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UNION ELECTRIC

January 27, 1995

Donald E. Brandt
Senior Vice President
Finance and
Corporate Services

Mr. Ken Rademan
Director-Utility Services Division
Missouri Public Service Commission
Truman State Office Building
Jefferson City, MO 65102

Dear Ken:

Enclosed are five copies of our proposed "UE/CUSTOMER SHARE IN SAVINGS PLAN." In addition to the "mechanical" aspects of the Plan, the document includes an explanation of the rationale behind our proposal.

Of necessity, the document includes detailed information relative to earnings and dividend forecasts. I am certain that you appreciate the extreme sensitivity of this information and will afford it strict confidential treatment.

Bill Jaudes and I appreciate the time and attention that you and your fellow staff members have devoted to this matter. We look forward to discussing our proposal with you at your convenience. If you have any questions, please do not hesitate to call Bill or me.

Sincerely,

Enclosures

This was previously filed as 'Confidential', but during the hearing it was determined not to be so it can go in exhibit file as is

Lowell

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Exhibit No. 21
Date 6-1-99 Case No. EO-96-14
Reporter TLT

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FOR DISCUSSION PURPOSES ONLY

UE/CUSTOMER SHARE IN SAVINGS PLAN

FOR

UNION ELECTRIC COMPANY

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UE/CUSTOMER SHARE IN SAVINGS PLAN

INTRODUCTION

The UE rate moratorium was in effect until September, 1994. After the moratorium, the Staff of the Missouri Public Service Commission (MoPSC) began a review of UE's financial performance, using the 12 months ending June 30, 1994. The Staff review indicated UE's Missouri electric revenues could be from $80 to $100 million more than would be indicated by a return on equity of 11.7% or 11.0%.

UE agrees that 1994 was a good year, but one that is unlikely to be repeated in the foreseeable future. Favorable weather, historically low interest rates, a decline in fuel costs, the absence of a nuclear refueling outage, near flawless performance at Callaway and our continued emphasis on cost control all contributed to the 1994 outcome. However, the budget for the period 1995 through 1999 indicates that our earnings will be quickly deteriorating to levels significantly below 1994. Our budget for the years 1995 through 1999 is summarized on Attachment A.

Further, we believe that our budget reflects substantially greater "downside" risk than it does "upside" potential. As a result of our switch from Illinois coal to western coal, fuel costs essentially "bottomed out" in 1994. Interest rates, particularly short-term rates that impact our nearly $600 million of floating rate debt, have been rising. None of the 50 analysts surveyed by the "Blue Chip Financial Forecasts" is forecasting lower interest rates. Whereas the embedded cost of long-term debt was calculated by Staff at 6.97% as of June 30, 1994, by year-end 1994 the cost had already increased to 7.18%. Corporate downsizing has already resulted in the elimination of approximately 1,300 full time jobs. UE accomplished this downsizing without massive layoffs which would have hurt the economy of the entire service area. However, with each job that has been eliminated, opportunities for further reduction become more difficult. Callaway is budgeted to operate near 100% between refuelings. The refuelings themselves, long the standard for the industry, are budgeted to reflect continuing performance improvement.

Even at our current dividend level (with no further dividend increases) and at current rates, our dividend payout would be near 100% in 1995 and, on average, exceed 100% over the budget period 1995 through 1999. Any substantial rate reduction based upon 1994 figures, would necessitate a sizable dividend cut, and would likely be followed by a rate increase filing in the near future to reflect the changed circumstances in subsequent years. Both events would be perceived as severe negatives by the investment community.

While we believe that there is substantial "downside" risk in our budgets, we are committed to controlling costs and to continuous performance improvement. "Beating the Budget" would be an indication of our success as managers. If we are successful in controlling costs and improving performance, we believe it is appropriate for both our shareholders and our customers to share in the savings.

SHARE THE SAVINGS PROPOSAL

We have developed a proposal (loosely based in concept on the Southwestern Bell plan) that would provide for the sharing of earnings in excess of a 12.95% return on equity.

	Sharing Percentage	
Earnings Level	UE	Customer
11.70% to 12.95% ROE	100%	0%
Over 12.95% to 13.70% ROE	75%	25%
Over 13.70% to 14.45% ROE	50%	50%
Over 14.45% to 15.20% ROE	25%	75%
Over 15.20% ROE	0%	100%

As a part of the plan, UE would agree to not seek any increase in rates unless the earnings level falls below 10.70% or if an unusual event occurs which would have a significant adverse impact on electric operations, such as those events set forth in paragraph 4 of the Joint Stipulation and Agreement in Case No. ER-93-52.

The plan would be in effect for three years (through 1997), subject to renewal if the parties agree and the Commission approves.

The return on equity (ROE) would be calculated using the reconciliation methodology described in Attachment B. The calculations would be performed by us and submitted to the staff for review in order that the sharing could be implemented in June of the following year. Any benefit flowing to the ratepayers would be handled by a credit to customers based on kwh sales, over a four-month period beginning in June of the year after the period in review.

RATIONALE FOR 12.95% AS BEGINNING OF FIRST BAND OF SHARING

The proposed return on equity at which customers begin to share in UE's cost savings - over 12.95% - was derived by adding 1.25% to the top of Staff's return on equity range of 11.70%. The 1.25% increment is appropriate since the budgeted ROE for 1995 is 11.24%, or 46 basis points below the high end of Staff's range. If the current dividend per share of $2.44 is merely maintained and not increased during 1995, a 12.95% return on common equity would result in a dividend payout ratio of 87%, using the Company's June 1994 book value per share of $21.68 as a simplified proxy for regulated rate base per share. The projected dividend payout ratio of 87% is significantly above the industry average of 75%, indicating a smaller than average cushion of earnings above the current dividend at the point where we propose that the sharing begin. If the industry average dividend payout ratio of 75% were maintained at the 12.95% level of return on equity, the current dividend would have to be decreased by 14%, from $2.44 to $2.105.

UE's current stock price valuation (approximately 155% of book value) makes UE an unattractive acquisition target. We believe that maintenance of UE's corporate independence is an appropriate regulatory consideration and is in the ultimate best interests of our Missouri customers. If the sharing plan begins at a rate of return that is so low that it requires UE to cut the current level of its dividend, then the price of a share of UE's common stock would certainly fall, possibly to a level where UE would become an attractive takeover candidate for an entity with no interest in the energy needs, economic development, quality of life, and employment in the State of Missouri. (Florida Power & Light's strategy of cutting the dividend to become a "growth" stock is not an alternative for UE -- FP&L's service area is growing at many times the rate of the St. Louis and eastern and mid-Missouri area.)

There has been a concerted push for economic development in the State of Missouri due to the efforts of the Missouri Department of Economic Development and the St. Louis Economic Development Council, among others. UE has worked in close partnership with these organizations in pursuing economic development in Missouri. In just the last year, UE contributed significantly to economic development projects in Jefferson City, Cape Girardeau, Rolla, Farmington and St. Louis. We believe UE must remain a financially viable partner to continue working with these two organizations. A substantial rate reduction would essentially eliminate our financial ability to continue our meaningful support of economic development in Missouri.

While lower electric rates benefit regional economic development, our rates are already below the national and regional averages and have declined on both a real and actual basis over the past five years. Under this sharing proposal, prospects remain excellent for real rates to continue to fall indefinitely into the future. If earnings remain sufficient so UE can target its allocation of financial and human resources in coordination with state and regional officials, UE has the potential for a much larger impact on the economic development of Missouri than to further reduce electric rates below that resulting from this sharing proposal.

UE's dividend must be maintained at least at its current level in order to provide a degree of basic fairness to its stockholders. If UE's common stock dividend is reduced because the initial band of sharing is set at a level which is too low, then the situation has the effect of replacing common stock with variable rate, subordinated, perpetual life, noncumulative, nonrecourse debt. There are no investors who would knowingly invest in this type of security.

Even though UE's dividend-to-accounting book value ratio is relatively high in the industry, this has resulted, not from our dividend being too high, but rather from our book value being a subpar indicator (relative to other electric utilities) of the value of our property. As long as new investments are being added to a firm during periods of inflation, its book value will at least partially reflect the increased value in assets which occurs due to inflation. If relatively few new investments are made, increased economic value will not be reflected in book value. Since UE has not added major generating units to our system since 1984, our book value per share of $21.68 at the end of June 1994 actually represented approximately $35 per share in current year's dollars. Of all electric utilities which have not had write-offs exceeding 10% of their book value, only four have accounting book values that are more divergent than UE's when viewed in terms of the age of their property and their valuation in current year dollars. When adjusted for inflation, UE's dividend to book ratio is no longer relatively high for the industry, but is instead within 0.4 percentage points of the mean for the industry. Likewise, on a similar inflation adjusted basis, UE's market-to-book ratio is within 4 percentage points of the mean.

RATIONALE FOR THE UPPER BANDS

The upper bands were determined using a band width of 0.75% for each 25% addition to the sharing with customers. This determination was more subjective than that of the starting point, but is believed by the Company to be an equitable sharing proposal among the Company stockholders and its customers.

MONITORING PROGRAM

Monitoring the performance of UE during the plan period will be accomplished by UE continuing to provide the information it is currently providing to the MoPSC Staff. This consists of the Monthly Surveillance Reports and the Quarterly Report of Rate of Return on Rate Base.

ONE TIME REFUND TO CUSTOMERS

UE proposes to include in this sharing plan a one time refund of $20 million. This refund would be given as a credit to all customers based on kwh sales, over a four-month period beginning with the billing cycle following the entry of a final non-appealable order of the MoPSC approving this plan.

NUCLEAR DECOMMISSIONING COSTS

Nuclear decommissioning costs will be reviewed as currently provided by law and Commission regulations. With the filing of a new nuclear decommissioning cost study on September 1, 1996, rates would be increased if necessary to reflect increased annual decommissioning costs, effective January 1, 1997, if the return on equity for 1996 resulting from the reconciliation procedure in Attachment B is less than 10.7%. Otherwise, these costs (whether increased or decreased) would be included in the calculation of the returns in determining the sharing percentages. In its nuclear decommissioning case order, the MoPSC will use language similar to that used in the past concerning the inclusion of nuclear decommissioning costs in the Company's cost of service.

ALTERNATIVE TO THE ONE TIME REFUND

As an alternative to the one time refund described above, UE proposes a rate reduction of $10 million, the full amount of which would be applied to the Primary Service Rate. The tariffs to implement this refund would be filed to become effective with the first billing cycle following the entry of a final non-appealable order of the MoPSC approving the plan. If this alternative is chosen, we would increase each percentage in the table on page 3 by 0.25%.

The rate reduction should be given to the Primary Service Rate customers for several reasons. Of all of UE's rates, the rates to industrial customers, as compared to residential rates, are most out of line with both the USA average and the Missouri average. The UE industrial rate is 68% of the UE residential rate, whereas the average Missouri industrial rate (excluding UE) is 59% of the average Missouri residential rate (excluding UE). The national average for an industrial rate is 58% of the national average residential rate. In actual rate values, UE's industrial rate of 5.10¢/kwh compares unfavorably to the non-UE Missouri average industrial rate of 4.36¢/kwh. Additionally, the large customers are the ones who are most likely to make either location or production decisions on the basis of electric rates. This exposes UE to a greater competitive impact from the current level of its Primary Service Rate. It also has the greatest negative impact on economic development by either new customers or expansion by existing customers.

For these reasons, any rate reduction should benefit the Primary Service Rate customers. Of course, all other customers will also benefit as the economy of the UE service area improves as a result of the rates being more attractive to large employers in the area.

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Attachment A

UNION ELECTRIC COMPANY

Data Per 1995-1999 Budget
($000)

	1995	1996	1997	1998	1999	5-Year Trended Growth Rate
Revenues	$2,097,061	$2,134,299	$2,178,061	$2,218,973	$2,255,753	1.9%
Fuel	359,260	375,258	364,610	396,458	419,120	3.7%
Purchased gas	68,040	73,908	78,660	83,796	85,368	6.0%
Labor	273,757	280,792	285,412	300,407	312,176	3.4%
Other O&M	369,108	362,996	355,288	384,352	399,726	2.2%
Depreciation	235,829	244,106	253,081	259,977	266,277	3.1%
Other taxes	217,884	221,650	225,800	229,764	232,169	1.6%
Income taxes	175,507	177,005	192,319	172,777	165,945	-1.4%
Total Operating Expenses	1,699,385	1,735,715	1,755,170	1,827,531	1,880,781	2.6%
Operating Income	397,676	398,584	422,891	391,442	374,972	-1.3%
scellaneous, net	5,673	5,077	4,000	4,490	5,582	-1.5%
erest	140,385	138,595	141,654	141,553	142,081	0.5%
Preferred dividends	13,248	13,248	13,248	13,248	13,248	0.0%
Earnings on Common Stock	$249,716	$251,818	$271,989	$241,131	$225,225	-2.5%
Earnings Per Share	$2.45	$2.47	$2.66	$2.36	$2.21	
Return on Common Equity	11.24%	11.30%	12.18%	10.82%	10.22%	
Dividends Per Share	$2.43	$2.47	$2.51	$2.55	$2.59	
Dividend Payout Ratio	99.38%	100.17%	94.24%	108.00%	117.44%	
Earnings Less Dividends	$1,555	($428)	$15,658	($19,285)	($39,276)	
Callaway Refueling	Yes	Yes	No	Yes	Yes	

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Attachment B

Reconciliation Procedure

1. The period used in determining sharing, will be a calendar year. An earnings report will be submitted to the Commission and to all parties to this agreement by one hundred and five (105) days after the end of each plan year. The earnings report will be similar to the attached Schedule 1.

2. The earnings report will reflect the following:

   a. The Company's Missouri electric net operating income and equity return will be based upon calendar year operating revenues, expenses, and end-of-year rate base.

      The Missouri electric allocation factors shown in Schedule 1 will be calculated consistent with past UE rate proceedings and will be updated for each year of the share the savings plan.

   b. The annual depreciation expense will be based upon the depreciation rates in effect at December 31, 1994.

   c. Company will omit items from the cost of service which have been traditionally excluded in UE rate proceedings, (e.g., lobbying expense, charitable contributions, goodwill advertising, etc.).

   d. Net operating income will be normalized for the effect of any prior year "sharing" credits.

   e. Net operating income will reflect changes in the recovery of nuclear decommissioning costs ordered by the MoPSC.

   f. The earnings report will utilize:

      - Staff's ratebase offsets for income tax and interest expense, as calculated in past UE rate proceedings.

      - Staff's traditional calculation of the interest deduction for income taxes.

      - A cash working capital ratebase offset of $20 million for each year of the plan.

- An annual expense adjustment to normalize the cost of refueling the Callaway nuclear plant.

- An updated capitalization structure and embedded costs for determining the end-of-year weighted cost of debt and preferred stock.

g. The earnings level upon which sharing is based are those described in item 2a through 2f above. UE/Staff/OPC reserve the right to petition the Commission for resolution of disputed issues relating to the operation or implementation of this share the savings plan.

3. None of the parties to this agreement shall be deemed to have approved or acquiesced in any ratemaking principle, valuation methodology, cost-of-service methodology, or cost allocation underlying any of the provisions contained in this agreement. This agreement does not prejudice, bind, or affect any party thereto, except as necessary to effect the terms of this agreement.

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UNION ELECTRIC COMPANY
12 MONTHS ENDED XX / XX / XX

	TOTAL ELECTRIC	MISSOURI ELECTRIC ULTIMATE CONSUMERS
Plant in Service	$	$
Reserve for Depreciation		
Net Plant		
Add:		
Fuel and Materials & Supplies		
Cash Working Capital		
Prepayments		
Less:		
Income Tax Offset (Staff Method)		
Interest Expense Offset (Staff Method)		
Customer Advances		
Accumulated Deferred Income Taxes:		
Account 190		
Account 282		
(A) Total Rate Base	$	$
(B) Net Operating Income	$	$
(C) Return on Rate Base ((B) / (A))	%	%
(D) Return Portion Related to Debt & Preferred	%	%
(E) Return Portion Related to Common Equity ((C) – (D))	%	%
(F) Equity Percentage of Capital Structure	%	%
(G) Achieved Cost of Common Equity ((E) / (F))	%	%

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UNION ELECTRIC COMPANY
12 MONTHS ENDED XX / XX / XX

	TOTAL ELECTRIC	MISSOURI ELECTRIC ULTIMATE CONSUMERS
Operating Revenues	$	$
Operating & Maintenance Expenses:		
Production:		
Fixed Allocation		
Variable Allocation		
Directly Assigned		
Total Production Expenses		
Transmission Expenses (Fixed)		
Distribution Expenses (Distr. Plant)		
Customer Accounting Expenses (Direct)		
Customer Serv. & Info. Expenses (Direct)		
Sales Expenses (Direct)		
Administrative & General Expenses:		
Directly Assigned		
Labor Allocation		
Total Administrative & General Expenses		
Total Operating & Maintenance Expenses		
Depreciation & Amortization Expense:		
Fixed Allocation		
Labor Allocation		
Directly Assigned		
Total Depreciation & Amortization Expense		
Taxes Other than Income Taxes:		
Fixed Allocation		
Variable Allocation		
Labor Allocation		
Directly Assigned		
Total Taxes Other than Income Taxes		
Income Taxes:		
Federal Income Taxes		
Environmental Tax (Net Plant)		
Missouri State Income Tax		
Other States' Income Taxes		
Total Income Taxes		
Net Operating Income	$	$

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UNION ELECTRIC COMPANY
12 MONTHS ENDED XX / XX / XX

ALLOCATION FACTORS

	TOTAL ELECTRIC	MISSOURI ELECTRIC ULTIMATE CONSUMERS
Fixed	100.00%	%
Variable	100.00%	%
Nuclear	100.00%	%
Distribution	100.00%	%
Mo. Distribution Plant	100.00%	%
Labor	100.00%	%
Net Plant	100.00%	%
Operating Revenues	100.00%	%
Operating Expenses	100.00%	%