

concerning whether this Commission has jurisdiction is that AmerenUE is making the argument before the Missouri Commission that the Missouri Commission has no jurisdiction and Ameren is making the argument at the FERC that the Missouri Commission does have jurisdiction. This matter will be addressed further in the EEInc. section below but it should be remembered from the Staff's Prehearing Brief that Ameren argued to the FERC that the Office of the Public Counsel's (Public Counsel's) concerns about AmerenUE's rights to power from the EEInc. Plant is in the area of jurisdiction of the Missouri Commission and should be addressed by the Missouri Commission. (May 25, 2004 Applicants' Motion For Leave To Submit Answer And Answer in FERC Docket No. EC04-81, filed by Ameren Corporation, Dynegy, Inc., Dynegy Midwest Generation, Inc., Dynegy Power Marketing, Inc., Illinova Corporation, Illinova Generating Company, and Illinois Power Company; Ex. 237, Schallenberg Surrrebuttal, pp. 3-4).

Finally, the Staff would note the origins of its excess earnings-revenues complaint case against AmerenUE. The Commission in the initial paragraph of its May 11, 2006 Order in Case No. EO-2006-0430, In the Matter of an Investigation of Union Electric Company d/b/a/ AmerenUE, stated as follows:

> Based on requests from interested persons and the need to discuss and protect proprietary and confidential information, the Commission hereby directs the Staff of the Commission to conduct a formal investigation of Union Electric Company d/b/a AmerenUE, specifically to include, but not limited to, the Joint Dispatch Agreement, the EEI, Inc. issues, and sulfur dioxide emission allowances. The Staff shall file a report with the Commission no later than June 11, 2006. The Commission hereby directs the Staff to hereby conduct the investigation expeditiously and authorizes it to take any appropriate action including filing a complaint against AmerenUE if, based on the investigation, it determines such action is appropriate.

The Staff's June 12, 2006 Report filed in Case No. EO-20006-0430 stated, in part, as follows:

> The Staff's current conclusion regarding the retail electric rates currently charged by AmerenUE in Missouri is that the Staff is not yet able to determine whether those rates are "just and reasonable" or excessive, i.e., the Staff is not yet able to determine whether AmerenUE is recovering in rates its prudently incurred costs or in excess thereof, is earning a reasonable return on its appropriate rate base or in excess thereof and what is required for AmerenUE to have a reasonable opportunity to recover in rates its prudently incurred costs and earn a reasonable return on its appropriate rate base in the future based on efficient and economical management. . . .

The Staff's June 12, 2006 Report further stated as follows:

> As the Commission is aware, in AmerenUE's May 17, 2006 Limited Motion For Reconsideration Or Clarification Of Discovery Deadlines And Motion For Expedited Treatment, AmerenUE stated that it will file a general rate case on or before July 10, 2006. The Staff has no reason to not believe that AmerenUE will file a general rate case on or before July 10, 2006. The Staff intends to continue with its audit of AmerenUE and continue to proceed with the discovery matters addressed hereinabove, as appropriate, prior to AmerenUE filing its general rate case. The Staff assumes that upon AmerenUE filing its general rate case, the Commission will issue an Order setting an intervention period and scheduling an early prehearing conference for the purpose of the parties proposing a procedural schedule to the Commission. . . .

On July 7, 2007, AmerenUE filed a rate case to increase its Missouri retail electric rates by $360,709,000, a 17.67% increase over current rate levels. Part of AmerenUE's case is the application of an obscure provision of the Commission's rules, 4 CSR 240-10.020 that AmerenUE asserts entitles it to an additional $386,744,000. AmerenUE is not literally asking for this additional $386,744,000, but at least in its July 7, 2006 filing was citing this rule as providing additional support for its revenue requirement request of $360,709,000.

The Staff filed its direct case on December 15, 2006 and on December 29, 2006 the General Counsel's Office filed an Overearnings Complaint with the Commission. The Commission had specifically authorized the Staff to file an overearnings complaint by the Staff in this case in its Order of July 14, 2006. The Staff filed on Thursday, April 19, 2007 a Revised

True-Up Reconciliation which shows the revenue requirement positions of the various parties. The Staff shows its own calculation of AmerenUE's revenue requirement as ($62,107,732) at the Staff's 9.25% return on equity recommendation.

FUEL ADJUSTMENT CLAUSE (FAC)

Should AmerenUE's proposed fuel adjustment clause be approved and, if so, with what modifications or conditions? Should any tracking or sharing of changes in off-systems sales margins be implemented?

Nothing occurred during the evidentiary hearings that caused the Staff to change its position that the Commission should not allow AmerenUE to implement a fuel and purchased power costs recovery mechanism, a fuel adjustment clause (FAC) or an interim energy charge (IEC), but if AmerenUE is granted a FAC by the Commission, revenues from off-system sales should flow-through the FAC to reduce both the level of the FAC rate and its volatility rather than be shared with AmerenUE shareholders. (Ex. 245, Wood Rebuttal, p. 2, lines 21-22; Ex. 246, Wood Surrebuttal, pp. 4-5).

Mr. Wood testified that he was not aware of any study or analysis that shows that AmerenUE's proposed incentive mechanism meets the requirements of 4 CSR 240-20.090(11)(B), that is, he was not aware of any study or analysis which shows that AmerenUE's proposed incentive mechanism is structured such that anticipated benefits to AmerenUE's customers from the incentive mechanism equals or exceeds the anticipated costs of the mechanism:

> 4 CSR 240-20.090(11)(B): Any incentive mechanism or performance based program shall be structured to align the interests of the electric utility's customers and shareholders. The anticipated benefits to the electric utility's customers from the incentive or performance based program shall equal or exceed the anticipated costs of the mechanism or program to the electric utility's customers. For this purpose, the cost of an incentive mechanism or performance based program shall include any increase in expense or reduction in revenue credit that increases rates to

> customers in any time period above what they would be without the incentive mechanism or performance based program.

(Ex. 246, Wood Surrebuttal, p. 6, lines 1-20).

Section 386.266.4 provides, in relevant part, that the Commission must find that the adjustment mechanism is reasonably designed to provide the utility a sufficient opportunity to earn a fair return on equity:

> 4. The commission shall have the power to approve, modify, or reject adjustment mechanisms submitted under subsections 1 to 3 of this section only after providing the opportunity for a full hearing in a general rate proceeding, including a general rate proceeding initiated by complaint. The commission may approve such rate schedules after considering all relevant factors which may affect the costs or overall rates and charges of the corporation, provided that it finds that the adjustment mechanism set forth in the schedules:
>
> (1) Is reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity

(Emphasis added). It is the Staff's position that AmerenUE does not need a FAC, or an IEC, in order to have a reasonable opportunity to achieve its authorized rate of return and AmerenUE does not need a FAC, or an IEC, since its revenue opportunities in off-system sales mitigate much of its fuel price risk. (Ex. 245, Wood Rebuttal, p. 4, line 1 – p. 5, line 6). In fact, one of the reasons that January 1, 2007 was chosen as the end of the update period in this case was that some of the recent increases in coal costs to AmerenUE would not be certain until January 1, 2007. (Ex. 245, Wood Rebuttal, p. 5, lines 1-5). Staff witness John P. Cassidy testified that through the true-up process, all known and measurable increases in coal and freight costs, as well as nuclear fuel price increases reflected in production expense at January 1, 2007, would be included in the Staff's cost of service determination. (Ex. 208, Cassidy Rebuttal, p. 6, lines 1-9).

The following table was in the Staff's Supplemental Pre-Hearing Brief but it is being repeated here because the headings for the columns shifted in the brief, thus making the table

difficult to read. The table demonstrates that the majority of AmerenUE's actual net generation is provided through the use of nuclear and coal fired facilities:

Primary Fuel Source	Purchases & Net MWH Generation 6/30/2006	6/30/06 % of Total	Purchases & Net MWH Generation 12/31/2006	12/31/06 % of Total
Nuclear	8,079,309	15.1%	10,116,660	19.1%
Coal	39,458,584	73.5%	39,375,535	74.1%
CTG Gas/Oil	451,481	0.8%	409,889	0.8%
Hydro/Pump	958,832	1.8%	955,563	1.8%
Purchased Power	4,706,599	8.8%	2,252,920	4.2%
Total	53,654,805	100%	53,110,567	100%

(Ex. 208, Cassidy Rebuttal, p. 2, lines 19-28).

Various parties, including the Staff have referred to UE/AmerenUE, not having had a rate increase case in 20 years. The Staff believes that a summary review of UE/AmerenUE rate increase and decrease cases before and after the Missouri Supreme Court found electric fuel adjustment clauses to be unlawful in *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41 (Mo. banc 1979) would be instructive. In none of the situations identified below did UE/AmerenUE "volunteer" to forego or reduce an increase of rates associated with the phase-in of the Callaway nuclear generating unit, or "volunteer" to otherwise reduce rates, without the Commission first either opening a docket to commence an investigation or the Staff commencing an earnings audit which showed UE/AmerenUE to be in an excess earnings-revenues situation.

UE/AmerenUE Rate Increase and Complaint Decrease Cases From Approximately 1970 To The Present.

(1) Case No. 16,654, 14 Mo.P.S.C.(N.S.) 515, 521 Report And Order (October 31, 1969) – "The Company will be permitted to earn a return of 12.3 percent under the estimated revenues that will be produced on the rate of return, hereinafter found to be fair and reasonable. . . . A fair and reasonable rate of return for the Company to earn on its net original cost rate base, applicable to its Missouri intrastate operations, is 7.23 percent."

(2) Case No. 17,107, 16 Mo.P.S.C.(N.S.) 245, 254 Report And Order (December 3, 1971) – Under the heading "15. *Capital Costs – Common Equity*" appears the following sentence, among others: "The Company will be permitted to earn a return of 11.9% under the estimated revenues that will be produced on the rate of return, hereinafter found to be fair and reasonable." Under the heading "16. *Original Cost Rate of Return*" appears the following sentence, among others: "A fair and reasonable rate of return, original cost rate base, Missouri, for the company is found to be 7.87%."

(3) Case No. 17,433, 17 Mo.P.S.C.(N.S.) 408, 101, Report And Order (November 17, 1972) – Under the heading "19. *Original Cost Rate of Return.*" appears the following sentence, among others: "A fair and reasonable rate of return for the Applicant to earn on its net original cost rate base is 8.15 percent."

(4) Case No. 17,965, 18 Mo.P.S.C.(N.S.) 440, 444, Report And Order (March 29, 1974) – In the last Union Electric rate case, the Commission established a reasonable rate of return to Company of 8.15% on original cost rate base and a return to equity of 12.36 percent." – interim electric rate increase case – Commission denied UE's request

(5) Case No. 17,972, 19 Mo.P.S.C.(N.S.) 93, 101, Report And Order (June 7, 1974) – "Company will be permitted to earn a return on equity of 12.8 percent under the revenues that will be produced on the rate of return hereinafter found to be fair and reasonable. . . . The rate of return hereinafter found to be fair and reasonable produces a rate of return of 8.42 percent on Company's net original cost rate base applicable to its Missouri intrastate operations which we find to be fair and reasonable."

(6) Case No. 18,314 and 18,527, 20 Mo.P.S.C.(N.S.) 395, 421, Report And Order (December 22, 1975) – "The Commission concludes that Union Electric should be authorized to file tariffs designed to give the Company the opportunity to earn a rate of return on rate base of 8.72 percent and a return on common equity of 12.9 percent."

(7) Case No. ER-77-154, 22 Mo.P.S.C.(N.S.) 6, 23, Report And Order (January 19, 1978) – ". . . the Commission finds that 13.1 percent is the appropriate return on book equity." The Commission found the weighted cost of capital to be 9.109 percent.

(8) Case No. ER-80-17, Report And Order (April 24, 1980) (decision not published in Mo.P.S.C.(N.S.)) – increase in gross revenues, exclusive of gross receipts and franchise taxes, of $20,473,500 on an annual basis authorized

(9) Case No. ER-81-180, 24 Mo.P.S.C.(N.S.) 434, Report And Order (July 13, 1981) – increase in gross revenues, exclusive of applicable gross receipts taxes, of $49,975,000 on an annual basis authorized – *Re Union Electric Co.*, Case No. ER-81-180, 24 Mo.P.S.C.(N.S.) 443, Supplemental Report And Order (July 31, 1981) – additional increase in gross revenues, exclusive of applicable gross receipts taxes, of $14,894,493 on an annual basis as a result of .099 cents per kilowatt hour in additional increased coal prices authorized

(10) Case No. ER-82-52, 25 Mo.P.S.C.(N.S.) 194, 221, Report And Order (July 2, 1982) – ". . . the Commission finds that the appropriate and necessary return on common equity to be allowed Company is 15.62 percent. Applying this figure to the capital structure found appropriate herein results in an overall rate of return of 11.71 percent."

(11) Case No. ER-83-163, Report And Order (July 6, 1983) (decision not published in Mo.P.S.C.(N.S.)) – increase in gross revenues, exclusive of applicable local taxes including gross receipts and franchise taxes, of $30,500,000 on an annual basis authorized – cancellation costs of Callaway II issue was separately decided in a Report And Order that appears at 26 Mo.PS.C.(N.S.) 298 (1983) and a Report and Order On Remand that appears at 28 Mo.P.S.C.(N.S.) 189 (1986).

(12) Case Nos. EO-85-17 and ER-85-160 – Callaway Generating Facilities Commercial Operation Case – March 29, 1985 Report and Order issued (27 Mo.P.S.C.(N.S.) 183, 270) - ". . . the Commission determines that UE's recommended return on equity of 15.62 percent should be adopted in this case. This results in an overall return of 12.7 percent."

(a) Commission ordered 8 year phase-in: 6 years of rate increases followed by 2 years of no rate increases, but recovery of deferred equity

(b) Total increase over the phase-in period of approximately $652 million or 66% increase in rates

(13) Case Nos. AO-87-48, EO-85-17 and ER-85-160 – Tax Reform Act of 1986 – April 3, 1987 Order Granting Motion issued (29 Mo.P.S.C.(N.S.) 51-52)

(a) UE filed, on March 24, 1987, Motion To Revise Rate Phase-In Plan

(b) Commission granted UE's Motion - ordered smaller rate increases in Years 3 through 6 of the phase-in than originally authorized by the Commission in order to reflect lower corporate tax rates as a result of the Tax Reform Act of 1986

(14) Case Nos. EC-87-114 and EC-87-115 – Excess Earnings Complaint Cases – December 21, 1987 Report and Order issued (29 Mo.P.S.C.(N.S.) 313, 337, 339) - ". . . The current authorized return on equity is 15.62 percent. All parties agree that the cost of equity has decreased since the Callaway rate case. . . ." – ". . . the Commission finds that the Company's authorized return on equity shall be 12.01 percent, resulting in an overall cost of capital of 9.94 percent."

(a) Staff requested that Years 4 through 6 of phase-in rate increases be eliminated, the accrual of additional phase-in deferrals end, the accumulated balance of phase-in credits be reduced, and rates be decreased by $30 million on an annual basis

(b) Commission permitted a .38% increase in rates, rather than a 4.6% increase in rates for Year 4 of the phase-in, eliminated Years 5 and 6 of the phase-in rate increases, and terminated the accrual of phase-in deferrals

Phase-In Year	Initial Phase-In And Subsequent Rate Changes Per MoPSC Decision (3/29/85) Case Nos. EO-85-17 and ER-85-160	Rate Changes As Modified by Tax Reform Act of 1986 Per UE Motion and MoPSC Order (4/3/87) Case Nos. AO-87-48, E0-85-17 and ER-85-160	Rate Changes As Modified by MoPSC Decision (12/21/87) Case Nos. EC-87-114 and EC-87-115
1 (April 9, 1985)	14% ($138million)	-	-
2 (April 9, 1986)	10% ($112.4 million)	-	-
3 (April 9, 1987)	7.3% ($90.1 million)	4.6% ($57.4 million)	-
4 (April 9, 1988)	7.3% ($96.7 million)	4.6% ($60.1 million)	.38%($5.6million) [1]
5 (April 9, 1989)	7.3% ($103.7 million)	4.6% ($62.9 million)	NO INCREASE
6 (April 9, 1990)	7.3% ($111.3 million)	4.6% ($65.8 million)	NO INCREASE

(15) Case No. EO-87-175 – Comprehensive Customer Class Cost Of Service and Rate Design Case – November 6, 1990 Report and Order issued (30 Mo.P.S.C.(N.S.) 406); Case Nos. EM-91-29 and EM-91-404 – Arkansas Power & Light Company's (APL) Sale Of Its Missouri Facilities To UE – September 19, 1991 Report And Order issued (1 Mo.P.S.C.3d 96)

(a) UE agrees to absorb $30 million decrease in annual revenue requirement allocated to Small General Service, Large General Service, and Primary classes

(b) Rate moratorium for UE customers to January 1, 1993 (26 months)

(c) Amount of any acquisition adjustment/premium paid by UE to APL agreed by UE to be treated below the line for ratemaking purposes and not to be recovered in rates

(d) Rate moratorium for former APL customers

(16) Case No. ER-93-52 – End of Amortization Of Callaway Phase-In Deferrals – November 3, 1992 Report And Order issued (1 Mo.P.S.C.3d 416)

(a) UE agrees to $40 million decrease in annual revenues effective January 1, 1993

(b) Rate moratorium to September 1, 1994 (20 months) (possible increase in cost of decommissioning Callaway without increase in customer rates covered)

(18) Case No. ER-95-411 – End of rate moratorium on September 1, 1994

(a) One-time credit of $30.0 million to all UE Missouri retail electric customers

[1] Under the Case No. EC-87-114 and EC-87-115 decision, the 0.38 percent increase ($5.6 million) took effect on December 31, 1987.

(b) Rate reduction to all UE Missouri retail electric customers of $30.0 million

(c) Establishment of experimental alternative regulation plan (EARP) for three one-year periods commencing July 1, 1995 and ending June 30, 1998

(i) Sharing credits from first year of first EARP (July 1, 1995 – June 30, 1996) - $43,662,000 sharing credits – Case No. EO-96-14, 5 Mo.PS.C.3d 319, 320 (1996)

(ii) Sharing credits from second year of first EARP (July 1, 1996 – June 30, 1997) - $17,897,000 sharing credits – Case No. EO-96-14, 7 Mo.P.S.C.3d 306 (1998)

(iii) Sharing credits from third year of first EARP (July 1, 1997 – June 30, 1998) - $28,375,000 sharing credits – Case No. EO-96-14, *Union Electric v. Public Serv. Comm'n*, 136 S.W.2d 146, 149 (Mo.App. 2004).

(19) Case No. EM-96-149 – Merger of UE and Central Illinois Public Service Company (CIPS)

(a) Rate reduction to occur on September 1, 1998 after the final year of the first EARP to be equal to the average annual total revenues credited to customers, adjusted to reflect normal weather, for the three one-year sharing credit periods of the first EARP – $16,321,000 – *Union Electric v. Public Serv. Comm'n*, 136 S.W.2d 146, 149 (Mo.App. 2004).

(b) If the rate reduction did not occur on September 1, 1998, an additional credit, i.e., a "rate reduction credit," would be issued equal to the excess rates billed between September 1, 1998 and the effective date of the rate reduction.

(c) Establishment of second EARP for three one-year periods commencing July 1, 1998 and ending June 30, 2001

(i) Sharing credits from first year of second EARP (July 1, 1998 – June 30, 1999) – $20,214,000 sharing credits – Case No. EM-96-149, 9 Mo.P.S.C.3d 396, 397-98 (2000)

(ii) Sharing credits from second year of second EARP (July 1, 1999 – June 30, 2000) - $28,000,000 sharing credits – Case No. EM-96-149, 10 Mo.P.S.C.3d 211, 212-13 (2001)

(iii) Sharing credits from third year of second EARP (July 1, 2000 – June 30, 2001) - $40,000,000 sharing credits – Case Nos. EC-2002-1, EM-96-149, EC-2002-1025, and EC-2002-1059 – 11 Mo.P.S.C.3d 411, 412 (2002).

(20) Case No. EC-2002-1 – Staff excess earnings/revenues complaint case against AmerenUE filed July 1, 2001

(a) Rate reduction of $110 million in increments over three years

(b) See 19(c)(iii) above: Sharing credits of $40 million to its Missouri customers from third year of second EARP

Returning to the instant case, the Staff identified it as not a sufficient reason alone, but the Staff contends that not providing AmerenUE a FAC, or an IEC, preserves strong incentives for AmerenUE to be prudent in its efforts to purchase fuel and power. On cross-examination Staff witness Warren Wood testified that the reporting and surveillance requirements of the FAC rules are not sufficient to assure that electric utilities will maintain the efficiency of their generating plants and not let heat rates deteriorate. The purpose of the reporting and surveillance requirements is to make more readily available the information necessary to perform the appropriate assessments regarding the operations of the generating facilities. (Vol. 17, Tr. 998, line 25 – Tr. 999, line 20).

Mr. Wood was asked on cross-examination whether AmerenUE's surrebuttal proposal to (1) net off-system sales against fuel costs, (2) cap and defer four percent by rate class and (3) spread any changes over 12 months resolves some of the Staff's concerns about an FAC for AmerenUE. Respecting AmerenUE's surrebuttal proposal to net off-system sales against fuel costs, Mr. Wood responded that AmerenUE's proposal is a step better than its earlier positions, but the Staff still has concerns regarding how the benchmark is set and how the sharing mechanism is structured. (Vol. 17, Tr. 1000, line 22 – Tr. 1001, line 8). He stated that he had concerns with the four percent cap and defer proposal as had been talked about at the FAC rulemaking roundtables because prudently incurred costs are rolled into a future period and interest is applied to those costs which result in a further increase: "You may just be making the

situation worse later to enjoy a short-term benefit." (*Id.* at 1001, line 9 – Tr. 1002, line 1). Mr. Wood said he viewed spreading the costs over 12 months to be advantageous. (*Id.*).

Regarding the Staff's position on heat rate tests and/or efficiency tests, 4 CSR 240-3.161(2)(P) and 4 CSR 240-3.161(3)(Q), Mr. Wood indicated that having read AmerenUE witness Mark C. Birk's Surrebuttal Testimony, and having listened to Mr. Birk's responses to cross-examination questions, Mr. Wood thought that AmerenUE and the Staff were closer on these matters than he had originally thought when he read Schedule MJL-2-10 and -11 to AmerenUE witness Martin J. Lyons, Jr.'s Fuel Adjustment Clause Direct Testimony, Exhibit No. 12. (Vol. 17, Tr. 1002, line 15 – Tr. 1005, line 25). Mr. Wood stated that he thought that AmerenUE, without much difficulty, could comply with the four (4) procedures that he identified in his Rebuttal Testimony. (*Id.* at 1006, lines 5-9). Mr. Wood did not move away from the Staff's position that electric utilities operating under a FAC must have procedures in place that:

(1) Require testing of generation plant heat rates no less frequently than every two (2) years;

(2) Generally conform to industry-standard performance testing methodologies;

(3) Require identification of plant components that are diminishing overall plant heat rates; and

(4) Require cost-effective maintenance or replacement activities to plant components that have been identified as diminishing overall plant heat rates.

(Ex. 245, Wood Rebuttal FAC, p. 8, lines 5-11).

In response to questions from the Bench, Mr. Wood indicated that 4 CSR 240-3.161(2)(P) and 4 CSR 240-3.161(3)(Q) address the reduction in incentives that an electric utility has to keep its generating units operating efficiently if the utility can pass through fuel costs. (Vol. 17, Tr. 1006, line 23 – Tr. 1007, line15). He said that there needs to be some monitoring capability

regarding the efficiency and the maintenance of the generating units at or above levels achieved prior to the effective date of the FAC rules. (*Id.* at 1007, line 16 – Tr. 1009, line 2; Tr. 1010, line 14 – Tr. 1012, line 23).

Sharing Mechanism

The Staff is not recommending a sharing mechanism for profit margins from off-system sales ("OSS margins") in this proceeding. In its direct filing, AmerenUE proposed a sharing mechanism for OSS margins that was separate from its proposed Fuel Adjustment Clause ("FAC"). (Schukar Direct, Ex. 28, pp. 18-22). In Surrebuttal Testimony, AmerenUE witness Mr. Martin J. Lyons, Jr. proposed to combine OSS margins with fuel expense to serve native load in an FAC. (Lyons Surrebuttal, Ex. 21, pp. 20-22). (Note: The preceding two sentences correct an inadvertent error in the Staff's Supplemental Pre-Hearing Brief.[2])

At the time the Staff filed its Supplemental Pre-Hearing Brief in this proceeding, it was not entirely clear to the Staff whether AmerenUE's new proposal was merely an alternative approach or whether the Company had abandoned its earlier proposal in favor of the approach described by Mr. Lyons in his surrebuttal testimony. Consequently, in its Supplemental Pre-Hearing Brief (pp. 19-25), the Staff addressed the previous proposal in considerable detail.

During the hearing, it was established that Mr. Lyons' proposal is now AmerenUE's official position. (Vol. 13, Tr. 192, ln. 6-11). The fundamental principles underlying Staff witness Dr. Michael S. Proctor's opposition to the sharing mechanism originally proposed in the Company's direct filing (Schukar Direct, Ex. 28, pp. 18-22) are set out in Dr. Proctor's rebuttal

[2] The original language, which appears on page 24 of the Staff's Supplemental Pre-Hearing Brief, is hereby amended as follows: "In fact, the proposed sharing mechanism is one-sided, providing only benefits to shareholders when fuel costs net of profit margins from off-system sales go below ~~above~~ the normalized level for this case, but does not provide for shareholders taking on downside risk when fuel costs net of profit margins go above ~~below~~ the normalized level for this case."

testimony. (Proctor Rebuttal, Ex. 228, pp. 5-26). Those principles are equally applicable to Mr. Lyons' new sharing proposal. Accordingly, and in light of the adequate detail provided in the Staff's Supplemental Pre-hearing Brief incorporated herein, the Staff will not go into detail in this brief.

The Staff specifies two principles that must be incorporated in a properly designed sharing grid: 1) the expected value of the sharing grid should be equal to the normal level for profit margins approved by the Commission for this case; and 2) the probability of the downside risk or detriment should be equal to the probability of the upside reward or benefit. (Proctor Rebuttal, Ex. 228, p. 25). AmerenUE has not shown that the new sharing mechanism proposed in its surrebuttal testimony meets the design principles proposed by the Staff. In fact, the proposed sharing mechanism is one-sided, providing benefits to shareholders when fuel costs net of profit margins from off-system sales go below the normalized level determined for this case. It does not provide for shareholders taking on downside risk when fuel costs net of profit margins go above the normalized level determined for this case. (Lyons Surrebuttal, Ex. 21, p. 21-22). (Note: The preceding two sentences were misstated in the Staff's Supplemental Prehearing Brief and are corrected herein.)

In the Rules that the Commission adopted to implement the electric utility FAC and IEC provisions of Section 386.266 RSMo. ("Senate Bill 179"), the Commission adopted standards regarding incentive mechanisms or performance based programs in 4 CSR 240-20.090(11)(B), which states as follows:

> Any incentive mechanism or performance based program shall be structured to align the interests of the electric utility's customers and shareholders. The anticipated benefits to the electric utility's customers from the incentive or performance based program shall equal or exceed the anticipated costs of the mechanism or program to the electric utility's customers. For this purpose, the cost of an incentive mechanism or performance based program shall include any

increase in expense or reduction in revenue credit that increases rates to customers in any time period above what they would be without the incentive mechanism or performance based program.

The Staff submitted surrebuttal testimony stating that the Company has not met the standard of 4 CSR 240-20.090(11)(B). The Staff is not aware of any studies or analyses that show that AmerenUE's proposed incentive mechanism is structured such that anticipated benefits to the Company's customers from the incentive mechanism equal or exceed the anticipated costs of the mechanism. (Wood Surrebuttal, Ex. 246, p. 6).

Accordingly, the Staff recommends that the Commission not adopt AmerenUE's proposed one-sided sharing mechanism.

OFF-SYSTEM SALES

How should off-system sales be recognized in AmerenUE's revenue requirement and what amount of off-system sales margin is appropriate for the test year?

Introduction

AmerenUE is proposing that off-system sales margins amounting to $202.5 million be included in its revenue requirement in this proceeding. (Tr. 1174, ln. 1; 1416, ln. 12). The bottom line regarding this issue is that $202.5 million represents only about ** ___** of the Company's 2007 budgeted amount of ** ____** million. (Proctor, Surrebuttal, Ex. 229, p. 29, ln. 25; Brosch Surrebuttal, Ex. 504, p. 9, ln. 6-7). The Staff believes that such a wide disparity, amounting to ** _____ ** million, between the level of off-system sales margins that AmerenUE reasonably expects to earn and the amount it is willing to reflect in rates is indefensible. Measured against AmerenUE's budgeted amount, the Staff's off-system sales margin proposal of approximately $230 million[3] is eminently reasonable. In fact, in light of the

[3] based on the Revised True-up Recommendation filed by the Staff on April 19, 2007.

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evidence primarily concerning the Company's 2007 budgeted amount for off-system sales margins, the Staff believes that the Commission should consider the Staff's recommendation to be a *minimum* amount to be included in this proceeding.

This brief will address this matter in greater detail and will also show why the Staff's approach to developing its recommended level of off-system sales margins is superior to that proposed by AmerenUE. The Staff incorporates herein by reference, its Supplemental Pre-Hearing Brief, filed in this case on March 7, 2007.

Background

Off-system sales margins ("OSS margins") are equal to the difference between the amount of revenues realized from off-system sales and the variable cost of fuel and purchased power used to produce those sales. The revenues from off-system sales are a function of the spot-market electricity prices. Staff witness Dr. Michael S Proctor demonstrated the very high degree of correlation between fuel dispatch prices and the spot-market electricity prices. The off-peak price of electricity is highly correlated to the price of coal (Proctor Direct, Ex. 227, p.9, ln. 19-22; Sch. 2.1); that is, the variation in the price of coal is a good predictor of the variation in the spot-market price of electricity. This high degree of correlation between fuel dispatch prices and spot-market electricity prices reflects the fact that it is generally during the off-peak times that electric utilities have relatively low-price coal-fired generation capacity available to produce electricity for off-system sales. On the other hand, on-peak electricity prices are highly correlated to the price of natural gas (Proctor Direct, Ex. 227, p. 14, ln. 19-22; Sch. 4.1), since the spot-market price for electricity during the on-peak hours is primarily determined by natural

gas-fired generation. The Staff would note that AmerenUE agrees that these correlations exist. (Schukar 1/29 Rebuttal, Ex. 30, p. 9, ln. 4-11).

Capitalizing on these high correlations, Dr. Proctor developed the following annual average levels for spot-market electricity prices based on his recommended normal coal and natural gas prices:

$30.63/MWh - Off-Peak[4] (based on coal price)

$54.51/MWh - On-Peak[5] (based on natural gas price)

(Proctor Surrebuttal, p. 10, ln. 4-8; p. 15, ln. 3-6)

AmerenUE agrees with the Staff's recommended overall coal dispatch price of approximately 139 cents/MMBtu. (Finnell Rebuttal, Ex. 87, p. 33, ln. 15-21; Proctor Surrebuttal, Ex, 229, p. 32, ln. 1; Proctor Direct, Ex. 227, p. 8, ln. 14-16). However, the Staff and Company do not agree on the appropriate dispatch price for natural gas to use to determine the on-peak, spot-market price for electricity. The Staff has consistently proposed a natural gas dispatch price of $7.00 per MMBtu. On the other hand, the Company proposed a natural gas dispatch price of $6.00 per MMBtu in its direct filing,[6] a price of over $7.00 in its rebuttal filing[7], and in its surrebuttal filing, a price of $6.58 per MMBtu. (Tr. 1509, ln. 9-10; Proctor Surrebuttal, Ex. 229, p. 24, ln. 15-17). Additionally, although issues related to the actual production cost

[4] weekdays from 11 p.m. through 6 a.m., and weekends.

[5] weekdays from 7 a.m. through 10 p.m.

[6] In its Direct filing, AmerenUE proposed use of an adjusted three-year average (2003 through 2005) of prices. (Schukar Direct, Ex. 28, p. 17, ln. 5-8).

[7] In its Rebuttal filing, AmerenUE proposed to use the cost of natural gas actually burned in its gas-fired generation during 2006. (Proctor, Surrebuttal, Ex 229, p. 26, ln. 4-6)

modeling (the "fuel model") have been resolved between the Staff and the Company, they do not agree on the methodology used to determine the spot-market electricity prices to be input into the fuel model, which includes both the appropriate electricity price data and the appropriate form to use for the regression models that correlates spot-market prices with fuel dispatch prices. Most importantly, there is a dispute as to the relevance or importance of the Company's 2007 fuel budget in determining the appropriate level of OSS margins to be used in determining AmerenUE's revenue requirement in this proceeding. The discussion that follows addresses these contested matters.

Argument

The Staff's recommended natural gas dispatch price of $7.00/MMBtu is appropriate.

In developing his $7.00 natural gas price recommendation, Dr Proctor made several significant observations in his analysis of the data to determine an appropriate level for the natural gas dispatch price. All of these observations supported his recommendation. First, he looked at the original Company-supplied natural gas price data from January 2003 through November 2006. Using twelve-month moving averages[8], Dr. Proctor calculated a trend for natural-gas prices. (Proctor Direct, Ex. 227, Sch. 3). This trend through November 2006 resulted in a price $7.00, consistent with the most recent price of $7.11 in November 2006. (Proctor Direct, Ex. 227, p. 13, ln. 1-7; Sch. 3). While this twelve-month average included a high price from December 2005, Dr. Proctor also noted a significant low in prices in March 2006 followed by another in October 2006, but then observed that in November 2006, the natural-gas price had risen to just above $7.00 per MMBtu. (Proctor, Direct, Ex. 227, p. 13, ln. 16-22).

[8] "Using twelve-month moving averages smoothes out the month-to-month behavior and allows the analysis to focus on trends in annual average behavior. Thus twelve-month moving averages are the most appropriate data to use when analyzing trends in annual average prices." (Proctor Rebuttal, Ex. 228, p. 31, ln. 16-19).

Based on these various observations, Dr. Proctor concluded that an estimated normal gas price of $7.00 per MMBtu "is consistent with both historical trends and recent observations." (Proctor Direct, Ex. 227, pp. 13-14). In addition, Dr. Proctor updated this data through January, 2007 in his surrebuttal testimony, where he calculated both a most recent three-year average (2004, 2005 and 2006) as well as an average for 2006. This original data produced a three-year average of $6.93 per MMBtu and a slightly lower average for 2006 of $6.89 per MMBtu. However, Dr. Proctor noted that the price for October 2006 was "significantly low," and when the price for January 2007 was substituted for the low October 2006 price, the average increased to $7.03 per MMBtu. (Proctor, Surrebuttatl, Ex. 229, p. ln. 4-9) All of these various calculations provide substantial evidence that, aside from the low price in October of 2006, the trend, recent prices and recent averages all support the $7.00 per MMBtu as being a level that the Commission should adopt.

Subsequent to his direct testimony filing, Dr. Proctor learned that the Company-supplied data he had been using, and which AmerenUE itself had used in its own direct case, was now being considered as deficient by AmerenUE. With respect to natural gas, AmerenUE's concern was that, even though the original data supplied was specific to AmerenUE's gas-fired generation plants and was being used to determine dispatch prices by AmerenUE, these prices represented only a single day's spot-market price for each month. AmerenUE witness Shawn Schukar proposed instead that, even though this new data for natural gas prices is based on a Chicago hub price[9], the monthly averages of daily spot-market prices for on-peak days be used to calculate gas dispatch prices for AmerenUE. (Schukar 1/29 Rebuttal, Ex. 30, p. 13, ln. 8-21; Proctor Surrebuttal, Ex. 229, p. 3m ln. 4-15; p. 9, ln. 19 – p. 10, ln. 15). In regard to the

[9] Daily gas prices, as reported in Platts Gas Daily Midpoint For Chicago Large End Users

introduction of this new data for natural gas prices, Dr. Proctor states, "For purposes of correlating to on-peak spot-market electricity prices, it really doesn't matter which of the two natural gas price series is used." (Proctor, Surrebuttal, Ex. 229, p. 10, ln. 9-10) Thus, Dr. Proctor found no compelling reason to use the new natural gas price data being proposed by the Company. Despite having no compelling reason to use the new data, in his surrebuttal testimony, Dr. Proctor did provide some analysis of this data for purposes of comparison. First Dr. Proctor calculated the four-year trend for these prices and found that this trend confirms a price at or above the $7.00 per MMBtu level. (Proctor, Surrebuttal, Ex. 229, Sch. 2.3). In addition, Dr. Proctor calculated an average natural gas price of $6.98/MMBtu for the most recent three years, a figure almost identical to that calculated over the same three year period from the original natural gas price data. In addition, for this newly introduced natural gas price data, Dr. Proctor found that while the twelve-month average for 2006 yields a lower level of only $6.58 per MMBtu, the reason for this lower average level was below-average prices for the months of September, October and December, and because of this, Dr. Proctor could not support using this twelve-month period to calculate a normal level. (Proctor Surrebuttal, Ex. 229, p. 32 , line 21 – p. 33, ln. 4). In essence, Dr. Proctor's analysis looked at the weight of all the evidence and found that it supports the use of the $7.00 per MMBtu natural gas price; *i.e.*, 1. trends, 2. updated trends, 3. trends on the new data, 4. current prices for natural gas and 5. most recent three-year averages compared to a single year average price, where three of the months (getting 3/12 of the weight in the calculation) are not representative of average levels.

All of these observations regarding trends, averages and current natural gas prices, whether developed in connection with Dr. Proctor's direct testimony or his surrebuttal, support the reasonableness of his recommendation of $7.00 gas. Each and every one of Dr. Proctor's

observations on price levels is, if not equal to or higher than his recommendation, much closer to it than to the $6.58 value most recently proposed by AmerenUE. (Tr. 1177, ln. 2-4; 1509, ln. 9-10). The Company's figure represents the average of the 2006 actuals, and as such, is not representative of a normal level. In particular, September, October and December of 2006 were well below their three-year averages, which would have a significant impact in lowering the calculation of the twelve-month average that includes low prices from these three months. For this reason, the average price for 2006 alone should not be considered representative of a normal price for natural gas. (Proctor Surrebuttal, Ex. 229, p. 32, ln. 21 - p. 33, ln. 4; Tr. 1617, ln. 9-14). Moreover, while taking averages is a "simple" calculation to perform, the Commission should be leery of depending on that approach alone when dealing with normalization of prices that can take unexpected turns for brief periods of time. Dr. Proctor's method of looking at several indicators, including averages, is a much more complete approach.

If the weight of Staff's own evidence is not sufficient to convince the Commission of the validity of the Staff's recommended level of $7.00 per MMBtu for natural gas, then consider the Company's own evidence. Further support for the Staff's recommendation can be found in Schedule 15-1 attached to the surrebuttal testimony of Company witness Shawn Schukar. Presented there (along with coal prices) is a plot of prices of natural gas delivered to utilities since 1990, as well as forecasts for the coming years. Those forecasts show natural gas prices climbing to approximately $7.50 per MMBtu in 2007 and 2008, suggesting that, if anything, Dr. Proctor's recommended natural gas price is somewhat low, but in any event, supporting the superiority of his recommendation to that of the Company.

During the hearings, Dr. Proctor stood cross-examination and took questions from the Commissioners regarding his recommended natural gas price of $7.00 per MMBtu. Specifically,

Commissioner Murray asked questions concerning Dr. Proctor's inclusion, in his calculation of the recent three-year averages, of a month (or months) following the 2005 hurricanes, which saw elevated natural gas prices. (Tr. 1456-1473; 1504-1507). He explained that his calculations also included other months with abnormally low gas prices, and further, that one of the ways to normalize for the effects of abnormalities is to use multi-year averages. (Tr. 1459, ln. 16-19; 1460, ln. 22-23; 1472, ln. 10 – 1473, ln. 1; 1505, ln. 11 – 1506). As discussed in the preceding paragraph, the Company's latest gas dispatch price proposal of $6.58/MMBtu, which is based solely on 2006 data, places too much weight (three months out of twelve) on abnormally low prices and should therefore not be used.[10]

In addition, during cross-examination, in response to a question whether it would be statistically valid to remove all high peaks in gas prices including the three that occurred in the aftermath of the 2005 hurricanes, Dr. Proctor replied:

> In my view, it wouldn't. That would lower the average. You have to look at all the numbers that were below the average. I think you could -- and I haven't done this – you could say, well, those three are outliers. I'm going to take them out. Then in order to be fair, you would have to go in and say, well, let me look at all the ones that are low and pull those out, those outliers out.
>
> And what's happening is you're getting into an area of judgment rather than just calculating a statistical average.

Further, while cross-examining Dr. Proctor, the Company's counsel incorrectly used a set of prices from which Dr. Proctor had removed the trend over a four-year period (2003 to 2006) to point out that the months following the hurricanes were above the average shown in that data. However, the data used in this cross examination was from Dr. Proctor's work papers where the

[10] AmerenUE's switch from a multi-year average price to a single-year average is curious in light of the Company's pointed defense (albeit with respect to power prices) of the use of multiple years' worth of data in the rebuttal testimony of witness Schukar. In response to the question whether he agrees "that the use of 2006 alone prices is appropriate," Mr. Schukar responded: "No. As indicated previously, it is important to take an average across several years to reduce the potential impact associated with unusual seasonal weather variations and to otherwise remove normal volatility in prices." (Schukar 1/29 Rebuttal, Ex. 30, p. 5, ln. 10-14).

trend had been removed to calculate the cyclical and random components of the price series. Thus that data reflects a four-year average that includes 2003, and as the price data shown on Schedule 2..3 in Dr. Proctor's surrebuttal testimony clearly indicates, the very low natural gas prices from 2003 are totally inappropriate for use in calculating a normal price.

Finally, on cross-examination, Dr. Proctor gives even a further reason for adopting the $7.00 per MMBtu natural gas price as normal based again on Company data; this time, the Company's fuel budget for 2007.

> And the company used a – what's called a forward curve for [C]ynergy hub. One of the things that I observed and one of the reasons I did not want to back off the $7 gas price was that it looked very much to me like gas prices were starting to go back up, natural gas prices were starting to go back up. I think the forward [C]ynergy hub price confirms what the market's expecting about what's going to be happening over the next 12 months.
>
> So in those – in those terms, the $7, you know, you've heard all this stuff about it not being normal but including these high prices from Katrina and so forth, but it may actually turn out to be a low price looking out into the future. And it certainly appears from what the [C]ynergy hub forward prices were that that's probably the case.

Tr. 1563, ln. 10-24.

The Staff's recommended off-peak and on-peak spot-market electricity prices are appropriate and were calculated using a valid methodology.

The disagreements between Company and Staff can be broken down into price data issues and methodology issues related to specification of the proper relationships between spot-market electricity prices and fuel dispatch prices.

a. Price data issues:

As noted previously, the Staff used the same spot-market price data as the Company for developing its spot-market electricity price recommendations for its direct filing. Subsequently, the Company discovered a problem with the spot-market electricity price data, which was used

by both parties. That data did not include the congestion and loss components of price at the generating stations for the recent months following the start of the Midwest ISO energy markets. (Proctor Surrebuttal, Ex. 229, p. 6, ln. 3-6). To correct the oversight, Company witness Shawn Schuker proposed that the average Locational Marginal Prices ("LMP's") at the Company's coal-fired plants be used. The Staff opposes this approach because it understates those prices, since off-system sales are not spread evenly over all of AmerenUE's coal units or even confined to its coal-fired units; rather, they are likely to come primarily from the higher cost coal-fired units, and in some cases, from high cost gas-fired units. (Schukar 1/29 Rebuttal, Ex. 30, p. 12, ln. 12-15; Proctor Surrebuttal, Ex. 229, p. 9, ln. 4-18). Instead, Dr. Proctor regards these prices as "a lower bound on prices actually received by AmerenUE for off-system sales." (Proctor Surrebuttal, Ex. 229, page 9, ln. 16-18; Tr. 1560, ln. 15-16).

Dr. Proctor has calculated the differences associated with using the Company's new data for both natural gas prices and spot-market electricity prices. Dr. Proctor finds that a reduction in the annual, average on-peak price from introducing the new data is $3.22/MWh, and the reduction for off-peak prices due to the new data was only $0.65/MWh. (Proctor, Surrebuttal, Ex. 229, p. 25, ln,19 and p. 26, ln. 6)[11]

Although in theory, there may be grounds for applying a slight discount to the Staff's recommendation,[12] the Staff would urge the Commission, before doing so, to give due

[11] The Staff would note that the cross examination by AmerenUE's counsel that resulted in what is marked as Exhibit 110, attributes $20 million difference between Staff and Company as "Corrected Schukar." But by Dr. Proctor's calculations, the major component of difference has to do with the new spot-market data introduced by Mr. Schukar as representative of on-peak prices.

[12] If the Commission were to elect to impose such a discount, Dr. Proctor recommends that it be no greater than two percent, which approximates the reduction in off-peak prices reflected in the model results using the data proposed by AmerenUE witness Schukar. (Proctor Surrebuttal, Ex. 229, p. 31, ln. 13).

consideration to the budgeted level of OSS margins in the Company's aforementioned 2007 fuel budget (further discussed below).[13] As Dr. Proctor stated in answer to a question from Commissioner Gaw concerning his recommendation about taking this matter into account:

> Well, I think the Commission has to take a whole lot of different things into account. Okay? And when they look at where to set the – where to set the prices in this, my recommendation is that they didn't lower it from the initial levels, and part of that had to do with information that came out just prior to me filing surrebuttal testimony about where the fuel budget was.
>
> And their fuel budget was way above – not way above, but above the results that the Staff was getting in their run, in their fuel budget for 2007. And to me, that was a red flag telling me, yes, if you look literally, maybe we should lower these prices by 2 percent to reflect the differences for losses and so forth, but how does that fit together with, you know, what the company's showing now or putting in their fuel budget for 2007?

Tr. 1560, ln. 21 – 1561, ln. 11.

b. Methodology issues

After considering the filings of other parties, for purposes of his surrebuttal filing, Mr. Schukar changed his analytical approach. (Tr. 1199, ln. 10 – 1200, ln 17). Based on Dr. Proctor's analysis, including "corrections" thereto (and updates), Mr. Schukar ran regressions, over a four-year period, of monthly gas prices vs. monthly on-peak electricity prices and monthly coal prices vs. monthly off-peak prices, using the Company's revised gas price data and revised electricity price data. The result was an around-the-clock simple average purchased electricity price of $38.04/MWh, which was input into AmerenUE's fuel model to produce the Company's

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[13] During cross-examination of Dr. Proctor, counsel for AmerenUE took him through a series of calculations that eventually were admitted into the record as Exhibit 110. (Tr. 1475-1488). This series of calculations was used by AmerenUE to characterize the differences between the Staff and the Company and to put dollar values on various explanations of these differences. For example, a calculation of two-percent was used to characterize the difference between Staff and Company on electricity price data. However, this characterization would be false, as two-percent was the approximate difference in off-peak prices, but on-peak prices had a much higher difference of approximately six percent. (Proctor Surrebuttal, Ex. 229, p. 31, ln. 13-17). Thus, the table constructed does not correctly account for differences in data.

now-proposed $202.5 million in OSS margins. (Tr. 1416, ln. 12 – 1417, ln. 6; Schukar Surrebuttal, Ex. 32, p. 5, ln. 14-20). In contrast, in order to develop normal off-peak and on-peak spot-market electricity prices, the Staff correlated twelve-month moving average spot-market electricity prices to twelve-month moving average fuel dispatch prices. (Proctor Direct, Ex. 227, p. 9, ln. 13-17; p.14, ln. 14-17).

In his rebuttal testimony, AmerenUE witness Schukar raises concerns about Dr. Proctor's analysis and then attempts to "correct" the analysis by correlating monthly fuel dispatch prices and monthly spot-market electricity prices. Mr. Schukar's modeling fails to take into account the fact that spot-market electricity prices exhibit a monthly cyclical pattern, while fuel dispatch prices do not. (Proctor Surrebuttal, Ex. 229, p. 11, ln. 18 – p. 16, ln. 7). This is a fatal flaw in Mr. Schukar's analysis, and the Company's proposed spot-market electricity prices and profit margins from off-system sales are based on this flawed analysis. (Proctor Surrebuttal, Ex. 229, p. 11, ln. 5-15). Dr. Proctor shows that it is only appropriate to determine these correlations on an annual average basis, and that Mr. Schukar's approach results in an underestimate of the correlations in the annual average prices, and a biased estimate of the correct relationships between these annual average prices. (Proctor Surrebuttal, Ex. 229, p. 11, ln. 5-15; p. 11, ln. 18 - p. 16, ln. 18).

Unfortunately, the Company's present position is based on Mr. Schukar's faulty corrections to Dr. Proctor's analysis of the correlation between spot-market electricity prices and fuel dispatch prices. The Commission should therefore disregard AmerenUE's spot-market electricity prices and instead adopt the Staff's recommended prices, which are grounded in the statistically sound analytical approach employed by Dr. Proctor.

AmerenUE's 2007 fuel budget shows the Company's proposed level of off-system sales margins to be unreasonably low.

Quite apart from all of the sparring over the inputs to the fuel model and the methodologies used to develop those inputs, the ultimate issue is the appropriate level of OSS margins to be included as an offset to the Company's costs in the calculation of its revenue requirement in this proceeding. AmerenUE's 2007 fuel budget clearly shows that the Staff's recommended amount of about $230 million is far more reasonable than AmerenUE's recommendation of $202.5 million. The Company has budgeted a ** _____** for OSS margins in 2007. (Proctor, Surrebuttal, Ex. 229, p. 29, ln. 25; Brosch Surrebuttal, Ex. 504, p. 9, ln. 6-7). This is ** ___** more than the $202.5 million that AmerenUE is recommending for inclusion in rates. The budget even exceeds the Staff's recommendation by ** ___**.

Not surprisingly, during the hearing AmerenUE tried valiantly to discredit the use of the fuel budget figure for purposes of establishing a normal level for profit margins from off-system sales, and it will undoubtedly endeavor to do so in its brief. For example, on cross-examination, counsel for AmerenUE pursued a line of questioning with Dr. Proctor that was designed to indicate that that the budget should be disregarded because it does not represent a normal level. However, the only factor that was identified as not having been normalized was the plant outage schedule, and Dr. Proctor allayed that potential concern by pointing out that the outage schedule for 2007 really differs very little from a normal schedule. (Tr. 1606, ln. 2 – 1607, ln. 7).

The fact is that the development of the annual budget, including the fuel budget, is serious business at AmerenUE. For one thing, the Company claims that the wages and salaries of its employees are dependent upon AmerenUE's success in meeting or exceeding certain earnings targets. If the Company comes in below the target, management employees will actually lose money. (Tr. 2144, ln. 20-22). In the fuel realm, the budgeted OSS margins level of **_____ ** constitutes a target. As one might expect for such an important exercise, the

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highly sophisticated fuel model, with its inherent normalizing capability, is utilized in the process of developing the fuel budget. (Tr. 1232, ln. 8-24). Given that management and other employee earnings are, in effect, tied to the fuel budget, it would be naïve to think that the ** _____ ** budgeted for OSS margins is anything other than an eminently achievable goal. And the Staff's recommended level for OSS margins for this proceeding is fully **_____ _____** less than this figure!

During the hearing, Chairman Davis asked Dr. Proctor about the probability that AmerenUE would reach the $240 million level in OSS margins. Dr. Proctor stated that he considered it very likely and then quantified his response based on the statistical analysis presented in his rebuttal testimony, stating that there is a 69-70% probability that AmerenUE would meet or exceed that level. (Tr. 1516, ln. 5 – 1517, ln. 12; Proctor Rebuttal, Ex. 228, pp. 9-11). Indeed, in January alone, the Company enjoyed off-system sales volumes in excess of ** _____** and an associated profit (margin) of some ** _____ **. (Tr. 1623, ln. 15-25). "]I]f you multiply that by 12, that's way outside the bounds of where anybody is setting the prices for." (Tr. 1624, ln. 1-2). The Staff does not mean to suggest, however, that the Company could sustain such a level of profits for the entire year. Nonetheless, it should be noted that the first month's profit is nearly ** ___ ** of the Company's proposed annual amount to be included in rates; and further, that AmerenUE's OSS margins for the remainder of the year could decrease by almost ** ___ **, and it would still achieve its budgeted target of **_____ **. If Staff's recommended annual margin amount of $230 million is the goal, OSS margins in the remaining months could decrease by about ** ___ **; and, measured against AmerenUE's totally unreasonable proposal of $202.5 million to be included in rates, monthly OSS profits for the remaining eleven months of 2007 could drop by about ** ___ **.

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Conclusion

For all of the foregoing reasons, the Commission should reject AmerenUE's proposal of $202.5 million for off-system sales margins to be included in rates, in favor of the Staff's very reasonable figure of $230 million, which is based on the natural gas dispatch price ($7/MMBtu) and spot-market electricity prices ($30.63/MWh---off-peak and $54.51/MWh---on-peak) developed by Dr. Proctor. In fact, in light ofAmerenUE's 2007 budgeted amount for off-system sales margins, the Staff believes that the Commission should consider the Staff's recommendation to be a *minimum* amount to be used for setting rates in this proceeding.

DEMAND SIDE MANAGEMENT

Should AmerenUE set megawatt and megawatt hour goals for Demand Side Management (DSM)? If so, what should those goals be?

Staff recommends that the Commission require AmerenUE to adopt the DSM goals shown in Table 1 of Staff witness Lena Mantle's highly confidential rebuttal testimony. (Mantle Rebuttal, p. 3 ln. 18-19). These goals were proposed by Missouri Department of Natural Resources Energy Center (MEC) witness Brenda Wilbers' highly confidential direct testimony. (Wilbers Direct, p. 7 ln. 21-22, p. 8 ln. 1-2). Staff witness Mantle used these goals and the peak demand and energy forecast used in AmerenUE's preferred resource plan to calculate the megawatt and megawatt hour goals proposed in her highly confidential rebuttal testimony. (Mantle Rebuttal, p. 2, ln. 8-15). However, Staff believes that the goals proposed by Brenda Wilbers may be unreasonably low. (*Id.*, at p. 2, ln, 18; Tr. Vol. 21, p. 1771, ln. 8-18). Staff recommends that these "peak demand and energy reduction goals be revised after the Staff, Office of Public Counsel, MEC and other parties that intervene in the upcoming case have had

an opportunity to review the comprehensive resource planning filing that AmerenUE has agreed to make on February 5, 2008 in Case No. EO-2006-0240." (*Id.* at p. 3, ln. 19-23).

Should AmerenUE fund Demand Side Management programs at minimum levels? If so, at what levels?

Commission Rules provide that demand-side resources and supply-side resources should be evaluated on an equivalent basis. 4 CSR 240-22.010(2)(A). Staff does not recommend requiring an expenditure amount requirement for DSM programs. (Mantle Rebuttal, p. 4, ln. 1-2). "To require a specified level of resources be spent on DSM programs does not treat supply-side and demand-side resources on an equivalent basis." (*Id.* at p. 3, ln. 8-10). Staff takes the position that the cost-effectiveness of DSM programs for AmerenUE customers is more important than the specific dollar amount spent on the programs. (*Id.* at p. 3, ln. 10-11).

HOW SHOULD DSM PROGRAMS BE SELECTED?

Staff takes the position that DSM programs should be screened for cost-effectiveness. (Mantle Rebuttal, p. 3, ln. 12; Tr. Vol. 21, p. 1774, ln. 16-25). If a program is initially found to be cost-effective, the program should be subject to evaluation in an integrated resource planning screening model. (*Id.* at p. 3, 12-13). If, after this evaluation, the program is considered cost-effective, Staff recommends evaluation of the risk and uncertainty of the program. (*Id.*, p. 3, ln. 13-14). Staff does not recommend implementation of a DSM program that has not undergone this extensive analysis simply to fulfill a dollar amount spending requirement. (*Id.*, p. 3, ln. 15-16).

LOW-INCOME PROGRAMS

Should AmerenUE continue to fund its current low-income weatherization program? If so, how should the program be funded?

AmerenUE should continue to fund its current low-income weatherization program at an amount of approximately $1.2 million annually regardless of whether AmerenUE's fuel

adjustment clause and off-system sales proposals are adopted. (Mantle Rebuttal, pg. 4, ln. 11-23) Mr. Mark, testifying on behalf of AmerenUE, stated that the low-income weatherization program had been successful in the past, and that the program was worth supporting in the future. (Tr. Vol. 21, p. 1668, ln. 20-21; p. 1669, ln. 6-8) One half of the expenditures for this program should be placed in the demand-side resource regulatory account and be recovered from ratepayers. The other half of this amount should be funded by AmerenUE. (Mantle Rebuttal, pg. 4, ln. 21-23) AmerenUE agrees with this division of the funding, as testified to by Mr. Mark. (Tr. Vol. 21, p. 1672, ln. 18-20; p. 1697, ln. 10-19)

The weatherization program is not currently included in AmerenUE's electric tariffs. Therefore, AmerenUE should include the weatherization program in its electric tariffs. (Mantle Rebuttal, pg. 5, ln. 2-5) AmerenUE also agrees that the low-income weatherization program should be included in its electric tariffs. (Tr. Vol. 21, p. 1672, ln. 24-25; p. 1673, ln. 1)

AmerenUE should also perform a process and impact evaluation of the current weatherization program to determine if any improvements could be made to the program and to determine, if possible, the amount of energy savings being achieved as a result of the program. AmerenUE also agrees that an evaluation should be conducted. (Tr. Vol. 21, p. 1673, ln. 2-4) The cost of this evaluation should be funded from the $1.2 million amount set aside for the weatherization program. The cost of the evaluation should not exceed $120,000. (Mantle Rebuttal, pg. 5, ln. 6-10)

Should AmerenUE fund low income programs at minimum levels?
If so, at what levels?

Staff does not recommend that AmerenUE should fund low income programs at minimum levels. Staff recommends that the funding of the program be set at $1.2 million a year.

VOLUNTARY GREEN PROGRAM

Should the Commission approve AmerenUE's proposed Voluntary Green Program?

The Commission should not approve the Voluntary Green Program (VGP) proposed by AmerenUE. (Mantle Rebuttal, p. 2, ln. 11). AmerenUE's proposal would provide a means to allow its customers to purchase Renewable Energy Certificates (RECs) and to retire those RECs on behalf of its customers. (Mill Direct, p. 13, ln. 2-11). Staff witness Lena Mantle testified that "RECs are a market mechanism that represent the environmental benefits associated with generating electricity from renewable energy resources." (Mantle Rebuttal, p. 2, ln. 13-14). Purchasing a REC is a way to support renewable energy; it is not, however, the same as directly purchasing renewable energy, and it does not provide for the delivery of renewable energy. (*Id.*, p. 3, ln, 10-11; and Tr. Vol. 21, p. 1731, ln. 8-22) A customer who purchases a REC is not actually purchasing renewable energy, and the purchase of a REC does not obligate AmerenUE to produce any renewable energy. (Tr. Vol. 21, p. 1740, ln. 19-25; p. 1741, ln. 1-2) In addition, Staff believes that there is a likelihood of serious confusion on the part of customers who may purchase a REC, believing wrongly that they are purchasing renewable energy. (Mantle Rebuttal, p. 3, ln. 3-5).

AmerenUE should be investing its resources in the development of renewable power generation rather than in the purchase of RECs. (Mantle Rebuttal, p. 2, ln. 15-17). RECs may be purchased by consumers who wish to support renewable energy from a number of websites, independent of an electric utility program. (*Id.*, p. 4, ln. 1-2). RECs are available to be purchased by AmerenUE customers "even if AmerenUE does not offer the VGP program." (*Id.*, p. 4, ln. 6). AmerenUE should demonstrate its commitment to the development of renewable energy in a more tangible way, "such as development of a wind farm or biomass generation

plant." (*Id.*, p. 1, ln. 28-29). The Commission should not approve AmerenUE's VGP as presented in its proposed tariff.

ELECTRIC ENERGY, INC. (EEInc.)

How should the expiration of the affiliate power supply agreement with EEInc. be treated for ratemaking purposes? Would it be lawful and proper for the Commission to impute to AmerenUE's revenue requirement the net effect on AmerenUE's variable production costs of power from EEInc.? Was the action taken by AmerenUE respecting the expiration of the affiliate power supply agreement with EEInc. prudent?

The Staff attempted to address this issue as completely as possible in its Pre-Hearing Brief but time constraints did not permit the Staff to brief the issue as completely as it had hoped to do. The Staff's Supplemental Pre-Hearing Brief filed on March 7, 2007 should be used in conjunction with the instant Staff Post-Hearing Brief. The Staff will attempt to be non-repetitive as much as possible and not repeat, for example, UE's representations to this Commission and the SEC regarding the Joppa Plant being part of the UE system, among other things.

An appropriate place to start a review of this issue is the FERC, which is not an ally of AmerenUE on this issue respecting jurisdiction. In fact, there is even reference by the FERC to possible sales by EEInc. to AmerenUE at cost based rates in the FERC Order Granting Market-Based Rate Authorization to EEInc. quoted below. As noted in the Introduction to this the Staff's Post-Hearing Brief and in the Staff's Supplemental Pre-Hearing Brief, Ameren has argued at least once and FERC has stated at least twice that the Missouri Commission has jurisdiction regarding the retail ratemaking treatment of AmerenUE's EEInc. decisions. Ameren Corporation, Dynegy, Inc., Dynegy Midwest Generation, Inc., Dynegy Power Marketing, Inc., Illinova Corporation, Illinova Generating Company, and Illinois Power Company argue at pages 43 and 44 of their May 25, 2004 Motion For Leave To Submit Answer And Answer filed in FERC Docket No. EC04-81 that "[if] any entity should have the right to compel AmerenUE to

purchase capacity or energy from EEInc. to serve native load, it should be the MoPSC, as part of a prudence review of AmerenUE's retail rates, or some similar proceeding." They argued that this issue "falls squarely within the area of primary jurisdiction of the MoPSC." On July 29, 2004 the FERC issued an Order Authorizing Disposition Of Jurisdictional Assets And Accepting Power Purchase Agreements Subject To Conditions in which it stated in relevant part at paragraph 68 that Public Counsel's EEInc. issues were a state commission matter. Public Counsel and Missouri Industrial Energy Consumers (MIEC) filed Requests For Rehearing and Ameren and the other Applicants filed on September 7, 2004 Motion For Leave To Submit Answer And Answer To Requests For Rehearing wherein Ameren and the other Applicants stated at pages 3-4 that the Missouri Commission has primary jurisdiction. The FERC's April 18, 2005 Order Denying Rehearing unequivocally pointed again, in paragraph 10, to the Missouri Commission's primary jurisdiction.

On September 15, 2005, as amended on November 3, 2005, EEInc. filed an application with the FERC for market-based rate authority, with an accompanying tariff, in FERC Docket No. ER05-1482. The Missouri Commission and the MIEC filed Notices Of Intervention and Public Counsel filed a Motion To Intervene And Protest. FERC's December 8, 2005 Order Granting Market-Based Rate Authorization to EEInc., at paragraphs 32 and 34, looks to the Missouri Commission for resolution of issues relating to retail rates. The Staff would also direct the Commission to paragraph 31 of the FERC's Order Granting Market-Based Rate Authorization:

> 31. . . . [EEInc] states that, consistent with Commission precedent, EEInc's tariff provides that it will not make any sales of power to a franchised utility affiliate *without first receiving* authorization from the Commission. However, this limitation does not prevent EEInc from selling to affiliates such as AmerenUE, either at a cost-based or market-based rate, once the necessary Commission authorizations have been received.

> 32. EEInc adds that many of the same arguments that the Missouri Office raises here have been raised and rejected by the Commission in another proceeding, in which the Commission found that the issues were retail issues that are properly before the Missouri Commission, the relevant state commission.[22]
>
> [22] EEInc states that the Commission has addressed similar arguments in *Ameren Corp.*, 108 FERC ¶61,094 at P 68 (2004), *order on reh'g*, 111 FERC ¶61,055 at PP 9-10 (2005).

(113 FERC ¶61,245 at pp 31-32, p. 61,962 (2005); Emphasis added).

In addition to the Constitutional issues noted above that AmerenUE asserts in its Pre-Hearing Brief that the proposed EEInc. adjustments raise, AmerenUE argues in its Pre-Hearing Brief that the proposed EEInc. adjustments violate the U.S. Constitution's Takings Clause. Raising Constitutional issues is a standard scare tactic of AmerenUE, which was rejected by the Western District Court of Appeals when AmerenUE took a similar approach regarding the Commission's decisions respecting the Staff's adjustments relating to the third year of the first UE experimental alternative regulation program: *Union Electric Co. v. Public Serv. Comm'n*, 136 S.W.3d 146, 161 (Mo.App. W.D. 2004). Finally in its Pre-Hearing Brief on the EEInc. issue, AmerenUE contends that the proposed EEInc. adjustments constitute retroactive ratemaking in violation of AmerenUE's Due Process rights. This argument is another fanciful construct of AmerenUE which as with its Takings Clause argument could be applied by AmerenUE to virtually any discrete ratemaking adjustment a party would propose under AmerenUE's fashioning of this principle.

The Staff views the Electric Energy Inc. (EEInc.) – Joppa Plant issue as a matter of prudence or, more precisely, a matter of imprudence on the part of AmerenUE. The Staff treated the components of the Power Supply Agreement between EEInc. and the Sponsoring Companies as still being in place. (Ex. 225, Meyer Direct, p. 7, lines 8-14).

AmerenUE, by itself, held more than the necessary share of votes under the EEInc. Bylaws to continue to purchase power from EEInc. at cost based rates after December 31, 2005. Each year for the period 1953-2003, EEInc.'s Form No. 1 to the Federal Power Commission, the FERC's predecessor, and then to the FERC, stated at page 102 that EEInc. is directly controlled by the Sponsoring Companies through their ownership of the voting securities of EEInc. (Ex. 237, Schallenberg Surrebuttal, p. 9). "Article II, Section 6. Voting." of the EEInc. Bylaws provides that "decisions to allocate the sale of generating capacity of EEInc. among the EEInc. stockholders in a manner other than in accordance with their percentages of ownership of EEInc. stock in the event of such capacity available for sale to parties other than the U.S. Enrichment Corporation" and "a material change in the business purpose or objectives of EEInc." constitute "corporate restructuring transactions" and "other major corporate actions." "Article II, Section 6. Voting." of the EEInc. Bylaws also provides that when any holder of voting capital of EEInc., including such holder's affiliates, owns in excess of 50% of the voting capital stock of EEInc., "all corporate restructuring transactions and other major corporate actions shall be decided by the vote of the holders of 75% or more of the outstanding shares of the Corporation entitled to vote." This latter provision is applicable because AmerenUE and its affiliate Ameren Energy Resources Company, combined, own 80% of the voting capital stock of EEInc.[14] (Ex. 237, Schallenberg Rebuttal, pp. 21-22). Counsel for AmerenUE stated on the record on March 29, 2007 in

[14] AmerenUE owns 40% of the stock of EEInc. and Ameren Energy Resources Company owns 40% of the stock of EEInc. as a result of the following FERC Dockets. On December 13, 2001 in FERC Docket No. EC02-34-000, AmerenCIPS and Ameren Energy Resources Company filed, pursuant to Federal Power Act (FPA) Section 203, for authorization for AmerenCIPS to transfer its 20% common stock interest in EEInc. to Ameren Energy Resources Company. FERC issued its Order Authorizing Disposition Of Jurisdictional Facilities on February 25, 2002. In FERC Docket No. EC04-81-000, the Merger Application of Ameren, Dynegy, Inc., Illinova Corporation and Illinova Generating Company, the FERC issued on July 29, 2004 its Order Authorizing Disposition Of Jurisdictional Assets And Accepting Power Purchase Agreements Subject To Conditions. The FERC authorized Illinova Generating Company to transfer its 20% interest in EEInc. to Ameren Energy Resources Company. Prior to this merger with Ameren, Illinois Power Company had become a direct wholly owned subsidiary of Illinova.

response to a question from Commissioner Steve Gaw that he knew of no such vote by the shareholders:

> COMMISSIONER GAW: Okay. And then I'd just ask counsel whether or not there is any action that parties are aware of regarding a vote of the shareholders dealing with EEI's contract -- contracts or offerings or business that relates to a change in the customers that it had or in regard to a change in the way -- in the purpose of EEI that anyone's aware of?
>
> MR. DOTTHEIM: I believe there is nothing reflected in the board of directors' minutes. I've looked myself at the FERC Form 1, the annual report to the FERC of EEInc for 2005. I have not seen anything there reflected, and I've looked at the -- the annual report to -- of EEInc for 2005, and there's -- I have not seen anything in that document, both the FERC Form 1 for 2005 is an attachment to Mr. Naslund's deposition, and the EEInc annual report for 2005 is also an attachment to Mr. Naslund's deposition.
>
> COMMISSIONER GAW: Okay. And Ameren have anything different?
>
> MR. BYRNE: I -- I know of no such vote by the shareholders.

(Vol. 38, Tr. 4392, line 4 – Tr. 4393, line 1).

In actuality, AmerenUE uses Professor Robert C. Downs to provide the basis for its defense in this matter. Professor Downs almost always provided definitive testimony when it was prefiled as direct, rebuttal, or surrebuttal, but tended to provide somewhat nuanced testimony on cross-examination. Although he stated it was the fiduciary duty of the board of directors of a corporation to maximize profits for the corporation, he testified on cross-examination that "[i]t's far more complicated than just saying maximizing profits." (Vol. 25, Tr. 2389, lines 3-4). Professor Downs related that directors in considering what to do would and are entitled to consider a large number of things that could impact the company - the long-term and short-term effects on profitability and customer base, the amount of money, the impact on employees, the safety of the company, the ability of the company to handle possible future risks, any factor that could impact the company presently or in the future, etc. – but the directors are

"not guarantors of going to happen." (*Id.* at 2389, line 6- Tr. 2391, line 1). He said that "Directors are entitled to make reasonable judgment calls." (Tr. 2395, lines 23-24).

Examples of the more nuanced testimony that Professor Downs provided in his prefiled testimony are displayed by the underlined excerpts below from his rebuttal testimony:

> A. . . . Nevertheless, it is absolutely clear that the directors of EEInc. have powerful fiduciary duties to EEInc. when they are acting as directors of EEInc. Those fiduciary duties are not reduced to account for their positions with the major shareholder (AmerenUE, or Ameren Energy Resources, an AmerenUE affiliate). The directors may be called upon to wear two hats, but they only wear one hat at a time. It would be legally impermissible for AmerenUE to insist, through coercion or direction of its employee/directors, that EEInc. sell its assets to AmerenUE for less than fair market value. AmerenUE has a similar issue with its own shareholders. Even if it has improperly forced EEInc. to sell its power to AmerenUE for less than fair value, AmerenUE could not properly then transfer that value to customers for less than fair value, absent a commercially reasonable business reason that would benefit the Company and its shareholders.

(Ex. 45, p. 6, lines 2-12; emphasis added).

> A. . . . I believe that EEInc is legally *obligated* to sell its power at fair market value. EEInc. owns that power. The ratepayers do not own that power. The shareholders of EEInc. and their shareholders are entitled to have their corporations make a profit and are entitled to insist that the assets of the corporations not be donated to third parties, without proper business justifications which benefit the corporations and their shareholders. . . .

(Ex. 45, p. 10, line 19 – p. 11, line 1; emphasis added).

Also, there is definitive evidence that AmerenUE seeks to selectively apply Professor Downs' view of the law, i.e., apply Professor Downs' view in the EEInc. situation, but not apply Professor Downs' view in the 4 CSR 240-10.020 situation. AmerenUE witness Gary S. Weiss is sponsoring AmerenUE's 4 CSR 240-10.020 calculation. But part of AmerenUE's case is the application of an obscure provision of the Commission's rules, 4 CSR 240-10.020, that AmerenUE asserts entitles it to an additional $386,744,000. AmerenUE is not literally asking for this additional $386,744,000, but at least in its July 7, 2006 Direct Testimony filing was

citing this rule as providing support for its full revenue requirement request of $360,709,000. (Ex. 10, Weiss Direct Testimony, pp. 29-30). Mr. Weiss stated that AmerenUE was "not proposing rates to recover the full amount of the revenue requirement that it is legally entitled to as a result of the application of 4 CSR-10.020 [sic] in this case." (*Id.* at 30, lines 10-12).

Regarding AmerenUE's approach, Professor Downs did not surprisingly find any violation of any fiduciary duties:

> Q. Professor Downs, I would like to pose a question for you based on your testimony. I would like for you to assume that Ameren UE believes that it is legally entitled to three quarters of a billion dollar rate increase, about a $750 million rate increase, but it is only seeking $360 million in a rate increase. Would such an action be inconsistent with your direct testimony that AmerenUE has a legal responsibility to maximize the profit to its shareholders?
>
> A. What Ameren is going to do is what its board of directors is going to do is make a decision about what the best position is to take in front of the regulatory agency. And they may have their reasons for not asking for the entire amount. They may think it's not the right time. I mean, there are lots of possibilities about why they wouldn't go to the regulatory agency for more than they thought they could get. I don't know a lot about this process, but my understanding is that there's a lot of pushing and pulling in this process. And so the reasons that the board may have, may be very legitimate, practical business reasons to do that and so -- so I would say it's not at all inconsistent with what I think the law requires or permits.
>
> Q. Is there a certain amount of discretion?
>
> A. Discretion in what way?
>
> Q. Discretion on the part of the board.
>
> A. The board needs to make a business judgment about what it's going to do and the board has some leeway. There's always an issue about how much leeway. The business judgment rule gives them some leeway, but they still have their fiduciary duties to the company and to the shareholders.

(Ex. 259, Downs Deposition, p. 28, line 9 - p. 29, line 20).

It is not unusual for the larger utilities regulated by the Commission to retain a former state commissioner from a state commission other than Missouri to submit testimony in a utility

rate increase case or in a Staff excess earnings/revenues complaint case. AmerenUE chose to proceed in this manner in its rate increase case retaining former Michigan Commissioner David A. Svanda at a fee of $12,500 per month. (Ex. 261, p. 94, line 7 – p. 95, line 2). Mr. Svanda filed Direct Testimony, but does not address the EEInc. issue in his Direct Testimony. His Rebuttal Testimony solely addresses the EEInc. issue and his Surrebuttal Testimony addresses issues (return on equity, storms/Taum Sauk and fuel adjustment clause) other than EEInc. Since Mr. Svanda left the Michigan Commission in August 2003, he has operated his own consulting firm, Svanda Consulting, comprising himself. (Ex. 4, Svanda Direct, p. 1, lines 10, 21- p. 2, line 2). In that time, he has filed testimony before (1) the District of Columbia Public Service Commission, the Pennsylvania Public Utility Commission and the Maryland Public Service Commission in 2005 on behalf of an association of merchant generators, (2) the FERC on behalf of MISO, and (3) a California court in 2005 on behalf of SBC on a pole attachment matter. (Ex. 261, Svanda Deposition, pp. 11, line 1 – p. 17, line 4; Ex. 267, Svanda Errata Sheets; Vol . 25, Tr. 2486, line 21 – Tr. 2488, line 18).

Curiously, AmerenUE leaves it to Mr. Svanda to attempt to analogize the Staff's EEInc. adjustment to the Staff's request for an investigation of Commission jurisdiction of the Aquila, Inc. sale of the Aries Power Project to Calpine Corporation, in Case No. EO-2004-0224. The EEInc. issue goes as far back as the Staff's 2001-2002 excess earnings-revenues complaint case against AmerenUE, Case No. EO-2002-1, which ended in a settlement. A review of the Report And Order in Case No. EO-2004-0224 which is a schedule to Mr. Svanda's Rebuttal Testimony reveals that in Case No. EO-2004-0224, neither the Public Counsel nor the Staff sought to analogize Commission jurisdiction over the Aries Power Project to Commission jurisdiction

respecting energy and capacity from the EEInc. Joppa Plant. AmerenUE, not the Staff, has sought to analogize the two cases.

Just as with Mr. Downs, Mr. Svanda was asked about AmerenUE's decision to not seek recovery of the hundreds of millions of dollars purportedly due it under AmerenUE's interpretation of 4 CSR 240-10.020. Mr. Svanda responded as follows:

> Q. If you bear with me. Assuming hypothetically AmerenUE believes it is legally entitled to a $747 million rate increase, but it is only seeking $361 million of that rate increase, would such an action be inconsistent with your statement that the board of directors of AmerenUE has a fiduciary duty to run AmerenUE profitably?
>
> MR. BYRNE: I'm going to interpose an objection. I think that calls for a legal conclusion. As we've discussed, Mr. Svanda is not a lawyer, but you can go ahead and answer subject to that objection.
>
> THE WITNESS: I don't see an inconsistency there. I was, without allowing you to drag me into a full discussion of PUHCA and things like that, just trying to outline the fact that operating a utility is done within a certain field of relevance. We all have reference to regulatory compacts and all of those kinds of issues that come into play, and so that's why I even mentioned it in my earlier response in this whole line. I don't think that it is fiduciarily irresponsible to recognize the regulatory climate and that you may not be able to ask for every last nickel that you might be entitled to, but within the regulatory world a reasonable request is placed. That's part of that fiduciary responsibility and recognizing the real world and acting properly within it.
>
> Q. (By Mr. Dottheim) Mr. Svanda, I think you made reference about me dragging you into PUHCA. I don't believe I ever mentioned PUHCA. I believe you mentioned PUHCA. I don't believe I made any attempt to drag you into PUHCA. So, I want to be very clear about that. I had no intention of doing so. So, in any future questions I ask you or any question I've asked you so far other than possibly a follow-up to one of your answers where you made reference to PUHCA, I am not attempting to drag you into PUHCA. Next, regarding your attorney's objection, I think possibly my use of the word or term fiduciary duty, I believe that term appears repeatedly throughout your testimony.

(Ex. 261, Svanda Deposition, p. 76, line 22 - p. 78, line 12).

When given the opportunity at his deposition to assert that Directors who voted to sell power at cost based rates violated their fiduciary duty, Mr. Svanda declined to do so. Instead, he

testified that he would consider such conduct as the Director exercising his/her "independent judgment as a director:"

> Q. . . . if any members of the board of directors voted to provide energy at cost based rates instead of at market based rates, would you consider that to be a breach of that director's or directors', plural, fiduciary duty?
>
> A. I guess I would consider it to be that director exercising their independent judgment as a director and they would be exercising that discretion, you know, on their own. If they felt -- if a director felt justified in that sort of vote, they would have to stand any test that might be thrown their way in that regard. That's my point about the independence of a director. They deal based on the information that they have before them.

(Ex. 261, Svanda Deposition, p. 61, lines 5-18).

Mr. Rainwater did not concur with Mr. Svanda on this matter respecting a Director's exercise of his/her independent judgment. In fact, Mr. Rainwater clearly indicated that the EEInc. Directors, other than the Kentucky Utilities Directors voting against awarding the power supply agreement to AEM post-December 31, 2005, do not and have not exercised independent judgment, and had Mr. Naslund exercised independent judgment, he would not be reappointed to the EEInc. Board of Directors:

> Q. Is it correct that Union Electric and its other affiliates always vote together on the EEInc board decisions?
>
> A. It's been my experience that they have always voted together.
>
> Q. And how do they know to do that?
>
> A. They exercise their independent judgment and vote the way they believe they should vote.
>
> Q. So let me posit this hypothetical. Assume that Mr. Naslund who was one of the UE representatives on the board went and sided with the Kentucky Utilities gentleman, the Kentucky Utilities board director, and decided -- said, "I think the PSA is the way to go. Let's re-up it on the same terms and do modification 18."
>
> You with me? You got that hypothetical?
>
> A. Yes, I do.

Q. Would Mr. Naslund be greeted with open arms back at UE?

A. Our view would be that he did not follow his fiduciary duty.

Q. And what would happen to him?

A. I don't know.

Q. Well, are you the CEO?
A. Yes, I am.

Q. What would you recommend happen to him?

A. He would not likely be reappointed to the board.

Q. And why is that?

A. Because he did not follow his fiduciary duty.

Q. And how does he know what his fiduciary duty is?

A. That's a question asked Mr. Naslund.

Q. Well, do you ever talk with Mr. Naslund about, "Gee, there's a pretty big important vote on a -- on a affiliate we own that's contributing millions of dollars to UE's bottom line. How you gonna vote?"

A. Actually I have not. I have never directed him how to vote.

Q. Has anyone --

A. He's expected to act independently and vote in the interest of EEInc, which he did. And in corporate voting on boards, typically decisions are unanimous because boards deliberate until they arrive at the right decision. In the history of EEInc --

Q. And in this case they weren't unanimous, were they?

A. This was the first, I believe, in the history of EEInc in 50 years of operation that that was not unanimous.

Q. Has the EEInc board moved to oust those Kentucky Utilities directors for their failure to follow their fiduciary duties?

A. I don't believe we have.

Q. Are you contemplating doing that?

A. There was no consequence of their actions.

Q. Because they were shut out by the Ameren group?

A. That's correct.

Q. So effectively Ameren controls that board; is that correct?

A. No, that's not correct. The directors control the board, the directors are nominated and elected by Ameren and Kentucky Utilities.

Q. So if Ameren nominates and elects 80 percent of the directors, does Ameren control that board? Do --

A. Well, in common language you would say we have a controlling interest in the company.

(Vol. 23, Tr. 1962, line 16 – Tr. 1965, line 12).

Mr. Rainwater, who indicated that he served on the EEInc. Board of Directors from approximately 1998 to May 2004, obtained his understanding of his fiduciary duty as a director of a board of directors from a book he purchased and read. He did not recall that either EEInc. or Union Electric Company provided any training:

Q. . . . Mr. Rainwater, how do you know -- how did you know what your fiduciary duty was?

A. Well, all officers of our company have a general understanding of fiduciary duties, and we've provided training at times to people or people have provided training on their own. Speaking for myself, when I was appointed to the EEInc board ten years or so ago, that was probably the first corporate board that I'd been appointed to. I went to a bookstore and bought a book on what it means to be a director of a company, and I read it and, you know, what I recall from that is that it means that I have a duty to act in the interest of that company.

Q. Did EEInc provide any training?

A. Not that I can recall.

Q. Did Union Electric Company provide any training?

A. Not that I can recall.

Q. So the training you received was from the book you bought?

A. Training may have been provided. I'm just saying that this is ten years ago. I don't recall. I do remember buying the book and reading the book.

(Vol. 23, Tr. 1840, line 3 – Tr. 1841, line 2).

It should be noted that Mr. Svanda did provide certain other testimony not helpful to AmerenUE's position on EEInc. He identified depreciation and jurisdictional allocations as two issues where the FERC and the states could, and have, set different rates based on different methodologies. (Ex. 261, p. 84, lines 1-15; p. 93, lines 13-21). In fact, the U.S. Supreme Court in 1986, in *Louisiana Public Serv. Comm'n v. FERC*, 476 U.S. 355, 106 S.Ct. 1890, 90 L.Ed.2d 369 (1986), rejected the intimation that the Federal Communications Commission (FCC) cannot help but preempt state depreciation regulation of joint facilities if it is to fulfill its statutory obligation and determine depreciation for plant used to provide interstate service. The Court noted that "[w]hat is really troubling respondents [i.e., private telephone companies], of course, is their sense that state regulators will not allow them sufficient revenues." 106 S.Ct. at 1902.

Turning to AmerenUE's Policy witness, Mr. Warner L. Baxter, there was no need for Mr. Baxter to make any assumption about a $386,744,000 revenue requirement related to 4 CSR 240-10.020 because he noted AmerenUE's contention in his Direct Testimony:

Q. Okay. Mr. Baxter, if I understood some of your answers to Mr. Lewis (sic), I think you indicated that directors have a fiduciary duty to maximize a profit for the shareholders; is that correct?
A. Yes.
Q. I'd like to direct you again to the bottom of page 36 of your direct testimony. Bottom of page 36 of your direct testimony. There's a sentence at the bottom of page 36 that carries over to the top of page 37.

A. Line 22, is that what you're referring to, Mr. Dottheim?

Q. Yes, Mr. Baxter.

A. Okay.

Q. Where you state, "Finally, I would note as explained in Mr. Weiss's direct testimony that the company has provided additional support for the increase in its rates requested in this case because of the application of the Commission's depreciation rule, 4 CSR 240-10.020 which would lawfully entitle the company to an additional $386,744,000 in revenue requirement." Did I read that correctly?

A. You did.

Q. Okay. AmerenUE is not seeking recovery of that additional $386,744,000 which you assert it is lawfully entitled to, is it?

A. No. We -- we -- we cite that as further support as to why we believe the rate increase we have requested is appropriate.

Q. Is that not a breach of the board of directors of AmerenUE's fiduciary duty to not seek recovery of that $386,744,000?

A. No, I don't believe so. I think it is an issue that obviously one has a legal debate, and we believe to establish a fair and appropriate return for our rate -- excuse me, our shareholders as well as have a fair and appropriate return in this rate case, that all we need to seek is the monies that we've asked for in this case.

(Vol. 13, Tr. 250, line 1 – Tr. 251, line 15).

Professor Downs agreed that he was not testifying as an expert in electricity markets. (Vol. 25, Tr. 2400, lines 18-21). He indicated that he had not studied the long-term business plans of EEInc. to know what choices on any given issue are in EEInc.'s best long-term interest. (*Id.* at Tr. 2400, lines 22-25). He stated that based on what people from AmerenUE told him, for the indefinite future, it is pretty clear the advantage to EEInc. is to pursue market based rates. (*Id.* at Tr. 2400, lines 11-17). Professor Downs testified that "directors are required to use reasonable business judgment, and that includes informing themselves about the choices." (*Id.* at Tr. 2402, line 25 – Tr. 2403, line 2). Thus, "there's a requirement that the directors inform themselves before they vote. And so they may do that in a number of different ways." (*Id.* at Tr. 2402, lines 13-15). But there is no requirement that they do so by a study or an analysis. (*Id.* at

Tr. 2402, 16). Professor Downs agreed that a big decision would require that the directors inform themselves about the choices more than a little decision requires that they inform themselves. (*Id.* at Tr. 2403, lines 2-3).

Professor Downs admitted that he had not talked with anyone associated with Kentucky Utilities. (Vol. 25, Tr. 2411, lines 2-4). He testified that he did not know enough about regulatory law to know whether the Commission could accept that the Directors of EEInc. have a fiduciary duty to act in a certain way and still make an adjustment to UE's books for ratemaking purposes. (*Id.* at Tr. 2362, line 21 – Tr. 2363, line 14).

The March 25, 2004 Prepared Direct Testimony of Craig D. Nelson on behalf of Ameren before the FERC in Docket No. EC04-81-000, which was Exhibit 80 in the Metro East Transfer case, Case No. EO-2004-0180, is not consistent with Professor Downs' testimony. (Official notice/administrative notice was taken of this testimony, Vol. 23, Tr. 1872, line 4 – Tr. 1873, line 8, which was marked as Ex. 263, and it is also Exhibit No. 8 to the deposition of Charles D. Naslund). Mr. Nelson was Vice President – Corporate Planning of Ameren Services Company and Vice President of Central Illinois Public Service Company, d/b/a AmerenCIPS. (Ex. 8, p. 1 to Naslund Deposition, which is Ex. 262). The purpose of Mr. Nelson's March 25, 2004 Prepared Direct Testimony was to describe mitigation measures that Ameren, not EEInc., committed to undertake if its acquisition of Illinois Power Company was completed, including the acquisition by Ameren Energy Resources Company (AER) of a 20% interest in EEInc. from Illinova Generating Company. The mitigation measures were proposed because under certain assumptions the Illinois Power Company sale would fail to pass certain of the screens in Appendix A of the FERC's Merger Policy Statement. (*Id.* at 2-3).

Ameren, not EEInc., committed "to ensure that the only owner of EEInc not affiliated with Ameren – LG&E Energy's Kentucky Utilities Company ("KU") – is able to receive output from EEInc attributable to its 20 percent interest in EEInc, if it wishes to receive that much." (Ex. 8, p. 4 to Naslund Deposition, which is Ex. 262). Mr. Nelson expounded upon the Ameren commitment which involved directing the Ameren representative members of the EEInc. Board of Directors and directing AmerenUE and AER action at shareholder votes:

> A. Currently, Ameren subsidiaries hold a 60 percent interest in EEInc, which entitles them to, among other things, vote 60 percent of the outstanding shares in shareholder votes and, for all intents and purposes, to elect a majority of the members of the EEInc Board of Directors. The EEInc Bylaws currently provide for the allocation of capacity and energy from the generation facilities owned by EEInc in proportion to the owners' ownership shares. This provision, however, may be changed by a 75 percent vote of the outstanding shares. Upon consummation of the IP Sale, Ameren subsidiaries will hold 80 percent of the voting shares of EEInc.
>
> So as to prevent any ability of Ameren, following closing of the IP Sale, to "freeze out" KU from receiving the 20 percent of the EEInc capacity and output to which it is presently entitled, Ameren commits to: (i) direct its representative members of the EEI Board of Directors to take no action which would result in decisions to restrict KU's ability to receive up to 20 percent of the capacity and output of the generating facilities owned by EEInc (if KU desires to receive such capacity and output); and (ii) direct AER and AmerenUE (the Ameren subsidiaries that are EEInc shareholders) to undertake no action at shareholder votes that would restrict KU's ability to receive up to 20 percent of the capacity and output of the generating facilities owned by EEInc (if KU desires to receive such capacity and output). With these commitments in place, Ameren believes that KU is fully protected from any adverse impact that may result from Ameren's collective ownership in EEInc increasing from 60 to 80 percent.

(*Id.* at pp. 10-11). This testimony of Mr. Nelson clearly is not consistent with Professor Downs' testimony. The FERC at paragraph 50 of its July 29, 2004 Order Authorizing Disposition Of Jurisdictional Assets And Accepting Power Purchase Agreements Subject To Conditions stated "we rely on Applicants' commitment that EEInc/KU will be able to receive up to 20 percent of

the Joppa Facility's output in our finding of no harm to competition." (108 FERC ¶61,094 at P 50, p. 61,467).

Mr. Naslund identified several law firms that provide legal services to EEInc. He stated that he did not recall any specific instances where any of these firms provided any input on fiduciary duties. Mr. Naslund identified Mr. Kelley, a non-attorney, as the source of his knowledge about his fiduciary duties as a member of the Board of Directors of EEInc. when he first became a member of the Board, on various occasions during his tenure on the Board, and most notably on September 8, 2005 when the vote on the new power supply agreement occurred. (Vol. 25, Tr. 2542, line 10 – Tr. 2544, line 17; Vol. 27, Tr. 2580, line 18 – Tr. 2582, line 3). Mr. Naslund testified that he never sought legal advice but relied on Mr. Kelley's pronouncements. Vol. 27, Tr. 2612, lines 9-16).

Mr. Moehn is a witness on the EEInc. issue because of what he does not know, not because of what he knows and because of his job title. His prefiled, prepared testimony reads as if it is from a different person than the person who was on the witness stand. Mr. Moehn testified that being Vice President of Corporate Planning and responsible for the resource plan, it was decided that he would be the AmerenUE witness on EEInc. He said that prior to filing his Direct Testimony, he had no daily dealings with EEInc. (Ex. 260, p. 19, line 25 – p. 20, line 17; p. 64, line 8 – p. 65, line 1). AmerenUE counsel Thomas M. Byrne provided Mr. Moehn with draft questions and answers for his EEInc. Direct Testimony. (Ex. 260, p. 107, line 20 - p. 109, line 20). Regarding the documents filed at or issued by the Missouri PSC or the FERC, which he identified in his Direct Testimony, he either did not read them in entirety or at all. (Ex. 260, p. 22, line 23 – p. 26, line 2). Much of his Surrebuttal Testimony is nothing more than restating Professor Downs' testimony.

Mr. Moehn attempts to justify AmerenUE's conduct respecting EEInc. by arguing that when the 1987 contract ended on December 31, 2005, after the Midwest Independent Transmission System Operator, Inc. (MISO) Day Two Market started in April 2005, there was a robust wholesale market for EEInc. energy and capacity at market based rates whereas previously there had only been a world of bilateral contracts on a cost plus basis. (Ex. 35, Moehn Direct, p.13, lines 9-13; Ex. 36, Moehn Rebuttal, p. 19, lines 7-11; Ex. 37, Moehn Surrebuttal, p. 20, line 7 – p. 22, line 17).

In response to questions from the Bench, Mr. Moehn testified that there has been a significant wholesale power market in the MISO footprint "at least since 2000 and maybe a little bit further back from that." (Vol. 25, Tr. 2320, lines 16-17). He said that he did not know whether there is an organized market in the area south and east of the EEInc. Joppa Plant, but assumed that there are transactions of wholesale electricity in the southeast part of the U.S. (*Id.* at Tr. 2320, line 19 – Tr. 2321, line 2). He testified that he did not know whether prior to FERC Orders 888 and 889 there were transactions between utilities that occurred on a basis other than cost, the volume of transactions engaged in by AmerenUE post Orders 888 and 889, or the prices obtained by AmerenUE for wholesale transactions pre- and post-MISO Day 2. (*Id.* at Tr. 2327, lines 9-17; Tr. 2328, lines 10-20; Tr. 2329, lines 1-12). Mr. Moehn repeatedly revealed his extremely limited knowledge of his own testimony on the MISO Day 2 Market. (*Id.* at Tr. 2324, lines 7-21; Tr. 2325, lines 13 - Tr. 2326, line 1).

Professor Downs readily stated in his Direct Testimony at page 6, line 22, Exhibit No. 44, "I am not an expert in public utility regulation," and reiterated that statement at the evidentiary hearing, about not being an expert in public utility regulatory law:

> Q. [Micheel]. Mr. Downs, you're not an expert in regulatory law; isn't that correct?

A. [Downs]. That's true. That's not my area of expertise.

Q. And you're not offering any expert testimony with respect to regulatory law here today; is that correct?

A. That's true.

Q. Is it correct, also that you're not a fact witness, you don't consider yourself a fact witness in this case?

A. That's also true.

Q. And so you're just providing expert testimony on what you believe the law is, is that correct, with respect to corporate boards?

A. I believe that's true. It is also true that some of the comment in my direct testimony, rebuttal testimony and surrebuttal testimony probably expands upon that a little bit.

(Vol. 25, Tr. 2359, line 14 – Tr. 2360, line 6). His most immediate connection to public utility regulation, prior to being retained by AmerenUE, is being called, but not testifying as a witness, on behalf of David C. Wittig in the federal government's criminal case against Mr. Wittig and Douglas T. Lake for wire-fraud, money-laundering, circumvention of internal controls and conspiracy while they were officers of Westar Energy, Inc. (Ex. 259, p. 15, line 9 – p. 16, line 4). A review of the judicial decisions on governance cited by AmerenUE in its Prehearing Brief reveals that none of these cases involve public utilities and they are not on point.

Regarding Mr. Schallenberg's testimony on the Power Supply Agreement between EEInc., UE and the other Sponsoring Companies, Mr. Schallenberg has reviewed, in his work performing audits of electric companies in rate increase and decrease cases, all of the significant power supply agreements that affected the cost of service that was under examination. In his approximate 30 years of employment by the Commission, that review has occurred in seven (7) cases respecting Kansas City Power & Light Company, two (2) cases respecting Missouri Public

Service Company/UtiliCorp United, Inc., one (1) case respecting St. Joseph Light & Power Company and one (1) case respecting AmerenUE. Mr. Schallenberg has also submitted testimony before the FERC in natural gas transportation rate cases involving Williams Natural Gas Company (WNG) and Mississippi River Transmission Corporation (MRT) on issues including affiliated transactions between WNG and its parent and MRT and its parent. (Ex. 103, Schallenberg Deposition, p. 104, lines 10-22; Ex. 236, Schallenberg Rebuttal, p. 1, lines 17-22, p. 3, line 9 – p. 4, line 2 and Schedule 1).

Mr. Schallenberg testified that wholesale power was selling at market based rates even before he started working at the Missouri Commission in 1976. He stated that he saw energy and capacity sales by Missouri Commission regulated electric utilities from the late 1970's and subsequent years that were below cost, at what the market would bear, because there was an excess of capacity in this region. (Ex. 103, Schallenberg Deposition, p. 49, line 22 – p. 51, line 1). He identified the EEInc. Power Supply Agreement as unique because, among other things, it committed UE and the other Sponsoring Companies, from the beginning of the EEInc. contracts, to take, as standbys, energy that DOE did not take, when power supply agreements otherwise commit the purchaser to take a specific amount of energy and/or capacity. (*Id.* at 68, lines 14-23; p. 96, lines 2-16).

When inquiry was made of Mr. Schallenberg at his deposition regarding the fiduciary obligations of directors whether a director may not take the corporation's assets to help another corporation in which the director has an interest, Mr. Schallenberg stated, "I see it all of the time in affiliate transactions" and "It also happens to support nonregulated [activities]." (Ex. 103, Schallenberg Deposition, p. 30, line 21 – p. 31, line 10; p. 34, line 17 – p. 35, line 2). Among other things, Mr. Schallenberg referred to various deposition responses of Ameren Corporation

Chairman, Chief Executive Officer and President Gary L. Rainwater, who had also served as Chairman, Chief Executive Officer and President of AmerenUE, that the AmerenUE Board was "perfunctory." (*Id.* at 33, lines 2-7; p. 105, lines 1-16). At his deposition, Mr. Rainwater referred the function of the AmerenUE Board of Directors as "perfunctory" as follows:

> Q Now, to what extent does the Union Electric Board of Directors get involved in those sorts of resource decisions?
>
> A Well, any time there's a decision to build which requires a capital investment that's a decision that would go to the board.
>
> Q Does that go to the Union Electric board or the Ameren board?
>
> A It would go to the Ameren board.
>
> Q And does Union Electric have its own board?
>
> A Yes, it does.
>
> Q Would it approve those sorts of decisions before they're up to the Ameren board?
>
> A I don't think so.
>
> Q What sorts of decisions would the UE board deal with?
>
> A Decisions that I would call perfunctory kinds of decisions that would be at a level that would not need to go to the Ameren board. Let's say a decision to sell property that had been purchased to build a substation that we no longer needed, that would be approved by the UE board but would not need to go to the Ameren board.

(*Id.* at 63, line 12 – p. 64, line 6). Mr. Rainwater later in the deposition described the UE Board of Directors as "just an internal board that we use for what I would call perfunctory issues that need a formal approval but really don't rise to the level of going outside our directors for approval." (*Id.* at 72, lines 22-25).

AmerenUE made as a major part of its argument that the Power Supply Agreements between EEInc. and AmerenUE were typical purchase power contracts and AmerenUE should

have had no expectation of continued access to EEInc. energy and capacity at cost based rates on the basis that both from 1954-2005 and 1987-2005, the Atomic Energy Commission (AEC)/Department of Energy (DOE) and the Sponsoring Companies other than AmerenUE received approximately 83-84% of the output of the Joppa plant and paid for a similar level of EEInc.'s total costs associated with producing that output, while AmerenUE's ratepayers paid for the remaining total costs of the Joppa Plant through fuel and purchased power expenses included in rates. AmerenUE argues that this 16-17% of output that AmerenUE's ratepayers have received and paid for is far less than what they would have paid had AmerenUE's 40% share of EEInc. been included in rate base over the same period. (Ex. 36, Moehn Rebuttal, p. 8, lines 4-9; p. 16, line 18 – p. 17, line 5; Vol. 25, Tr. 2354, line 19 – Tr. 2356, line 5). Mr. Schallenberg testified that this argument by AmerenUE does not prove what AmerenUE contends that it does because AmerenUE left out of the equation that there is a customer that is not an owner, i.e., AEC/DOE. AmerenUE is not responsible for 40% of the total. AmerenUE is responsible for 40% of the total less AEC/DOE. (Ex. 103, Schallenberg Deposition, p. 80, line 19 – p. 81, line 21).

AmerenUE's attempt to explain the EEInc. issue by characterizing the Joppa Plant as a below-the-line investment because it is not in AmerenUE's rate base and AmerenUE's other generating facilities as above-the-line investments because they are in rate base is simply a AmerenUE construct. Mr. Schallenberg testified that just as UE's shareholders paid for UE's equity investment in the Joppa Plant, UE's shareholders paid for UE's equity investment in its other generating facilities, for example, Callaway and Taum Sauk, and that equity investment paid for by UE's shareholders is not in rate base. He related that cost of service for UE's other generating units could be recovered in rates through being placed in expenses, rather than

through being placed in rate base. Interest expense and profit are recovered in cost of service from ratepayers by being placed in rate base. Interest expense and profit are below net operating income. The term "below-the-line" is traditionally used for items for which recovery is being disallowed because of imprudence, for example. In the EEInc. situation, a rate of return is imputed into the cost of service that is independent of the rate of return that the Commission would have determined for rate base. (Ex. 103, Schallenberg Deposition, p. 98, line 14 – p. 102, line 15).

Mr. Schallenberg testified that UE never indicated that capacity and energy from the EEInc. Joppa Plant was not part of the UE system available to serve UE's native load customers until after UE's merger with Central Illinois Public Service Company (CIPS) and the restructuring of UE as a subsidiary of a non-exempt public utility holding company. In fact, before the merger, UE presented its plans to continue to use the Joppa Plant capacity and energy to serve its native load customers after the 1987 Power Supply Agreement ended December 31, 2005. As late as the 1990's, UE's electric supply resource plans indicated that the Joppa Plant would serve UE native load customers over a period of years beyond the existing EEInc. Power Supply Agreement termination date of December 31, 2005. For example, UE's June 1995 "Energy Resource Plan" shows 405 MW of Joppa Plant available to UE from 1995-2014. The planning horizon for this document is through 2014 and at no time is it indicated that Joppa Plant capacity and energy is not available to UE's native load customers. UE's October 1997 "Risk & Uncertainty Analysis Briefing" resource planning document continues to show AmerenUE's use of 405 MW of Joppa Plant through 2014 and shows extra Joppa Plant capacity and energy as early as 2010. (Ex. 237, Schallenberg Surrebuttal, p. 22, line 17 – p. 25 line 7; Vol. 27, Tr. 2747, line 6 – Tr. 2752, line 18).

In the Staff's 2001-2002 excess earnings-revenues complaint case against AmerenUE, Public Counsel obtained from AmerenUE its 10 year forecast resource plans commencing for the years 1998, 1999, and 2000. AmerenUE's 10 year forecast resource plan commencing for the year 2000, unlike its 10 year forecast resource plans commencing for the years 1998 and 1999, shows capacity and energy from the Joppa Plant terminating at the end of 2005 and not being available to AmerenUE thereafter. AmerenCIPS's 10 year forecast resource plan commencing for the year 2000 shows AmerenCIPS's share of capacity and energy from the Joppa Plant continuing through 2005 with its share of EEInc. Commencing in 2006, AmerenCIPS would receive not only its share of the Joppa Plant capacity and energy, but it would receive AmerenUE's 405 MW share of EEInc. as well. (Ex. 237, Schallenberg Surrebuttal, p. 25, line 8 – p. 26 line 13; Vol. 27, Tr. 2747, line 6 – Tr. 2752, line 18).

The EEInc. FERC Form 1 Annual Report, page 105, shows that at the time of the termination of the last Power Supply Agreement between EEInc. and the Sponsoring Companies and the award of a contract for 100% of the capacity and energy from the Joppa Plant to Ameren Energy Marketing Company (AEM), the EEInc. Board of Directors was comprised of the following individuals:

R. Alan Kelley Chairman of the Board, Electric Energy, Inc.
(Mr. Kelley was also identified by Mr. Naslund as being Senior Vice President of Ameren Energy Marketing Company (AEM) - Vol. 27, Tr. 2617, lines 19-21 – Ex. 510 (AmerenUE response to Staff Data Request No. 8) – Ameren Organizational Chart and Directors and Officers of Ameren Corp. and Subsidiaries – as of approximately 8/26/05, Mr. Kelley is shown as a Vice Pres. of Ameren Energy Resources (AER)[15] – as of approximately, 5/23/06, Mr. Kelley is shown as being a Director and President of Ameren Energy Generating (AEG))

Daniel F. Cole Senior Vice Pres., Administration, Ameren Services

[15] Mr. Rainwater identified Ameren Energy Resources as a subholding company of Ameren Corporation which owns Ameren Energy Marketing Company, Ameren Generating Company, Ameren Energy Development Company and maybe one or two other subsidiaries. (Ex. 258, Rainwater Deposition, p. 20, lines 16-20).

(Ex. 510 (AmerenUE response to Staff Data Request No. 8) – Ameren Organizational Chart and Directors and Officers of Ameren Corp. and Subsidiaries – as of approximately 5/23/06, Mr. Cole is shown as a Director of Ameren Energy Marketing (AEM) – as of approximately 8/26/05, Mr. Cole is shown as a Director of Ameren Energy Resources (AER) – as of approximately, 5/23/06, Mr. Cole is shown as being a Director and Senior Vice Pres. of Ameren Energy Generating (AEG))

Charles D. Naslund Senior Vice Pres. & Chief Nuclear Officer, AmerenUE

Paul W. Thompson Senior Vice Pres., Energy Services, LG&E Energy LLC

David A. Whiteley Senior Vice Pres., Energy Delivery, Ameren Services
(Ex. 510 (AmerenUE response to Staff Data Request No. 8) – Ameren Organizational Chart and Directors and Officers of Ameren Corp. and Subsidiaries – as of approximately, 5/23/06, Mr. Whiteley is shown as being a Director and Senior Vice Pres. of Ameren Energy Generating (AEG))

Thomas R. Voss Exec. Vice Pres. & Chief Operating Officer, Ameren Corp.
(Ex. 510 (AmerenUE response to Staff Data Request No. 8) – Ameren Organizational Chart and Directors and Officers of Ameren Corp. and Subsidiaries – as of approximately 5/23/06, Mr. Voss is shown as a Director and Executive Vice Pres. of Ameren Energy Marketing (AEM) – as of approximately 8/26/05 Mr. Voss is shown as a Director of Ameren Energy Resources (AER) – as of approximately, 5/23/06, Mr. Voss is shown as being a Director and Executive Vice Pres. of Ameren Energy Generating (AEG))

John N. Voyles, Jr. Vice. Pres., Regulated Generation, LG&E Energy Corp.

(Ex. 262, Naslund Deposition, Deposition Ex. 7, FERC Form 1 for the year ending 12/31/05).

The EEInc. FERC Form 1 Annual Report for the year ending 12/31/05, page 104, shows that at the time of the termination of the last Power Supply Agreement between EEInc. and the Sponsoring Companies and the award of a contract for 100% of the capacity and energy from the Joppa Plant to Ameren Energy Marketing Company (AEM), the EEInc. Board of Directors was comprised of the following individuals:

R. Alan Kelley Chairman of the Board, Electric Energy, Inc.
(Mr. Kelley was also identified by Mr. Naslund as being Senior Vice President of Ameren Energy Marketing Company (AEM) - Vol. 27, Tr. 2617, lines 19-21 – but Mr. Naslund did not identify Mr. Kelley as being among the EEInc. officers that recommended AEM to the EEInc. Board of Directors to be awarded the

contract to market EEInc. capacity and energy commencing January 1, 2006) - See list for Mr. Kelley under EEInc. Board of Directors)

Robert L. Powers President EEInc.
(Mr. Rainwater identified Mr. Powers as being an officer in Ameren Energy Resources (AER), Vol. 23, Tr. 1842, lines 4-13)

William H. Sheppard Vice Pres. EEInc.

James M. Helm Secretary-Treasurer EEInc.

Mr. Naslund testified that in 1999, AmerenUE put forward his name and the name of David A. Whiteley to be elected to the EEInc. Board of Directors. (Vol. 27, Tr. 2620, lines 17-25). He indicated that AmerenUE as a shareholder of EEInc. is allocated two individuals to nominate to the EEInc. Board of Directors. (Vol. 25, Tr. 2540, line 11 – Tr. 2541, line 1). He stated that he has been a Director seven (7) plus years. (Vol. 27, Tr. 2623, lines 10-11).

Mr. Naslund stated that neither prior to nor at the time of EEInc. entering into the contract with AEM did he inquire whether there were other entities available that could perform the service that AEM was to perform in the proposed contract. (Vol. 27, Tr. 2622, lines10-14). Mr. Naslund testified that the Officers of EEInc. came to a meeting of the EEInc. Board of Directors with a recommendation that the contract be awarded to AEM as the marketer of power from EEInc. (Vol. 25, Tr. 2550, line 24 – Tr. 2551, line 5). There was a Board resolution to endorse the recommendation of the EEInc. Officers and the Board passed the resolution endorsing their recommendation. The Officers of EEInc. did not say what alternatives they considered relative to marketers. (Vol. 27, Tr. 2640, lines 7 – Tr. 2641, line 6). Mr. Naslund does not know whether an RFP was sent out, but he does not believe so. (Vol. 25, Tr. 2551, line 21 – Tr. 2552, line 3; Vol. 27, Tr. 2639, lines 11-18). He said that there has never been a marketer other than AEM in the picture. (Vol. 27, Tr. 2583, lines 7-9).

In questioning from Chairman Jeff Davis, Mr. Naslund testified that he does not know whether EEInc. got the best deal (Vol. 27, Tr. 2639, lines 20-25). Mr. Naslund's testimony was the same to questions from Commissioner Steve Gaw. The EEInc. Board accepted the recommendation of the Officers of EEInc. The EEInc. Board did not evaluate the deal with AEM, the EEInc. Board did not evaluate whether there might be some other entity which could provide the service to be provided by AEM better than AEM, and the EEInc. Board did not evaluate the amount of money that would be going to AEM in the transaction. (Vol. 28HC , Tr. 2603, line 9 – Tr. 2605, line 4). **

Q. [ ]

A.[ ]

Q.

A.

Q.

A.

Q.

NP

A.

Q.

A. **

Mr. Naslund identified the "team" that drafted the new power supply agreement based on market rates as follows, as does page 3 of 3 of Public Counsel Exhibit No. 433 in part:

Andy Serri	President of Ameren Energy and Ameren Energy Marketing (AEM)
Dave Hennen	Legal counsel, Ameren Services
Don Gully	Manager, Ameren Energy Marketing (AEM)
Jim Helm	Secretary-Treasurer, EEInc.
Mike Pulliam	Marketing & Sales, EEInc.
Charlie Fryburg	Marketing & Sales, LG&E (Kentucky Utilities)

(Vol. 28HC, Tr. 2605, line 5 – Tr. 2606, line 21). Commissioner Gaw asked Mr. Naslund whether as a Director of the EEInc. Board of Directors it ever occurred to him that there was a conflict of interest regarding Messrs. Serri and Gully. Mr. Naslund responded that the thought did not occur to him. (*Id.* at 2606, lines 11-15).

Counsel for AmerenUE asked Mr. Naslund why he was not concerned, if he was not concerned, that there was not any recommendation or consideration of a marketer other than AEM. Mr. Naslund gave an answer in two parts, both of which are revealing, but the second part being particularly so:

> Q.[Cynkar] Mr. Naslund, following up on the Chairman's question, why wouldn't you have been concerned, if you weren't, why there wasn't any recommendation or consideration of a marketer other than AEM?

NP

A.[Naslund] I guess I'd answer that in two ways. One, I think having worked with the officers of EEI, I've always had a comfort level that their recommendations to us are sound, and so to a certain extent we have to rely on what they're bringing to us, since they've done all the leg work and know all the details, which really at the board level I wouldn't ever claim that we know all the details.

The second part of that is that in putting that power supply agreement together, it did have the involvement of all the sponsor companies, including LGE and the Ameren companies, and there seemed to be agreement between those parties that this was the most appropriate route to go.

And at the end of the day, then the recommendation came to us. With those inputs, I ended up voting in favor of putting that PSA in place.

((Vol. 27, Tr. 2641, line 15 – Tr. 2642, line 10; emphasis added).

PINCKNEYVILLE AND KINMUNDY

The Staff filed Direct Testimony of Stephen M. Rackers sponsoring a Pinckneyville and Kinmundy adjustment. The Staff determined not to pursue the adjustment that it had originally filed and therefore did not file any additional testimony on Pinckneyville and Kinmundy and did not offer the Direct Testimony of Mr. Rackers on this issue. The reconciliations filed by the Staff in this case reflect that the Staff is neither sponsoring nor supporting any adjustment. The Staff has not filed testimony in support of any party's position on this issue.

SO_2 ALLOWANCES/SO_2 PREMIUMS/2006 STORM COSTS

Should revenues received from environmental allowance transactions be included in the revenue requirement and if so, what amount?
Should the Company establish a regulatory liability to account for sales of environmental allowances sold by the Company?
Should SO_2 premiums (net of discounts) be included in the regulatory liability account?
Should the balance of SO_2 allowances less SO_2 Premiums paid be used to offset 2006 storm costs? If so, what is the proper storm cost level to include in the cost of service?

Staff strongly supports establishing a regulatory liability account on a going-forward basis for AmerenUE to book all gains resulting from sales of emissions allowances to, should the

company not have a fuel adjustment clause.[16] An active market exists for companies to sell excess allowances, and AmerenUE has traditionally been on the selling side (Tr. 3456). Establishing a regulatory liability account going forward from January 1, 2007 to capture the gains from sales of emission allowances will capture all of the SO_2 gains for ratepayers; and it will capture these gains regardless of their amount in any given year, in light of the potential high degree of fluctuation (Tr. 3539). Indeed, AmerenUE witness Moore testified that the company has no plans to sell any particular number of allowances in any particular year (Tr. 3481). Staff's proposal also avoids the potential for the value of the SO_2 emission allowance assets going to the shareholders rather than the ratepayers, which could happen if the Commission chooses to set rates based on a normalized level instead. The Commission may then consider the balance in that regulatory account as a component of fuel expense in the next rate case.

Staff recommends that SO_2 premiums (net of discounts) be included in that regulatory liability account (Surrebuttal Testimony of John P. Cassidy at 12). The State has suggested that AmerenUE could potentially manipulate the system by agreeing with coal vendors in the future to pay a higher SO_2 premium to get a lower base rate coal price (Tr. 3536). However, the only way to game the situation would be for the utility to negotiate new contracts with clauses that put more money into SO_2 premiums and reduce the other components of coal costs. (This scenario may only happen if there is no FAC.) The opportunity to manipulate prices in this manner is severely limited if it exists at all, because all of the company's 2007 coal needs are hedged, 97 or 98 percent of its 2008 needs are hedged, and 60 percent of its 2009 needs are hedged (Tr. 3542).

[16] If the company does have a fuel adjustment clause, then prospective emission allowance sales would run through the fuel adjustment clause along with any SO_2 premiums incurred for coal contracts.

Some parties have incorrectly suggested that Staff's proposed regulatory account would result in retroactive ratemaking. Appellate courts have addressed and defined retroactive ratemaking, and Missouri's Supreme Court has been quite explicit: in the *UCCM* case, it set forth the standard that the Commission can only consider past excess recoveries to determine what rate a utility should charge in the future to eliminate excess charges in the future.[17] The key to the prohibition against retroactive ratemaking is that the Commission may not re-determine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of its property without due process. Staff's proposal of a regulatory asset account is in keeping with this principle: the account would be established with the consent of the company, alleviating any due process concerns, and rates will be established on a prospective basis.

Finally, Staff believes that offsetting pre-January 1, 2007 SO_2 emission allowance gains with storm costs of the recent past is an excellent way of eliminating those storm costs that otherwise would be borne by ratepayers on a long-term basis, and those storm costs would not be used in a multi-year averaging technique or considered to project a future level of storm expense.

DEPRECIATION

A. Depreciation: Does 4 CSR 240-10.020 require any adjustment in this case for return on depreciation reserve? If so, what adjustment does 4 CSR 240-10.020 require? If

[17] "[T]o direct the commission to determine what a reasonable rate would have been and to require a credit or refund of any amount collected in excess of this amount would be retroactive ratemaking. The commission has the authority to determine the rate to be charged, § 393.270. In so determining it may consider past excess recovery insofar as this is relevant to its determination of what rate is necessary to provide a just and reasonable return in the future, and so avoid further excess recovery, See *State ex rel. General Telephone Co. of the Midwest v. Public Service Comm'n*, 537 S.W.2d 655 (Mo.App.1976). It may not, however, redetermine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of his property without due process. See *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe R. Co.*, 284 U.S. 370, 389-90, 52 S.Ct. 183, 76 L.Ed. 348 (1932); *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23, 31, 46 S.Ct. 363, 70 L.Ed. 808 (1926); *Lightfoot v. City of Springfield*, 361 Mo. 659, 236 S.W.2d 348, 353 (1951)." *State ex rel. Util. Consumers Council of Mo., Inc. v. Pub. Serv. Comm'n*, 585 S.W.2d 41, 58 (Mo. 1979).

AmerenUE is not in compliance with 4 CSR 240-10.020, what action should the Commission take as a consequence?

Rule 4 CSR 240-10.020 requires no adjustment to AmerenUE's revenue requirement. According to the rule, "income shall be determined on the depreciation funds of [utilities]" and "applied in reduction of the annual charges to operating income."[18] The rule requires in setting rates, that a credit of 3% of depreciation reserves be given to customers. In Ameren's case this would be a reduction of $135 million in revenue requirement.[19]

But as Staff witness Robert Schallenberg pointed out in his testimony at the hearing, if this rule is applicable at all, the PSC has "modified the rate through either its own motion or upon a proper showing that the 3 percent rate is not reasonably and equitably applicable."[20] In other words, the PSC has "given the depreciation reserve the same return as is applied to the rate base."[21] Here's what Mr. Schallenberg means: Traditional rate-making provides that the return on rate base be calculated as follows:

Gross Plant	100
-Depreciation Reserves	- 10
= Net Plant	90
x Rate of Return	x.08
= Return on Rate Base	7.2

Compare the traditional method above to the methodology suggested by Ameren under rule 10.020:

Gross Plant	100
x Rate of Return	x .08
= Return on Undepreciated Rate Base	= 8.0
- (3% x Depreciation Reserve)	- (.03 x 10)

[18] 4 CSR 240-10.020(4).

[19] Transcript, p. 3616, l. 16-22.

[20] Transcript, p. 3642, l. 1-4.

[21] Id, l. 20-22.

= Return on Rate Base	= 7.7

Witness Schallenberg suggests that the 3% imputation from rule 10.020 has been implicitly modified by Commission rate-making orders since at least the mid-'70's to be equal to the rate of return.[22] In other words the 3% has been modified to match the rate of return, in this example 8%. Here's the calculation under rule 10.020 with 3% modified to 8%:

Gross Plant	100
x Rate of Return	x .08
= Return on Undepreciated Rate Base	= 8.0
- (8% x Depreciation Reserve)	- (**.08** x 10)
= Return on Rate Base	= **7.2**

The changes appear in bold. When the 3% imputation to income is modified, as allowed by subsection 4 to match the rate of return of 8%, the return on rate base under the traditional method and rule 10.020 is the same. This is how the Commission should apply rule 10.020.

AmerenUE brought up the issue of applying rule 10.020 for the first time since the 1950's.[23] Notably, AmerenUE has not complied with the rule for nearly 50 years.[24] It has failed to file annual reports in compliance with the rule since 1958.[25] Now, AmerenUE not only asks the Commission to excuse its 50 years of noncompliance with the rule, it seeks a novel application of the rule to augment its revenues by $386 million above and beyond its original $360 million revenue request. The rule does not allow such an interpretation.

Ameren has wasted a great deal of the parties' time and resources litigating an untenable, mostly frivolous position under rule 10.020. There should be consequences. To begin, Ameren's credibility is suspect and the lack of credibility on this issue makes Ameren's position

[22] Transcript, p. 3642, l. 15-22.

[23] Transcript, p. 3641, l. 4-11.

[24] Transcript, p. 3641, l. 2-16.

[25] Id.

on other issues suspect. The amount of time and energy devoted to Ameren's frivolity is difficult to calculate. Several expert witnesses devoted many hours to research, written testimony, and live testimony on this issue. The total number of hours lost and dollars spent is, no doubt, tens of hours and thousands of dollars. Ameren shareholders, not rate payers, should pay for Ameren's lark. The Commission should: 1) make a finding that there is no merit to the company's position on this issue, 2) order the Staff to initiate a rule-making to rescind rule 4 CSR 240-10.020, and 3) consider directing the General Counsel to file a complaint against Ameren for its admitted failure to comply with the reporting requirements of rule 10.020.

As the Staff stated at pages 46-47 of its prehearing brief, the Staff conducted its depreciation analysis in this case by following the guidance the Commission gave in its March 10, 2005, *Report and Order* in the recent general electric rate increase case where the Commission reviewed the rates of The Empire District Electric Company, Case No. ER-2004-0570. (Mathis Direct and Surrebuttal Testimony). As the Staff noted in its prehearing brief, in that case the Commission stated, "In ratemaking, depreciation is an operating expense, the purpose of which is to return to the investors their original investment in an asset as it is consumed in the public service." *Report and Order* at 48. Further, the Commission stated, "It is the policy of this Commission to return to traditional accounting methods for Net Salvage," and that "the fundamental goal of depreciation accounting is to allocate the full cost of an asset, including its Net Salvage cost, over its economic or service life so that utility customers will be charged for the cost of the asset in proportion to the benefit they receive from its consumption." *Report and Order* at 54. In determining how to allocate the net salvage cost over the service life of an asset the Commission approved the following formula:

Depreciation Rate = (100% – % Net Salvage) / Average Service Life (years)

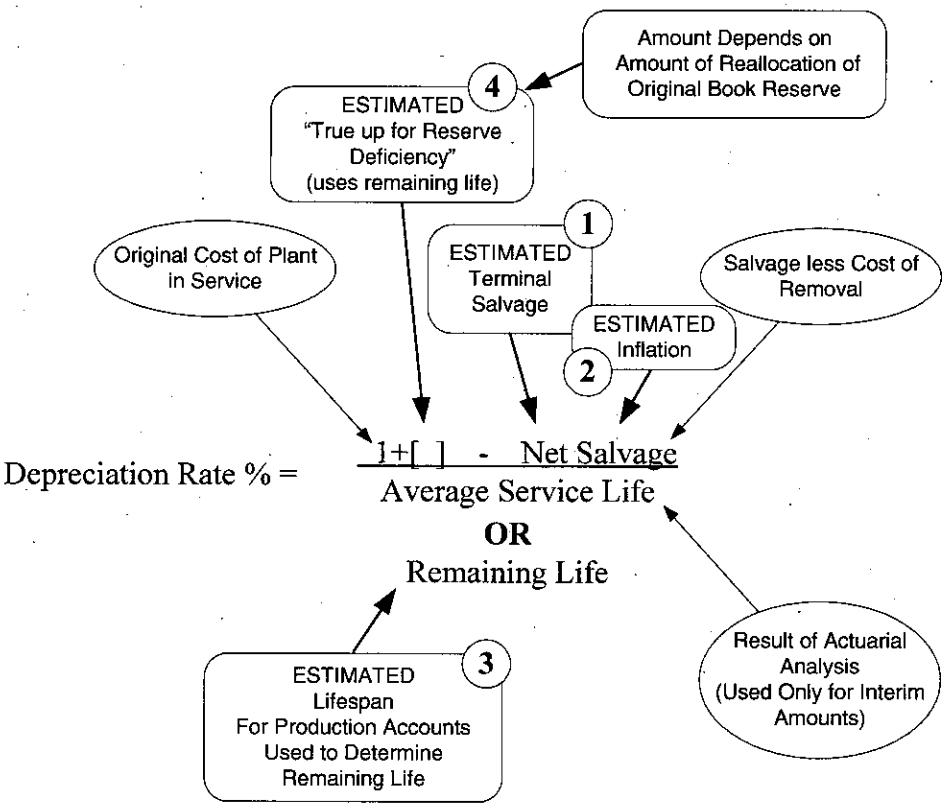
where net salvage equals the gross salvage value of the asset minus the cost of removing the asset from service and the net salvage percentage is determined by dividing the net salvage experienced for a period of time by the original cost of the property retired during that same period of time. *Report and Order* at 51-52.

However, in the *Report and Order* the Commission noted it generally rejects recovery of terminal net salvage associated with production plant accounts because "any allowance for this item would necessarily be purely speculative." *Report and Order* at 53.

Following the foregoing directives of the Commission, the Staff performed its depreciation study by using the straight-line method, the broad-group procedure and the whole-life technique. With the whole-life technique depreciation rates are based on estimated average service lives of the asset. With the straight-line method the full cost of an asset is divided by the service life of the asset in years and the resulting annual amount is charged to depreciation expense and credited to the accumulated depreciation account. With the broad-group procedure, rather than evaluating depreciation rates and depreciation expense for each asset separately, multiple assets with similar characteristics are grouped into a particular depreciation category and treated together as a whole for determining deprecation rates and depreciation expense for those assets. (Mathis Direct, p. 2).

In contrast to the approach taken by the Staff and the Commission's directives in Case No. ER-2004-0570, AmerenUE used, and requests the Commission adopt, the ***life-span approach*** to straight-line whole life depreciation—assume a date certain all the plant will be retired—and allow an accrual for ***both*** interim net salvage and ***terminal*** net salvage (value of property retired less the cost of removal—Stout, Tr.3702-03). (Stout Direct, p. 4). In her surrebuttal testimony, Staff witness Jolie Mathis presents the diagram following that shows

material differences between the depreciation study the Staff conducted in conformance with the Commission's directives and that conducted by AmerenUE's outside experts.



(Mathis Surrebuttal, p. 5).

Near the close of the evidentiary hearings in this case AmerenUE entered into a non-unanimous stipulation and agreement with the Staff regarding depreciation issues which they filed with the Commission on March 19, 2007. There AmerenUE agreed not to seek terminal net salvage for its steam and hydro-powered generation plants. By Rule 4 CSR 240-2.115(2)(D), the Commission may treat AmerenUE as having changed its position on that issue.

The depreciation issues presented to the Commission for decision in this case are the same as those set out in the Staff's prehearing brief. The Staff addresses them following in the same order as they appear in the list of issues and in the Staff's prehearing brief. The Staff notes

many of these issues were mislabeled by one letter in its prehearing brief. The Staff has conformed it labeling in this brief to match that of the issues list.

B. Fossil-fueled and hydro-powered generation plant depreciation rates: Should depreciation rates for the plant accounts for fossil-fueled and hydro-powered generation plants be based on average service lives with no truncation or a service life that is truncated at an estimated future final retirement date of each generation plant (Life Span)?

As it did in two rates cases for The Empire District Electric Company—Case Nos. ER-2001-299 and ER-2004-0570—the Commission should find here that the retirement dates AmerenUE's outside consultants used when they analyzed depreciation rates and depreciation expense for AmerenUE's fossil-fueled steam generation plants in this case are unreliable and unpersuasive. Further, because the alternative retirement dates the Missouri Industrial Energy Consumers' expert witness Selecky offers for AmerenUE's Rush Island units suffer from the same infirmities as those presented by AmerenUE, the Commission should also reject them as unreliable and unpersuasive. Instead of lives based on estimated retirement dates, the Commission should rely on the average service lives the Staff proposes. Despite AmerenUE's claims to the contrary, the Staff is not assuming the generating plants will remain in service forever; however, the Staff is assuming they will continue to operate at least as long as the longest average service life of any component at these plants; that is why the Commission should rely on the average service lives the Staff determined for the components of these generating plants.

As Staff witnesses Jolie Mathis and Guy Gilbert testified, the depreciation rates for the plant accounts for fossil-fueled steam and hydro-powered generation plants should be based on average service lives because historical experience is that these types of plants remain in operation as long as it is economical and feasible to continue to operate them. (Mathis Direct, p.

8). Further, AmerenUE presented no credible evidence it plans to retire of any of its fossil-fueled steam or hydro-powered generation plants. (Mathis Surrebuttal, pp. 8-10). AmerenUE has disclosed no plans to the Commission, or the Staff, as it is required to by Commission rule, as to how is would replace any of the capacity it would lose if the plants were retired in the not so distant future (Exhibit 273 HC, 457 P, 458 NP (AmerenUE's December 2005 Integrated Resource Plan); Gilbert Rebuttal, pp. 2-4). Moreover, AmerenUE's projected retirement dates have moved further into the future from those it proposed for these plants in the last case before the Commission where AmerenUE's rates were in issue—ER-2002-1. (Mathis, Surrebuttal, p. 10).

AmerenUE's witnesses agree that if a depreciation analyst is using life span for a power plant, it is the analyst's goal to use a life span that is based on the best estimate of the actual date that power plant would be retired. (Stout, Tr. 3703; Wiedmayer, Tr. 3719; Birk, Tr. 3646). However, the evidence in this case demonstrates neither AmerenUE nor its outside experts conducted a study to determine best estimates of the actual dates AmerenUE's power plants will be retired. The estimated retirement dates AmerenUE's experts used in their depreciation study are unrealistic—replacement of all of AmerenUE's baseload capacity of over 6,500 MW over a sixteen-year period. Further, the evidence in this case is that AmerenUE and its experts failed to take into account the planning needed to arrange the financing and construction of new plants when estimating retirement dates for its generating plants. Not only should the Commission reject the plant lives AmerenUE relied upon for its depreciation study, the Commission should point out the failings of AmerenUE and its depreciation experts to presenting credible plant retirement dates.

AmerenUE has four sites where it has built fossil-fueled steam electric generation plants which have approximately the following generating output capacities: Meremac—900, Sioux—950 MW, Labadie—2,430 MW, and Rush Island—1,100 MW (Birk, Tr. 3646-47). It also has a hydro-electric plant: Osage, which has an output capacity of about 226 MW (Wiedmayer Rebuttal, p. 25), and the Callaway nuclear plant which has an output capacity of about 1,292 MW (Nasland Direct, p. 3). The total capacity of all these plants is about 6,898 MW and the generating capacity of all of AmerenUE's plants is on the order of 8,500 MW. (Birk, Tr. 3646).

The annual increase in AmerenUE's capacity caused by the increasing demands of its customers is on the order of 200 MW per year. (Birk, Tr. 3647)

AmerenUE retained Gannett Fleming, Inc., to perform the depreciation study it presented in this case. Mssrs. William Stout and John Wiedmayer of Gannett Fleming, Inc., testified on behalf of AmerenUE. Although Mr. John Wiedmayer, stated in his direct testimony, "Probable retirement dates were estimated for each power plant" he later correctly, but inconsistently, stated, "The probable retirement date used for all steam production plants is June 30, 2026." (Wiedmayer Direct Schedule jfwe1, II-25.)

In response to the observation of Missouri Industrial Energy Consumers' witness Selecky made in his direct testimony that it was unlikely AmerenUE would retire 5,500 MW of generation the same year, in his rebuttal testimony, Mr. Wiedmeier presented a revised depreciation study based on estimated retirement dates for each power plant. He expressly stated the following regarding the dates used in his original study, "Retirement dates specific to each plant were not estimated in the depreciation study submitted along with my Direct Testimony." He further stated, "The original date was selected as a reasonable period (20 years) to recover the undepreciated portion of the steam plant given existing ages of the steam plants and the

uncertainties related to the future operation of the plants." (Wiedmayer, Rebuttal p. 23). In cross-examination, AmerenUE witness Birk testified he had not provided the average retirement date of June 30, 2026 to Mssrs. Stout or Wiedmayer. (Birk, Tr. 3652) He further testified as follows as to how the June 30, 2026 date was arrived at: "Basically, that came about because our integrated resource plan typically goes out 20 years. And at that point, that date was -- was poled as an average date for -- for all of the plants." AmerenUE filed an integrated resource plan in December of 2005 that included a 20-year planning horizon, but did not reflect replacement of any capacity lost by retirement of any of AmerenUE's current generating plants. (Exhibit 273 HC, 457 P, 458 NP; Tr. 3654-55). When squarely asked if he considered how capacity would be replaced on retirement of a plant, AmerenUE witness Birk responded affirmatively, but provided only comparative operational characteristics of potential new plant to old, and not any consideration of the planning and arrangement necessary to build and switch from one source of capacity to another. (Birk, Tr. 3655-56). Further, AmerenUE witness Birk indicated AmerenUE's estimated retirement dates were based on "decision points" as to when either major components would be replaced or the plant at the site retired. (Birk, Tr. 3650). In estimating retirement dates, he assumed the plant would be retired, not that major components would be replaced and the life extended. While AmerenUE's depreciation experts would not admit the use of an average retirement date for multiple sites was inconsistent with authoritative texts, they did admit the use of an average date for multiple generation plant sites was not supported by such authorities. (Stout, Tr. 3705; Wiedmayer, Tr. 3719-20).

The new retirement dates AmerenUE estimated are: 2021 for AmerenUE's Meramec plant site, 2027 for AmerenUE's Sioux plant site, 2033 for AmerenUE's Labadie plant site and 2037 for AmerenUE's Rush Island plant site. (Wiedmayer Rebuttal, p. 24). Further, AmerenUE

estimates retirement of its Callaway nuclear plant in October of 2024. (Stout Direct, p. 29). And it estimates retirement of its Osage hydro-electric plant at Bagnell Dam in 2046. (Wiedmayer Rebuttal, pp. 25-26). Based on these dates AmerenUE would need to be in a position to replace existing capacity as follows:

Year	Site	Capacity
2021	Meramec	900 MW
2024	Callaway	1,292 MW
2027	Sioux	950 MW
2033	Labadie	2,430 MW
2037	Rush Island	1,100 MW
2046	Osage	226 MW

In addition to replacing that capacity, AmerenUE needs to add generation capacity to satisfy the increased demand of its customers at the rate of about 200 MW per year. In today's environment, absent some catastrophic event or significant advance in technology, replacing 6672 MW of baseload capacity—essentially all of AmerenUE's baseload capacity—within a 16-year period is blatantly unrealistic. AmerenUE has presented no plans in this case, or in its integrated resource plan filed December 2005 in Case No. EO-2006-0240 (Exhibit 273 HC, 457 P, 458 NP), for how it would accomplish such a wholesale turnover of its generating fleet.

Mr. Wiedmayer testified he relied on AmerenUE employee Mark Birk, AmerenUE Vice-President for Power Supply Operations, for the new estimated retirement dates. (Wiedmayer, Rebuttal p. 24). AmerenUE witness Birk testified he considered anticipated increasingly stringent environmental requirements, the potential for new technologies and the finite life of thick-walled components of the existing plant, components such as boiler drums and headers to arrive at the estimated retirement dates he provided Mr. Wiedmayer. (Birk Rebuttal, p. 1). On cross-examination he stated the evaluation was performed "from an engineering and from an operational standpoint." (Birk, Tr. 3647).

In addition to relying on estimates of plant retirement dates provided by AmerenUE personnel without considering whether they were reasonable, the lack of rigor in how Mssrs. Stout and Wiedmayer approached their depreciation study for AmerenUE is also demonstrated by Mr. Stout's statement in his surrebuttal testimony and his testimony on cross-examination where he relied on publications several years old for his information on the capacities of AmerenUE's generating plants (Stout, Tr. 3705-09), information that is out of date at least for AmerenUE's Callaway plant—Mr. Stout testified it had a capacity of 1,236 MW (Stout, Tr. 3709) when Mr. Naslund had testified in direct that as a result of improvements Callaway's capacity had increased to 1,292 MW in 2005. (Naslund Direct, p. 6). Moreover, during the hearing Mr. Stout testified as follows:

> Q. Didn't you and Mr. Wiedmayer use an average retirement date of June 30th, 2026 for AmerenUE's non-nuclear steam generation units in the depreciation study for AmerenUE that was presented in direct testimony?
>
> A. Yes.
>
> Q.On page 13 of your correct[direct] testimony, you state--I'll let you get there before I start.
>
> A. Thank you.
>
> Q. Are you there?
>
> A. I am.
>
> Q. The final retirement date is estimated based on an informed judgment and incorporating the outlook of management and the consideration of both the life spans at the retired station or units and other units currently in service. Is that a correct quote?
>
> A. Yes.
> Q. In the depreciation study for AmerenUE that was presented in direct testimony, what specific information were you provided for, "the statements of others, for units currently in service" for AmerenUE's non-nuclear steam turbine generating unit[s]?
>
> A. I -- I was not provided that information by Ameren. That information is available to you based on studies that our firm has conducted for other electric utilities and

discussions with other depreciation experts with respect to the life spans that they used for similar fossil steam units.

Q. Is that as much specificity as you can supply?

A. Yes.

(Tr. 3708-09). Further, Mr. Stout's error in including AmerenUE's estimated retirement date of 2046 for its Osage hydro-electric plant at Bagnell dam when asserting the reasonableness of a 25-year period for replacing all of AmerenUE's fossil-fueled steam electric generating plant rather than the shorter period of 16 years bounded by AmerenUE's estimate of 2021 for Meramec and 2037 for Rush Island further demonstrates why the Commission should not rely on his testimony. (Stout Surrebuttal, pp. 2-3; Wiedmayer Rebuttal, pp. 25-26; Stout, Tr. 3710-12).

AmerenUE's proposed retirement dates for its fossil-fueled steam electric generating plants simply are not believable when measured by the standard of the best estimate of the actual date that they will be retired.

Likewise, the lives Missouri Industrial Energy Consumers' witness Selecky proposes for AmerenUE's generation plant units at its Rush Island site are not based on any specific study of that plant, and are based on AmerenUE's estimated lives for the units at Rush Island being significantly shorter than the lives it estimated for its generating units at its other generation plant sites. (Selecky Direct, pp. 8-9). Because the lives Mr. Selecky proposes suffer the same infirmities as the lives AmerenUE proposes, the Commission should also reject these Missouri Industrial Energy Consumer group proposed lives.

Because history and current conditions show no reason why AmerenUE's Osage hydroelectric plant at Bagnell Dam will be retired before the longest average service life the Staff determined for the components of the plant located there, the Commission should not rely on AmerenUE's license and assume the Osage generation plant will be retired at the end of that

license—now 2046. Instead, as it should for AmerenUE's fossil-fueled steam electric generating plants, the Commission should adopt the Staff's average service lives for determining depreciation rates and depreciation expense associated with AmerenUE's plant components located at its Osage plant.

C. Should the Commission assume that the Callaway Plant will be relicensed for an additional 20-year term, or should the Commission assume that the Callaway Plant will not be relicensed for purposes of calculating depreciation rates for the Callaway Plant?

For the bases discussed below, for depreciation rate and depreciation expense purposes, the Commission should assume AmerenUE will seek and obtain a 20-year extension of its Callaway nuclear plant license.

As Staff witness Warren Wood testified it is the Staff's position the Callaway Nuclear Plant will be relicensed for an additional 20 years because 20-year license renewals is an industry practice, AmerenUE has made statements indicating it plans to seek such a renewal and AmerenUE has disclosed no plans to the Staff, as it is required to by Commission rule, as to how it would replace the capacity it would lose if the Callaway Nuclear Plant were not relicensed. (Wood Direct, pp. 9-23, Wood Rebuttal, pp. 8-10 and Wood Surrebuttal, pp. 2-3).

During the hearing Commissioner Appling posed the following question to Charles Naslund, Senior Vice-President and Chief Nuclear Officer of AmerenUE, who testified in response as follows:

> Q. I don't have any question. I read your testimony and I've been listening upstairs to what -- the beginning of it. You-all are gonna extend this thing [Callaway nuclear plant license]?
>
> A. That certainly would be our plan, Commissioner.

(Tr. 4233).

Senior Vice-President and Chief Nuclear Officer Naslund testified that AmerenUE's Callaway nuclear plant has an output capacity of 1,292 MW representing about 10.3 percent of AmerenUE's total capacity and about 20 percent of AmerenUE's total baseload capacity. (Tr. 4219-20). He testified that when the plant is running it runs at 100 percent output continuously for nominally 18 months. (Tr. 4220). Mr. Naslund testified he was unaware of any discussions on the topic of replacing the output of the Callaway nuclear plant by the date 2024 AmerenUE used for that plant in its depreciation study or whether replacement of that plant's capacity was included in AmerenUE's integrated resource plan filed in December 2005 that included a 20-year planning horizon. (Tr. 4220). That plan did not include plans for replacing the capacity of AmerenUE's Callaway nuclear plant during the 20-year planning horizon of that plan. (Exhibit 273 HC, 457 P, 458 NP).

As to Mr. Naslund's stated concerns about adequacy of cooling water from the Missouri river in connection with extending AmerenUE's license for the Callaway plant's license, the following testimony demonstrates a serious flaw in AmerenUE's position:

> Q. I want to turn to your rebuttal testimony. And you indicate on page 2 of that, "Lack of adequate water supplies in the Missouri River is a consideration that might affect relicensing"?
>
> A. That's correct.
>
> Q. Do you know what percentage of the Missouri River flow at the intake point where Callaway obtains water from the river -- let me try rephrase a new question. The Callaway unit takes water from the Missouri River, does it not?
>
> A. Yes, it does.
>
> Q. Do you know what percentage of the total flow at that point where it's taking water from the river that it is removing, approximately even?
>
> A. It would be right at about 20 percent. Callaway uses 385 million standard cubic feet of water a year, and I think there's about 1.8 trillion come down the Missouri River.

(Tr. 4223-24). Mr. Naslund testified AmerenUE returns to the Missouri River only 25 percent of the water it removes. (Tr. 4232). It defies common sense that AmerenUE sends 15 percent of the flow of the Missouri river at the Callaway nuclear plant into the air as steam. Moreover, Mr. Naslund's own testimony refutes his estimate of 20 percent:

(385,000,000 / 1,800,000,000,000) x 100 percent equals 0.02 percent, not 20 percent.

Further, Mr. Naslund testified the plant has never been shut down due to insufficiency of cooling water. (Tr. 4233). The Commission should disregard Mr. Naslund's stated basis that the supply of cooling water for the Callaway nuclear plant from the Missouri River is a real concern for seeking a 20-year extension to AmerenUE's license to operate the plant.

D. Should terminal net salvage and inflation costs relating to the future retirement of the Company's generating plants be included in depreciation rates, and if so, how should such costs be calculated?

It is the Staff's position is that terminal net salvage and inflation costs relating to the future retirement of generating plants should not be included in depreciation rates because, as the Commission has in the past found, an adjustment for anticipated inflation in the future is not known and measurable and, therefore, too speculative for purposes of setting rates. Likewise, as the Commission has also found, the time when a plant will be dismantled—when terminal net salvage will occur—and the dollar amount that will then be incurred are also speculative, and not known or measurable. (Mathis Surrebuttal, pp. 3-7).

E. In the calculation of the Distribution, Transmission and General Plant depreciation rates, should the estimated Net Salvage Percents to be applied in the future determination of depreciation rates be calculated to reflect historic inflation rates based on analyses of historic net salvage percents or is an adjustment to such analyses required to reflect a different impact of cumulated historic inflation rates on historic net salvage as compared to the impact of cumulative expected inflation rates be reflected in the calculation on future net salvage.

The Staff filed no testimony addressing this issue. After the Commission's *Report and Order* in Case No. ER-2004-0570—a recent case where the Commission reviewed the electric rates of The Empire District Electric Company and provided guidance on deprecation issues—the Staff recognizes net salvage equals the gross salvage value of the asset minus the cost of removing the asset from service. Further, the net salvage percentage is determined by dividing the net salvage experienced for a period of time by the original cost of the property retired during that same period of time. *Report and Order* at 52.

Additionally, the Staff recognizes, as the Commission stated in its *Report and Order*, that the fundamental goal of depreciation accounting is to allocate the full cost of an asset, including its net salvage cost, over the economic or service life of the asset so that utility customers will be charged for the cost of the asset in proportion to the benefit they receive from its consumption. *Report and Order* at 54. Consequently, consideration of past or future inflation is not contemplated in the calculation of the net salvage percentage.

F. In the calculation of the Transmission, Distribution and General Plant depreciation rates should the net salvage percents applied in the determination of depreciation rates be based on actual net salvage expense?

Yes. The Staff filed no testimony addressing this issue. After the Commission's *Report and Order* in Case No. ER-2004-0570—a recent case where the Commission reviewed the electric rates of The Empire District Electric Company and provided guidance on deprecation issues—the Staff recognizes that net salvage equals the gross salvage value of the asset minus the actual cost of removing the asset from service and that the net salvage percentage is determined by dividing the net salvage experienced for a period of time by the original cost of the property retired during that same period of time. *Report and Order* at 52.

G. Is there a difference between the actual book accumulated depreciation and the theoretical accrued depreciation? If so, how should that difference be recovered from ratepayers?

It is the Staff's position that there is a difference between actual book accumulated depreciation and the theoretical accrued depreciation, but the Staff recommends no adjustment at this time to recover that difference from ratepayers. (Gilbert Rebuttal, pp. 4-7; Mathis Direct, pp. 9-10, Mathis Surrebuttal, p. 7)

H. What net salvage percentage should be used in the depreciation rate calculation for assets in Account 322?

The Staff's original position, which is supported by the testimony of Staff witness Mathis, was that a net salvage percentage of -37% should be used in the depreciation rate calculation for assets in Account 322. (Mathis Direct, schedule JLM-2). However, in the non-unanimous stipulation and agreement it entered into with AmerenUE regarding certain depreciation issues that they filed March 19, 2007, the Staff agreed that "[f]or Account 322 a net salvage amount equal to two-tenths of one percent, 0 .2 %, shall be added to the depreciation rate." Public Counsel and the Missouri Industrial Energy Consumers objected to that agreement; however, by Rule 4 CSR 240-2.115(2)(D), the Commission view the Staff as having changed its position on issues addressed in the agreement. Because the Staff's settled position better matches the net salvage percentages it determined for other accounts, the Staff requests the Commission adopt the position the Staff agreed to in the nonunanimous stipulation and agreement for the net salvage percentage to be used in the deprecation rate calculation for assets in Account 322.

CLASS COST OF SERVICE, RATE DESIGN AND MISCELLANEOUS TARIFF ISSUES

Parties in this case entered into a Nonunanimous Stipulation and Agreement Concerning Class Cost of Service and Certain Rate Design Issues that was filed with the Commission March 22, 2007. After modification on the record to except from the settled issues The Missouri Association for Social Welfare's proposal to create an "essential service rate" (Tr. 3975-76), no party opposed the agreement and the Commission approved it by an order issued April 5, 2007. As modified the agreement resolved all class cost of service, rate design and miscellaneous tariff issues listed in the list of issues presented to the Commission for resolution, with the exception of the five following issues:

1. AmerenUE's proposal to implement an economic development retention rider (Rider EDRR);

2. AmerenUE's proposal to implement an economic redevelopment rider (Rider ERR);

3. AmerenUE's proposal for an Industrial Demand Response Pilot program (Rider IDR);

4. AARP's "Safety Net" proposal that customers be provided credits of $25 per day for electric outages that extend beyond 48 hours; and

5. The Missouri Association for Social Welfare's proposal to implement an "essential services rate."

With the exception of the "Safety Net" issue, the Staff refers the Commission to its prehearing brief at pages 70-71 (Parts B, C and D) for its positions on the foregoing issues. In summary, the Staff supports the economic development retention rider, the economic redevelopment rider and the Industrial Demand Response Pilot program as proposed by AmerenUE, and the Staff opposes the ill-defined "essential services rate" as proposed by the Missouri Association for Social Welfare. AARP and the Consumers Council of Missouri first raised the "Safety Net" proposal as an issue to be decided by the Commission during their opening statement at the beginning of the March 2007 evidentiary hearing held at the

Commission's offices in Jefferson City in this case. (Tr. 126-27). In their opening statement they described the proposal as follows:

> And one specific item that is in that public testimony and not -- not significantly in the expert testimony is the idea of some type of ratepayer refund or credit that would give consumers some recognition of the terrible inconvenience and even safety risk that goes along with being out of service for, say, over two days. And I would point you to the Pacific Gas and Electric voluntary program, coined the Safety Net, I believe, which does gives consumers a small credit, $25 a day for each day after 48 hours of outage.
>
> And there is -- there is substantial evidence in the record in these public hearings, I believe, to support that type of tariff being approved, to just give a small monetary recognition for the inconvenience. And I think that certainly Ameren can afford it. Certainly compared with the other revenue opportunities and expenses that it faces, this is something very small to ask, and I believe the public would be very thankful and I think it would go a long way.
>
> If AmerenUE is not willing itself to give such small recognition to its customers, I mean, I know all I've gotten so far is this colored flier in the mail. If AmerenUE is not willing to voluntarily put something in place as much as PG&E has done, I urge the Commission to order them to do some type of small service.
>
> It would also, I believe, serve as some financial incentive for the planning processes that AmerenUE to more align itself to the type of distribution reliability that we would expect. And I don't think that expecting the majority of individuals to be reconnected after 48 hours is asking too much. Or if so, to at least compensate by $25 a day those consumers who have been out that long.
>
> So with that particular item which is not, I believe, before you in the prepared testimony today, I would conclude and ask that you issue a decision in this case that is just and reasonable for captive residential customers. Thank you.

(Tr. 126-28).

During the hearing AARP and the Consumers Council of Missouri pointedly clarified that they were proposing the costs of compensating customers without service over 48 hours by $25 were to be borne only by AmerenUE's shareholders, and not by AmerenUE's customers. (Tr. 3385).

AmerenUE has taken the position that, if the Commission were to require compensation of $25 to customers who were without service over 48 hours, the compensation should be borne

by AmerenUE's customers, not its shareholders, and that it would be unlawful for the Commission to require AmerenUE's shareholders to bear the costs of such compensation. (Tr. 3381 and 3385).

As to this proposal of AARP and the Consumers Council of Missouri, it is the Staff's position that such a proposal would be more appropriately taken up conceptually by AARP and the Consumers Council of Missouri in a rulemaking case. (Tr. 3865). Further, the Staff is not aware of any statutory provision by which the Legislature has given the Commission the power to "compensate by $25 a day those consumers who have been out [of power for over 48 hours]." Absent express statutory authority, the Commission has no power to enforce any principle of law or equity and, has not been empowered to determine damages or award pecuniary relief. *Katz Drug Company v. Kansas City Power & Light Company*, 303 S.W.2d 672, 679 (Mo. App. 1957); *American Petroleum Exchange v. Public Service Commission*, 172 S.W.2d 952, 955 (Mo. 1943).

COST OF CAPITAL ISSUES

What return on equity should be used in determining revenue requirement?

If utilities were mobile and could easily move their operations from one state to another,

Electric Utility ROE Awards 2006		
Number of Awards	ROE	State
1	11.90	IA
1	**11.25**	**MO (KCPL)**
1	11.00	WI
1	**10.90**	**MO (Empire)**
2	10.75	VT, MI
1	10.60	NV
1	10.54	MN
2	10.50	CO, WV
1	10.39	MN
2	10.25	VT, UT
2	10.20	ME, WA
1	10.12	IL
2	10.08	IL, IL
1	10.05	IL
2	10.00	OR, DE
1	9.75	CT
1	9.67	NH
1	9.60	NY
1	9.55	NY
25	10.36	Source: Ex. 519

they would all move to Missouri. Why? Because Missouri consistently makes return on equity (ROE) awards that are among the very highest in the land.[26] Kansas City Power & Light Company (KCPL), a generally well-managed utility that nonetheless managed to accidentally destroy a generating station a few years ago, received a pat on the back last December in the

[26] Ex. 519, being the *Regulatory Focus* published by Regulatory Research Associates on January 30, 2007. This exhibit reports 25 electric utility ROE awards for 2006, of which the highest – at 11.9% -- was an incentive ROE awarded to a proposed wind generation project. *See* Tr. 2898-99 *and esp.* 3022-23. .

form of the highest ROE award in the nation to an integrated electric utility for 2006: 11.25%.[27] The Empire District Electric Company, a notably less well-managed utility, also received a high ROE award last December: 10.90%.[28] Maybe the Commission was just in the Christmas spirit! In the present case, AmerenUE seeks an ROE of 12.2% which, if awarded, would be the highest ROE of any integrated electric utility in America.[29] In making this decision, the Commission should be mindful that each basis point of ROE awarded represents $540,000 of ratepayer money.[30]

The Commission's duty:

The Commission's duty with respect to ROE is to award a "fair and reasonable" return to investors on the value of the utility property committed to the public service.[31] Too little is an unconstitutional taking;[32] too much is an unconscionable windfall. The right amount – the "just and reasonable" amount -- is a return "equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties[.]"[33] The right amount is one that is fair to both the utility's investors and the utility's customers.[34] AmerenUE itself admits as much.[35]

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[27] Ex. 519, p. 7; Tr. 2874.

[28] Ex. 519, p. 7; Tr. 2874.

[29] Tr. 2880 (Vander Weide).

[30] *See* Hill Direct, Sch. 12-2. UE's rate base is approximately $5,400 million dollars, which, when multiplied by one basis point – one hundredth of a percentage point, 0.01 – yields $540,000 dollars.

[31] *St. ex rel. Missouri Public Service Co. v. Fraas,* 627 S.W.2d 882, 886 (Mo. App., W.D. 1981).

[32] *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia,* 262 U.S. 679, 690, 43 S.Ct. 675, 678, 67 L.Ed. 1176, 1181 (1923).

[33] *Id.,* 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

[34] *St. ex rel. Valley Sewage Co. v. Pub. Serv. Comm'n.,*515 S.W.2d 845 (Mo. App., K.C.D. 1974).

What is Return on Equity?

Utility rates are designed to produce a certain amount of revenue on an annual basis, the "revenue requirement."[36] This revenue requirement has three components: First, an amount equal to the utility's prudently-incurred operating and maintenance expenses on a going-forward basis. Second, an amount sufficient to pay the utility's annual tax obligations. Third, an amount sufficient to service the capital used by the utility. Part of that capital is debt and debt, as most folks are only too well-aware, is serviced by making regular payments to creditors. The other part of that capital is equity. Equity is serviced by paying dividends to the equity investors. It is this very last part of the revenue requirement that is the ROE. Another word for ROE is "profit." After all, all of the rest of the utility's annual revenue will be spent on operating expenses, taxes and debt payments. Only the fraction that is left after these obligations are met will flow to the utility's owners as a return on their investment.

Calculating the Cost of Capital:

All businesses use a mixture of debt capital and equity capital; the particular percentage of each type for any given business is referred to as its "capital structure."[37] UE's capital structure includes 48% debt and 52% equity.[38] The cost of debt capital can be readily determined from the instruments in question. These costs are thus historical or "embedded." The cost of equity capital or ROE, on the other hand, cannot be so easily determined. Instead, it is a matter of expert opinion.

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[35] Tr. 2950 (Company witness Nickloy: "I think it's important that the decision in this rate case is one that's fair and balanced.")

[36] *In the Matter of The Empire District Electric Company,* 13 MoPSC3d 350, 368-69 (*Report & Order,* March 10, 2005).

[37] For this discussion, *see Empire, supra,* 13 MoPSC3d at 369-70.

[38] Tr. 3021 (Hill).

ROE Recommendations[39]	
Analyst	**ROE**
Vander Weide (UE)	12.20
McShane (UE)	12.00
Gorman (MIEC)	9.80
King (OPC)	9.65
Hill (Staff)	9.25
Woolridge (AGO)	9.00

The Commission has the onerous task of sifting through the conflicting opinions of the various expert witnesses who have testified in this case.[40] The chart above sets out the several ROE recommendations offered in this case by six different experts. The several recommendations extend from a low of 9.00% to a high of 12.20%; a range worth some $130 million.[41] Each of these experts, it should be noted, is eminently qualified in this field.[42] Predictably, the Company's experts offer high ROE recommendations – 12.00% and 12.20%. The other experts offer much lower ROE recommendations, ranging from 9.00% to 9.85%.

It is noteworthy that these experts have reached such widely differing conclusions, although their training, data and methods are much the same. The fact is that the analytical methods used by the experts only appear to be mathematical and objective.[43] They are actually quite subjective and thus offer ample scope for manipulation in any desired direction.[44] Dr. Vander Weide admitted on cross-examination that he and the other analysts exercised

[39] Source: Ex. 270.

[40] *In the Matter of The Empire District Electric Company,* 13 MoPSC3d 350, 370 and 372 (*Report & Order,* March 10, 2005).

[41] Tr. 3016 (Hill).

[42] Admission by Mr. Cynkar, Tr. 2806; opinion of Dr. Vander Weide, Tr. 2869.

[43] *See discussion at* Tr. 3029-32 (Hill).

[44] *Id.*

"professional judgment" at several points in their analyses: the size of the proxy group; the composition of the proxy group; the choice of analytical methods utilized.[45] However, as the Commission has pointed out, "it is not the method employed, but the result reached, that is important."[46]

The Zone of Reasonableness ("ZOR"):

The Commission has devised an objective, analytical tool to assist it in parsing the recommendations of the experts and reaching a fair and reasonable result.[47] That tool is the "Zone of Reasonableness" (ZOR). The ZOR is defined as extending one hundred basis points – one percentage point – above and one hundred basis points below the recent national average of ROE awards in the appropriate regulated industry.[48] The national average ROE award for electric utilities last year was 10.36%,[49] so the ZOR extends from 9.36% to 11.36%.

The ROE recommendations offered by AmerenUE's two expert witnesses, Vander Weide and McShane, are both significantly above the top of the ZOR.[50] According to the Commission's own application of its analytical tool, these excessive recommendations must now simply be discarded. In its recent decision regarding Kansas City Power & Light Company, the Commission stated: "Because the return on equity recommended by DOE falls outside of the

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[45] Tr. 2869, 2871-72.

[46] *See Empire, supra,* 13 MoPSC3d at 372 n. 52, and collected cases there cited.

[47] Tr. 2866 (Dr. Vander Weide): "It's very reasonable to use a zone of reasonableness[.]" Staff witness Hill, on the other hand, expressed reservations concerning the use of a national average to set ROEs because the numbers considered in reaching the average do not reflect comparable risks. Tr. 3022-23.

[48] *See Empire, supra,* 13 MoPSC3d at 375; *In the Matter of Missouri Gas Energy,* 12 MoPSC3d 581, 593 (*Report & Order,* September 21, 2004); *In the Matter of The Empire District Electric Co.,* Case No. ER-2006-0315 (*Report & Order,* issued December 21, 2005); *In the Matter of Kansas City Power & Light Co.,* Case No. ER-2006-0314 (*Report & Order,* issued December 21, 2006); Tr. 2848, 2866-67, 2932.

[49] Ex. 519, p. 7.

[50] Ex. 270.

'zone of reasonableness', the Commission will discard it and find that it merits no further discussion."[51] Vander Weide's recommendation results in an ROR that is 154 basis points higher than Staff's; McShane's is 144 basis points higher. Those differences are worth $83 million dollars in Vander Weide's case and $77 million dollars in McShane's case.

Since the ZOR has become the Commission's principal analytical tool in setting ROE, it is worth considering how it might best be applied. Staff's expert witness, Stephen G. Hill, suggested that the results for Wisconsin and Missouri should not be considered in calculating the average that is the mid-point of the ZOR.[52] Hill suggests that the mid-point be set at 10.2 and that the ZOR extend from 9.2 to 11.2.[53]

"Adders" and "Subtracters":

Company witness Vander Weide proposes an upward adjustment to UE's ROE to reflect unusual financial risk: [54]

> AmerenUE's filed capital structure in this proceeding embodies greater financial risk than the financial risk embodied in the cost of equity estimates for my comparable companies. Thus, the cost of equity for my comparable companies will have to be adjusted upward so that investors in AmerenUE will have an opportunity to earn a return on their investment in AmerenUE that is commensurate with returns they could earn on other investments of comparable risk.

McShane proposes a similar adjustment.[55] The cost to ratepayers of this improper method would be $50 million every year.[56]

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[51] *In the Matter of Kansas City Power & Light Co.*, Case No. ER-2006-0314 (*Report & Order*, issued December 21, 2006), pp. 21-22. Certainly, a reviewing court might well be suspicious were the Commission to use this rule to exclude evidence from consideration in December, only to abandon the rule six months later.

[52] Tr. 3007-08.

[53] *Id.*

[54] Vander Weide Direct, 6.

[55] Tr. 3033.

This game of finding reasons to add an upward adjustment to the results of the comparative company analysis is one that the Commission has seen repeatedly. In the recent KCPL rate case, upward adjustments were urged to reflect (1) unusual construction risk (50 basis points), (2) off-system sales risk (526.35 basis points), and (3) general management excellence (50 to 100 basis points).[57] Likewise, in the recent Empire District Electric Company rate case, Dr. Vander Weide – then testifying for Empire – proposed an "adder" of 40 basis points to account "for the difference in the perceived financial risk of [the] proxy companies in the marketplace and the financial risk implied by [his] recommended capital structure for Empire."[58] Now, Dr. Vander Weide proposes an "adder" for AmerenUE based on the same consideration.

The concept of risk is particularly subject to manipulation by analysts. First, all of the classic financial analysis methodologies take the risk of the investment into account; thus, no "adder" or "subtracter" is necessary.[59] Second, the use of the upward adjustment method of Vander Weide and McShane is a violation of the comparative company ROE analysis required by the United States Supreme Court in *Hope* and *Bluefield.*[60] It is important to remember that those cases were written to explain why utility investors could not expect bloated and exorbitant returns. The use of an "adder" to evade the results of the required comparative analysis is contrary to both the letter and the spirit of the controlling cases and may expose the

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[56] Tr. 3036 (Hill).

[57] *In the Matter of Kansas City Power & Light Co.,* Case No. ER-2006-0314 (*Staff's Post-hearing Reply Brief and True-up Brief,* Docket Item No. 520, filed November 27, 2006), pp. 44-46.

[58] *In the Matter of The Empire District Electric Co.,* Case No. ER-2006-0315 (*Pre-hearing Brief of Staff of Public Service Commission,* Docket Item No. 191, filed September 6, 2006), p. 37 (*quoting* Vander Weide's Direct Testimony filed in that case, pp. 4 and 6).

[59] Tr. 3036 (Hill: "Basically, that kind of information is already included in stock prices.")

[60] *And see* Tr. 3035 (Hill).

Commission's decision to a heightened risk of reversal on appeal. Third, the methodology used by Company witnesses Vander Weide and McShane is unusual and contrary to basic principles of financial analysis: [61]

> There's a 100 basis points that I think is unreasonably added to the company's recommendation that has to do with the use of market value capital structures which I think runs counter to 50 years of regulatory history and flies in the face of the whole gas decision. I think it's just simply wrong.[62]

Finally, not all of the expert witnesses who testified in this case agreed with Dr. Vander Weide's contention that UE faces greater risks than other electric utilities.[63] In fact, Dr. Vander Weide himself abandoned the notion at hearing, admitting that UE faces only average risk for the electric utility industry.[64] It is only logical that average risk merits no more than an average ROE.

CONCLUSION

The eyes of Missouri are on the Commission as it makes this difficult decision.[65] AmerenUE does not deserve a pat on the back from the Commission. Its recent performance includes the Taum Sauk disaster – which resulted from the Company's negligence; the repeated, protracted outages in St. Louis; and a recent credit downgrade.[66] The Company admits that many of its customers are "angry and frustrated" and that reliability is a concern.[67] It faces only

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[61] Tr. 3017, 3033-35 (Hill).

[62] *Id.*

[63] Tr. 2945 (LaConte: "Well, I think that the risks that Ameren faces are lower than other utilities. . . . they should not receive a return on equity that is above average.") Tr. 3021 (Hill: "Ameren's risk factor both in terms of business risk and financial risk is below average.")

[64] Tr. 2879-80.

[65] Tr. 2995-96 (Nickloy).

[66] Tr. 2884.

[67] Admissions of Mr. Cynkar, Tr. 2811-12.

average risks.

For these reasons, Staff urges the Commission to adopt an ROE within the range determined by the recommendations of the non-Company expert witnesses, 9.00% to 9.80%. Ideally, the Commission should adopt the recommendation of Staff's expert witness, Stephen Hill. Hill's recommended ROE, 9.25%, is within the ZOR if it is adjusted as Hill proposed.[68] Additionally, Hill's recommendation is not only sufficient to provide a fair return on the value of AmerenUE's assets devoted to the public service, it will actually permit AmerenUE to improve its credit rating.[69] Finally, the Commission's decision would be eminently defensible on appeal because it would be a somewhat below-average ROE for a utility that faces below-average risk.

[68] Tr. 3007-08.

[69] The resulting pre-tax interest coverage ratio is 4.36x. S&P indicates that for a utility with a business position of 5 like AmerenUE, pre-tax interest coverage ratios between 3.5x and 4.3x are sufficient to support an A rating, higher than AmerenUE's present rating of BBB. Hill, Direct: 56-57.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record this 20th day of April 2007.

/s/ Kevin A. Thompson