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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2007-0002

SURREBUTTAL TESTIMONY

OF

MARTIN J. LYONS, JR.

ON

BEHALF OF

UNION ELECTRIC COMPANY
d/b/a AmerenUE

St. Louis, Missouri
February, 2007

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OF

MARTIN J. LYONS, JR.

CASE NO. ER-2007-0002

I. INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

A. My name is Martin J. Lyons, Jr. My business address is One Ameren Plaza, 1901 Chouteau Avenue, St. Louis, Missouri 63103.

Q. Are you the same Martin J. Lyons, Jr., who submitted Direct Testimony in this case on September 29, 2006, and Rebuttal Testimony on February 5, 2007?

A. Yes. My position and qualifications were described in my Direct Testimony.

Q. What is the purpose of your Surrebuttal Testimony?

A. My Surrebuttal Testimony reviews and responds to issues raised in the February 5, 2007, Rebuttal Testimonies of witnesses Warren Wood (for the Staff), Ryan Kind and Russell Trippensee (for the Office of the Public Counsel (OPC)), and Donald Johnstone (for Noranda Aluminum, Inc. (Noranda)) in regard to AmerenUE's proposed fuel adjustment clause (FAC) and the proposed treatment of off-system sales (OSS) as that treatment relates to the FAC. One of these witnesses (Mr. Johnstone) does not oppose AmerenUE's FAC request in principle, but suggests certain modifications to the Company's proposal, whereas these other witnesses (Wood, Kind, and Trippensee) contend that the proposed FAC should be rejected outright.[1] I previously addressed in my February 5, 2007 Rebuttal Testimony various FAC-related points raised in

[1] Messrs. Trippensee and Kind, in their February 5, 2007 Rebuttal Testimonies, do not directly oppose the FAC. However, Mr. Kind references his December 29, 2006 Direct Testimony, in which he expresses OPC's opposition to the FAC under all circumstances, and Mr. Trippensee makes clear that he too is reflecting OPC's position in this regard, but is providing his February 5 testimony to suggest modifications to the FAC proposal in the event the Commission approves an FAC for AmerenUE.

testimonies filed by other parties' witnesses on December 29, 2006. Some of the points made in these testimonies were also addressed in the February 5, 2007 Rebuttal Testimonies of AmerenUE witnesses Professor John Mayo, Shawn E. Schukar and Robert K. Neff.

Q. Please summarize your conclusions.

A. In response to the claims of the above-referenced witnesses from the Staff, OPC, and Noranda, my primary conclusions are as follows:

- Mr. Wood relies on a flawed analysis presented by Staff witness Michael Proctor in his January 31, 2007 Rebuttal Testimony to erroneously conclude that AmerenUE should not be allowed to implement an FAC on the grounds that profit margins from off-system sales (OSS margins) will provide a hedge against uncertainties in AmerenUE's fuel and purchased power costs. The flaws in Dr. Proctor's conclusions are explained in the Surrebuttal Testimony of AmerenUE witness Shawn E. Schukar. Consequently, Mr. Wood's rationale for opposing AmerenUE's FAC request is similarly flawed.

- Mr. Wood is also in error in arguing that an FAC is not needed or appropriate for a utility like AmerenUE which produces a majority of its energy from coal and nuclear generation. In many cases, utilities in the other 27 non-restructured states in which FACs are routinely used rely on these same generation resources to an even greater extent. Mr. Wood's position would defeat use of the tool given to the Commission by Senate Bill 179 (SB 179) and would keep Missouri squarely outside of the mainstream of U.S. utility regulatory policy.

- As outlined in the Surrebuttal Testimony of AmerenUE witness Mark C. Birk, Mr. Wood has made no showing that AmerenUE's current unit efficiency testing is inadequate, or that changes are needed in this area, particularly given that AmerenUE's proposed treatment of OSS revenues as outlined later in this testimony preserves AmerenUE's incentives to maintain and improve plant efficiency and availability.

- Mr. Kind's concerns about the allocation of charges from the Midwest Independent Transmission System Operator, Inc. (Midwest ISO or MISO) have already been fully addressed in Mr. Schukar's February 5, 2007 Rebuttal Testimony. In addition, as explained later in my testimony, the Company has modified its proposed treatment of OSS to alleviate MISO and other production cost allocation concerns in any event.

- The Company has modified its proposal in response to Mr. Trippensee's and Mr. Johnstone's recommendations and has lengthened the recovery period for true-up amounts subject to the FAC (to the extent that FAC

charges differ from actual charges) to a 12-month period from the originally-proposed 3-month recovery period.

- Mr. Trippensee incorrectly suggests that quarterly FAC adjustments would inappropriately create rate volatility and impose undue administrative burdens. Quarterly or even monthly FAC adjustments are made in nearly every other state that utilizes an FAC, and are far less administratively burdensome than the more frequent, full rate cases that would likely be necessary in absence of the FAC. These other state commissions do not appear to have the type of problems Mr. Trippensee is concerned about. Even this Commission has dealt with such adjustment clauses under the PGA since the 1960s and did so with FACs in the 1970s. Nevertheless, the Company is willing to modify its proposal to call for only three, as opposed to four, FAC adjustments per year, which would reduce the number of adjustments to address Mr. Trippensee's concern, even though that may increase the size of the individual adjustments.

- The Company recognizes the customer benefit of including a volatility mitigation mechanism in the FAC, along the lines suggested by Mr. Johnstone on behalf of Noranda. However, Mr. Johnstone's proposal to cap FAC adjustments at just 4% based on only the LTS rate (applicable only to Noranda) is insufficient and may lead to large deferrals, with interest, for other rate classes. Consequently, while the Company is willing to include a volatility mitigation mechanism as proposed by Mr. Johnstone, the 4% cap should be based on the Company's average realization on a cents per kWh basis, not just on the LTS rate.

- AmerenUE has always been committed to insulating its customers from any costs associated with the failure of the Taum Sauk facility and has consequently already agreed, as suggested by Mr. Trippensee, to exclude Taum Sauk related impacts from the FAC.

- Mr. Trippensee's proposals to exclude certain fuel-related costs and revenues in the FAC are unreasonable and unsupported. For example, ash disposal costs net of ash revenues are a direct function of the amount of fuel burned. These costs and revenues consequently are properly recovered with fuel costs. Similarly, railcar costs are directly related to fuel transportation which means, as Staff witness John Cassidy agrees, they should not be separated from other coal transportation costs. It also makes no sense to exclude hedging costs from the FAC as that would provide incentives against hedging of fuel costs. Mr. Trippensee's apparent proposal to keep fuel-related costs out of the FAC whenever these costs appear less volatile than others makes no sense. Not only are most of these costs volatile, such separation of fuel-related costs would only increase administrative complexity without offering any benefits of doing so.

- In addition to addressing concerns of various parties (including Staff, the Missouri Industrial Energy Consumers (MIEC), and OPC) about the treatment of off-system sales margins and how various costs would be allocated between native load and off-system sales in Mr. Schukar's February 5, 2007 Rebuttal Testimony, AmerenUE has also further responded to various parties' concerns by revising its proposed treatment of off-system sales. Under this compromise proposal, OSS revenues would be credited against total fuel costs and the resulting net fuel costs would be recovered through the FAC. To maintain incentives, AmerenUE is proposing a sharing grid under which it could retain a share of savings if it was able to reduce net fuel costs. This compromise FAC proposal avoids the cost allocation issues raised by various parties, deals with volatility in fuel and OSS margins, allows the recovery of prudently-incurred cost, and addresses the inherent asymmetry of other sharing proposals in light of increasing fuel costs.

II. OSS MARGINS AND VARIATIONS IN SUCH MARGINS DO NOT REDUCE RISKS ASSOCIATED WITH INCREASES AND VARIATIONS IN NATIVE LOAD FUEL COSTS AND DO NOT INVALIDATE THE NEED FOR AN FAC.

Q. Mr. Wood concluded in his Rebuttal Testimony that AmerenUE would not need an FAC because OSS margins substantially reduce native load fuel cost uncertainty. Is that a valid conclusion?

A. No, not at all. As explained in Mr. Schukar's Surrebuttal Testimony, a close examination of available evidence shows that variations in OSS margins will *not* offset variations in native load fuel costs. This invalidates Staff's primary conclusion that an FAC is not needed. As discussed in my Rebuttal Testimony, the proposed FAC is consistent with the mainstream of how fuel costs are recovered for utilities in other Midwestern and in non-restructured states. Like other coal-based Midwestern utilities with an FAC, AmerenUE faces significant fuel cost uncertainties that warrant implementation of the proposed FAC.

Q. You noted that, contrary to Staff's conclusions, netting OSS margins against native load fuel costs will not decrease fuel-related risks. Why is Staff's conclusion that AmerenUE's OSS opportunities "mitigate much of its fuel price risk" incorrect?

A. As Mr. Schukar explains in his Surrebuttal Testimony, Staff's conclusion that OSS opportunities would mitigate much of AmerenUE's fuel price risk is based on a flawed analysis presented in Dr. Proctor's Rebuttal Testimony. The risk mitigating effect of netting OSS margins against native-load fuel costs that Dr. Proctor found in his analysis is the result of his complete reliance on two entirely unrealistic and unrepresentative "all high" and "all low" fuel cost and market price scenarios he has constructed.

For example, Dr. Proctor's analysis incorrectly assumes that AmerenUE's average delivered fuel costs (which include transportation costs and quality adjustments relating to SO2 (for coal)) would always change in lock-step with average spot market prices for delivered coal, natural gas, and power – which is entirely unreasonable. AmerenUE's delivered fuel costs are based on multi-year coal and transportation contracts, which (as the most recent AmerenUE coal cost increase has shown) can easily change more than (or in the opposite direction of) the average spot market prices for coal, natural gas, and power. Because AmerenUE's fuel costs do not increase or decrease in lock-step with market prices for coal, natural gas, and power, Dr. Proctor's conclusions about the risk mitigation of OSS margins are invalid.

Second, Dr. Proctor's assumption that the market prices for coal move in lock-step with market prices for natural gas is equally unreasonable. A historic comparison of average delivered coal and natural gas prices shows that even over multi-year periods natural gas prices can increase when coal prices are decreasing, or (as the U.S. Department of Energy's current forecasts show) gas prices can decrease while coal prices are increasing. The fact that on-peak power prices tend to rise and fall with market dispatch prices for gas coupled with the fact that natural gas prices do not generally change in lock-step with coal prices means that changes in AmerenUE's (coal-fired driven) OSS margins will not generally offset fuel-cost risk.

Third, the apparent risk mitigation only exists in Dr. Proctor's all high and all low cases because he constructed these cases such that power prices change not only in the same direction, but also by a higher $/MWh amount than AmerenUE's coal and coal transportation costs. This is also unreasonable. Even if the market prices for power always moved in the same direction as AmerenUE's delivered coal costs (which they do not), it makes no sense to assume that the $/MWh change in AmerenUE delivered coal costs would always be less than the $/MWh change in power prices. If AmerenUE's coal and coal transportation costs change by more than power prices or in the opposite direction, the risk mitigation value of OSS margins does not exist. In addition to the normalized test-year case, Dr. Proctor analyzed only two (i.e., the all high and all low) combinations of possible future costs and market prices. His analysis did not consider any specific changes in AmerenUE nuclear fuel costs, natural gas prices, delivered coal prices, or power prices which can and do differ substantially from each other and from year-to-year. As Mr. Schukar shows, in the overwhelming majority of possible cost and price combinations, the combined uncertainty of movement in fuel costs and OSS margins is not lower than the risk of variations in native load fuel costs. The significant "hedge value" found by Dr. Proctor exists only for the very narrow, unique, and ultimately unlikely two sets of "all high" and "all low" combinations of costs and prices he has constructed. In the overwhelming majority of possible cost and price combinations, netting OSS margins will not mitigate fuel cost risks.

In short, the lack of a lock-step relationship between fuel costs and market prices for fuel and power does not exist. As a result, OSS margins will not mitigate AmerenUE's risk of increasing and volatile fuel costs, which directly undermines Mr. Wood's main argument of why he believes AmerenUE does not need the proposed FAC.

III. LIKE NUMEROUS OTHER UTILITIES WITH HEAVY RELIANCE ON COAL-FIRED GENERATION, AMERENUE NEEDS AN FAC TO HAVE A REASONABLE OPPORTUNITY TO EARN ITS AUTHORIZED RATE OF RETURN AND TO AVOID FREQUENT, REPEATED RATE CASES.

Q. What is Staff's second argument for opposing AmerenUE's FAC request?

A. Mr. Wood argues that a "[s] significant portion of AmerenUE's energy needs to serve its customers are provided by nuclear and coal-fired generation plants versus natural gas plants," and therefore AmerenUE should not be granted an FAC. He also argues that what he calls the "current approach" provides strong incentives for a utility to be prudent in its fuel and purchased power procurement activities.

Q. What factual support does Mr. Wood provide for his broad-brush conclusion that just because AmerenUE produces a majority of its energy from coal-fired and nuclear generation an FAC is not needed?

A. He provides no factual support. As outlined in my February 5, 2007 Rebuttal Testimony, the argument made by Mr. Wood has been rejected in 27 of the 29 other non-restructured states, including many states whose utilities have a reliance on coal-fired generation that is as great if not even greater than AmerenUE's reliance on such generation. (Martin J. Lyons, Jr.'s Rebuttal Testimony, p. 5, l. 14 to p. 6, l. 1-10; Schedule MJL-4; p. 8, l. 3-22 to p. 9, l. 1-17). In short, Mr. Wood's position would only serve to keep Missouri out of the mainstream of utility regulation in the United States, and would promote more frequent full-blown rate cases instead of taking advantage of FACs as a well-accepted regulatory tool that allows utilities to better match largely uncontrollable and volatile fuel costs with rates paid by customers benefiting from those costs. This is true whether fuel costs are rising, or falling, as the FAC provides for adjustments in fuel and purchase power costs whether those costs go up or down.

Mr. Wood also ignores the undisputed reality that AmerenUE faces volatility and increasing fuel and purchase power costs for the foreseeable future, a fact confirmed by the

testimony of Company witnesses Robert K. Neff and Randall Irwin, and Staff witness John Cassidy. Over just the next two years, the Company expects a more than $50 million increase in coal and coal transportation costs alone. In addition, the Company also expects an increase in the cost of nuclear fuel. Those increases alone, ignoring likely increases in labor and other operating and maintenance costs simply due to the operation of normal inflationary pressures, would significantly and quickly erode AmerenUE's rate of return and, absent adoption of an FAC, would very likely necessitate one or more additional rate cases in the near term. Given these sharply increasing costs and the volatility of such costs, the Company would not have a reasonable opportunity to earn a fair return in the absence of an FAC.

Moreover, without an FAC, AmerenUE's risks would be significantly above those of otherwise comparable utilities in other Midwestern states and nationwide. As AmerenUE's cost of capital witnesses Professor Vander Weide and Ms. McShane explain, the vast majority of otherwise comparable utilities operate under an FAC – which means their recommended allowed rate of return is only adequate if an FAC is implemented. The FAC AmerenUE has proposed is consequently not only consistent with the mainstream regulatory treatment of utilities' fuel costs, but it is also needed to ensure the Company maintains a comparable opportunity to earn a reasonable rate of return – no more and no less.

Q. What about Mr. Wood's apparent contention that not approving an FAC provides strong incentives to control fuel and purchased power costs?

A. First, Mr. Wood makes the mistaken assumption that AmerenUE or any other utility has the power to "control" coal, coal transportation, gas, nuclear fuel, or even purchase power costs. As Mr. Neff has outlined in his rebuttal testimony, these costs are volatile, are becoming increasingly volatile, and for the most part cannot be controlled by utilities. AmerenUE cannot dictate to the Union Pacific and Burlington Northern-Santa Fe railroads (the

only two available transporters from Wyoming's Powder River Basin) at what price the railroads will transport the tens of millions of tons of coal AmerenUE needs annually to provide service. AmerenUE cannot set the market price of coal or natural gas, or control the world market for enriched uranium. The cost increases AmerenUE has already experienced and will continue to experience proves those facts. AmerenUE does an excellent job of exercising what little control it has over fuel and purchase power costs, and is able to mitigate some of the volatility in those costs in the short term through hedging activities, but cannot control those costs or mitigate that volatility entirely or in the long run.

Q. Will the Company's proposed FAC remove its incentive to exercise whatever level of control it may have on these costs?

A. No, particularly given AmerenUE's proposed sharing mechanism. As explained in the February 5, 2007 Rebuttal Testimony of AmerenUE witness Shawn E. Schukar, the area where AmerenUE has a much larger ability to control overall production costs is through optimizing plant efficiency and availability. The sharing mechanisms I have set out in my direct testimony and the revised sharing grids I discuss below continue to provide the Company with a strong incentive to improve plant efficiency, plant availability, and other aspects of fuel costs over which it has control.

At bottom, Mr. Wood seems in a rush to jettison the benefits of an FAC, including the benefit of bringing Missouri into the mainstream of electric utility regulation. He ignores that doing so will strengthen utility credit quality and the Company's access to capital markets. This is critically important in a capital-intensive industry like the electric utility business, particularly given the huge capital needs facing the Company in the near term. Mr. Wood's rush to jettison an FAC for AmerenUE is based upon the flawed conclusion that an FAC would

remove appropriate incentives to control, to the extent possible, fuel and purchase power costs. This is in fact not true.

Q. Mr. Wood refers to a statement by AmerenUE's former Chairman Mueller, in which he noted that the Company's elimination of its fuel adjustment clause in Illinois gave it additional incentives to manage fuel costs effectively. Is this a good reason not to implement the proposed FAC?

A. No. Aside from the fact that a fuel adjustment clause made little sense in the restructured and deregulated Illinois market, fuel market fundamentals have shifted significantly since the 1990s. As Mr. Neff has explained in his February 5 Rebuttal Testimony, today's markets are defined by significantly higher volatility of both coal and coal transportation costs. In addition, the prices and volatility of natural gas, nuclear fuel, and purchased power have increased as well.

As I explained in both my Direct and Rebuttal Testimonies, AmerenUE strongly believes in the long-term benefits of regulatory mechanisms that provide efficiency incentives. But as Professor Mayo explained in his Rebuttal Testimony, there is little to be gained from holding utilities responsible for volatile and unpredictable costs that are largely outside of their control. Thus, AmerenUE has in fact proposed to combine the FAC with regulatory mechanisms that maintain proper incentives, such as the initially proposed treatment of OSS margins, the sharing grid discussed in my prior testimonies, and the revised fuel-savings sharing mechanism proposed and discussed below.

Mr. Wood completely ignores the incentives that can be coupled with an FAC, and spends not even one word giving consideration to the benefits of an FAC. Indeed, Staff's position in this case seems to be that, despite the Legislature's adoption of SB 179 and the Commission's hard work to implement FAC rules, the Commission should perhaps not

implement FACs after all – or do so only for those utilities who have chosen over the years to rely much more heavily on gas-fired generation to serve baseload needs (*see* Wood Feb. 5, 2007, Rebuttal Testimony, p. 5, line 1, and his reference to Empire and Aquila), while denying an FAC to those utilities who have made generation choices that would now universally be seen as wise. This makes no sense, in particular given also the fact that 51 of the 58 utilities in other non-restructured states for which FERC Form 1 data is available, including a vast majority of those with heavy reliance on coal, are able to utilize an FAC.

Q. Aside from the incentives provisions in AmerenUE's FAC proposal, are there other safeguards that address Mr. Wood's apparent effort to ensure that AmerenUE is "prudent in its efforts to purchase fuel and power" (page 2, lines 4-5)?

A. Yes. Unlike the FAC that Ameren's Illinois utilities utilized before restructuring was implemented, the Missouri FAC rules contain additional consumer protection measures that further ensure that utilities manage these costs prudently. Under the FAC rules, AmerenUE's entire financial picture will be reviewed in a full rate case every four years. The fuel costs recovered in the FAC will be reviewed as well at least once a year. If AmerenUE were to engage in imprudent fuel and purchased power procurement activities over the four years preceding the setting of new rates, AmerenUE would expect the Commission to take appropriate regulatory action to provide redress to ratepayers. In addition, between rate cases, the Commission's FAC rules implement the mandatory prudence review processes reflected in SB 179, and provide for extensive surveillance, reporting, and reviews by all stakeholders and the Commission to ensure that the Company acts appropriately in procuring fuel and purchase power.

IV. THERE HAS BEEN NO SHOWING THAT ADDITIONAL HEAT RATE TESTING IS REQUIRED FOR FAIR AND EFFECTIVE USE OF AN FAC.

Q. Please address Mr. Wood's Rebuttal Testimony relating to heat rate testing of the Company's generating units.

A. As addressed in detail in AmerenUE witness Mark C. Birk's Surrebuttal Testimony, AmerenUE's use of an efficiency deviation factor to track unit efficiency complies with the Commission's FAC rules and provides a superior method of tracking efficiency. Given the Company's revised FAC/OSS sharing proposal outlined later in my Surrebuttal Testimony, the Company has an incentive to continue to operate its plants efficiently and to seek to improve that efficiency. Mr. Wood's testimony simply fails to demonstrate that the heat rate testing he advocates is required or desirable in lieu of the efficiency testing utilized by the Company.

V. THE HANDLING OF MISO CHARGES VIA THE FAC HAS BEEN FULLY EXPLAINED IN DETAIL.

Q. Mr. Kind notes that a detailed specification of how MISO charges will be allocated between native load and OSS needs to be specified by the Company in order for the Commission to make an "informed decision" about the Company's FAC proposal. (Kind February 2007 Rebuttal Testimony, pp. 2-3). Do you agree?

A. No. I do not agree that details of the type Mr. Kind discusses would have been necessary for Commission approval of the Company's FAC request, because these items are in fact implementation details that would normally be developed in connection with actually filing for the first FAC adjustment. This is particularly true given that the MISO energy markets are less than two years old, and it has taken the MISO some time to solidify the various MISO schedules under which those charges arise. Nevertheless, the Company has already fully addressed Mr. Kind's concern in Mr. Schukar's February 5, 2007 Rebuttal Testimony, in particular, in Mr. Schukar's Schedule SES-12. The approach and level of detail provided in Mr. Schukar's February 5, 2007 Rebuttal Testimony also is fully consistent with the MISO cost and revenue allocation framework that, as Mr. Kind pointed out in his Rebuttal Testimony, the Minnesota Commission has recently approved. In addition, the netting of OSS revenues against

total fuel costs that the Company has proposed as a compromise in response to various parties' concerns should also ameliorate Mr. Kind's concern.

VI. THE COMPANY LARGELY AGREES WITH THE VOLATILITY MITIGATION PROPOSALS OF OPC WITNESS TRIPPENSEE AND NORANDA WITNESS JOHNSTONE.

Q. Messrs. Trippensee and Johnstone both expressed concern that the design of the FAC as originally proposed by the Company might create too much volatility in customer rates as upward and downward FAC adjustments occur. How do you address this concern?

A. Both Mr. Trippensee and Mr. Johnstone suggest that any FAC true-up amounts (i.e., the differences between actual fuel and purchase power costs and fuel and purchase power costs charged under the FAC) be recovered over a 12-month period rather than over a 3-month period as AmerenUE originally proposed. They both indicate that the longer recovery period will tend to smooth out customer rates. The Company agrees that their proposal reflects an improvement to the original FAC design and accepts their proposal.

Q. Mr. Johnstone also recommended that the amount of annual FAC rate increases should be limited. Would you please summarize what Mr. Johnstone has proposed?

A. Yes. Mr. Johnstone recommends that a volatility mitigation cap be included in AmerenUE's proposed FAC so that customers can plan on a year-to-year basis in relation to the possible level of their electricity costs. Mr. Johnstone proposes that the total increase in Noranda's rates (under the LTS class) due to FAC adjustments during each 12-month period be capped at 4% and that any fuel and purchased power costs in excess of the 4% cap be deferred, with interest, and recovered over the following 12 months. Recovery of deferred amounts would not be subject to the 4% cap during the 12-month deferral recovery period.

Q. What is AmerenUE's response to this proposal?

A. With one exception, AmerenUE finds Mr. Johnstone's proposal to be reasonable and acceptable. Because fuel and purchased power costs are a larger proportion of the electricity costs for Noranda (the LTS class), Mr. Johnstone's 4% cap for the LTS class equates to an unreasonably low cap for other classes (e.g., just 2.2% for the residential class). This may create even larger deferrals for other classes, and more interest costs, with even larger increases in subsequent 12-month periods than would result if a more reasonable cap was applied. This problem is solved if the 4% cap is calculated based on AmerenUE's average retail annual kWh realization (i.e., cents/kWh) for its total retail electric jurisdiction. Consequently, AmerenUE agrees to modify its FAC proposal to include Mr. Johnstone's volatility mitigation proposal, modified, however, to apply the 4% cap to AmerenUE's average annual kWh realization (i.e., cents/kWh) for its total retail electric jurisdiction.

VII. VARIOUS OTHER "CONCERNS" RAISED BY MR. TRIPPENSEE ARE WITHOUT MERIT AND INCONSISTENT WITH THE EVIDENCE.

Q. Mr. Trippensee implies that an FAC that calls for more than one FAC adjustment per year is somehow inconsistent with the Commission's FAC rules and is not reasonable. Do you agree?

A. Absolutely not. While I am not an attorney (and neither to my knowledge is Mr. Trippensee), it is apparent that the Commission specifically contemplated an FAC with precisely the number of possible adjustments contained in AmerenUE's proposed FAC (which, as noted above, AmerenUE has agreed to reduce from four to three). 4 CSR 240-20.090(4)(A) provides for one mandatory filing, and provides that an electric utility "may also file up to three (3) additional adjustments to its FAC within a true-up year with the timing and number of such additional filings to be determined in the general rate proceeding establishing the FAC …."

Moreover, Mr. Trippensee's novel view that an FAC should only be adjusted once per year would again take Missouri far out of the mainstream. As shown in Schedule MJL-5 (attached to this Surrebuttal Testimony): (1) the majority of non-restructured states allow FAC adjustments on a monthly or quarterly basis; (2) those states in which FAC adjustments are made annually, all rely on projected rather than historic fuel and purchase power costs to set FAC rates; and (3) the four other states in which FAC rates are based on historic costs all allow FAC adjustments on a monthly basis. Given Missouri's requirement that FAC rates be based on historic costs, allowing only for annual adjustments to FAC rates would not only be far from the regulatory mainstream, but would also result in significant cost recovery lags, even larger deferrals, higher interest charges, concerns by credit rating agencies, and rates that are poorly reflective of actual costs and which therefore fail to send timely price signals to customers. Restricting the FAC to annual adjustments would also be contrary to the more frequent adjustments allowed under the PGA for every Missouri local distribution company regulated by this Commission.[2]

Q. What about Mr. Trippensee's argument to the effect that rate cases develop cost structures for an annual or 12-month period, rather than a quarterly period, and therefore multiple FAC adjustments are inappropriate?

A. Mr. Trippensee's argument and concern makes little sense, and appears to be a "smoke and mirrors" type of argument. Despite the fact that the normalized test year developed in a rate case is for a 12-month period, utilities and this Commission frequently deal with rate changes that occur more than once a year. Such more frequent rate changes have been

[2] It is noteworthy that when it supports his points, Mr. Trippensee points to the PGA (e.g., p. 8, l. 6-7 of his Rebuttal Testimony), but when opposing the FAC in general, Mr. Trippensee ignores the fact that the operation of the FAC is quite similar in many respects to the operation of the PGA, albeit there are even more consumer protections built into SB 179 and the Commission's rules for the FAC than exist for the PGA.

implemented for four decades by this Commission in the context of the PGA for natural gas utilities. Quarterly and even monthly FAC rate adjustments are also used in the large majority of non-restructured states, where normalized 12-month test years are also used. Even under the existing rate structure, some rates change on a seasonal basis. The more than once-a-year rate adjustments also should not be a source of concern because the FAC rules also require the annual review and reconciliation of all costs.

Q. Mr. Trippensee also seems to suggest that the quarterly periods set out in AmerenUE's original proposal do not line up with a true-up year under the Commission's FAC rules. Please comment.

A. The Company agrees that if the effective date of the Commission's order in this case is after June 1, 2007,[3] the true-up year will begin on July 1, 2007. It would then, under its original proposal, make its first FAC adjustment filing on October 1, 2007, for changes in fuel and purchased power costs occurring during the preceding periods in the true-up year (i.e. in July and August, 2007). In that one circumstance, at the beginning of the operation of the FAC, an adjustment would be based upon changes in costs for two months, not three. Under its revised proposal, its first filing would be November 1, 2007, for costs occurring during July to September 2007. That does not make the FAC "inconsistent" with the true-up period. Moreover, AmerenUE, in response to some of the concerns expressed, has modified its proposal to reduce the number of annual adjustments from four to three.

Q. Mr. Trippensee suggests that FAC adjustments would "very likely overwhelm the regulatory resources of the Commission." Is that a reasonable concern?

[3] Mr. Trippensee assumes, perhaps correctly and perhaps incorrectly, that the Commission will delay making a decision in this case until just 2-3 days before the operation of law date in this case. The Commission is free to make a decision prior to June 1, 2007, if it so desires.

A. No. Mr. Trippensee's concern completely amazes me given that the regulatory commissions in nearly every other state in this country are able to use and administer FACs for their utilities, and have done so for many years, without "overwhelming" their resources. Yet, somehow, Mr. Trippensee and others who oppose FACs for electric utilities in Missouri seem to believe that Missouri would be "overwhelmed by" or incapable of implementing such a mainstream regulatory mechanism. As I have already explained in my Rebuttal Testimony, implementing an FAC more likely will reduce regulatory burdens by avoiding more frequent full rate cases that would be driven in large part by changing fuel and purchase power costs. More frequent full rate cases would impose a much greater (and inefficient) regulatory burden on all stakeholders' resources than does the use of an FAC.

Q. On pages 10 to 13 of his Rebuttal Testimony, Mr. Trippensee proposes to exclude certain fuel-related costs and revenues from the FAC. Are Mr. Trippensee's concerns valid and his proposals reasonable?

A. No, they are not. Mr. Trippensee states that he does not believe several cost items are appropriate for inclusion in the FAC. For example, he proposes that ash disposal costs and revenues incurred at coal plants should be excluded. However, such ash disposal costs net of ash revenues are a direct function of the amount of fuel burned. These costs and revenues consequently are properly recovered with fuel costs. They are also volatile and largely outside the Company's control because revenues from ash sales (and thus net disposal costs) depend greatly on market conditions for that commodity.

Mr. Trippensee similarly wants to exclude railcar repair costs and depreciation. However, these costs are directly related to fuel transportation, which means, as Staff witness Cassidy agrees on page 21 (lines 3-15) of his Direct Testimony, they should not be separated from other coal transportation costs. The inclusion of rail car repair and depreciation costs with

the FAC is also consistent with FERC accounting rules. It would not make sense to separate these costs of AmerenUE-owned rail cars from the cost of owning the cars. Also, when coal is moved in railroad equipment, the cost of the cars and their associated repairs is included in the railroad transportation rate, which then flows through the FAC as part of the delivered price of the coal. These costs are all legitimate transportation-related expenses that must be incurred to deliver the coal to the plants and should be included in the FAC, just like all transportation costs for natural gas are included in the PGA.

Mr. Trippensee even proposes to exclude hedging costs from the FAC because these costs are not sufficiently volatile. This is contrary to the practice for the PGA mechanism in Missouri and other states, and would create poor public policy as exclusion of hedging costs would create a strong disincentive to hedge fuel costs to the extent that is even feasible. In Missouri, all natural gas hedging costs are included for pass-through in the PGA mechanism, including broker costs and commissions, as well as losses and gains from hedging instruments, including futures, options, and other financial derivatives. The proposed FAC correctly recognizes that these prudently incurred hedging costs are sound fuel management practices and should be allowed for recovery.

Proper fuel management may also require periodic sales of excess fuel to reduce or manage fuel inventories. Such sales, as reflected in accounts 501 and 547, may be caused by unexpected variations in gas or coal usage caused by weather fluctuations, or other factors such as unit availability. Market conditions sometimes allow the sale of fuel from the portfolio and simultaneous replacement of similar, but lower cost, fuel from another location. Such sales are a normal part of fuel management activities, and gains and losses related thereto are appropriately passed through an FAC.

Mr. Trippensee's proposal to keep some of these clearly fuel-related costs out of the FAC appears to be based on his opinion that these costs are less volatile. This makes no sense. Not only are most of these costs volatile (and in the case of hedging costs are incurred to reduce fuel cost volatility), the proposed separation of fuel-related costs would only serve to increase administrative complexity without offering any benefits of doing so. For example, if railcar repair costs were excluded from the FAC, it would be the only component included in coal inventory cost items that would not be recoverable through the FAC. Excluding railcar repair costs from FAC recovery would require the Company to keep separate records for recoverable and non-recoverable coal inventory costs for purposes of the FAC.

Q. Do you agree with Mr. Trippensee's concern about excluding costs in Account 536, Water for Power, from the FAC?

A. Yes. The costs in the test period in Account 536 is an annual payment for water flow regulation by the dams upstream from the Osage Plant. This is an annual payment subject to additional assessment in the future based on a Federal Energy Regulatory Commission study of these headwater benefits. The Company agrees this cost need not be included in the FAC.

Q. Has AmerenUE addressed Mr. Trippensee's recommendation that the impacts of the Taum Sauk upper reservoir failure be removed from the FAC?

A. Yes. I already explained how AmerenUE will remove any increases in fuel and purchased power costs relating to the Taum Sauk plant from operation of the FAC in my February 5, 2007 Rebuttal Testimony (pages 30 – 34). As I explained in my Rebuttal Testimony, the simplest approach is to determine the Taum Sauk value for the normalized test year which would be reflected in the FAC rates through the "R-factor" in each FAC period until Taum Sauk resumes operations. This would guarantee the test-year value in each of the

subsequent years and would also avoid annual true-up calculations through production cost simulations. However, as I have also noted in my Rebuttal Testimony, AmerenUE would be willing to undertake such annual true-up calculations if that is the preference of the Commission.

VIII. THE COMPANY PROPOSES A NEW SHARING MECHANISM TO ADDRESS CONCERNS OVER COST ALLOCATION AND OSS SHARING.

Q. What was the original treatment of OSS margins proposed by AmerenUE?

A. AmerenUE's proposal was to recover native load-related fuel and purchase power costs in the FAC while leaving OSS margins out of the FAC. Base rates would have been reduced by a normalized level of test year OSS margins, which (as explained in my Rebuttal Testimony and that of Professor Mayo) would have provided strong efficiency incentives by keeping the Company fully at risk for changes in OSS margins. AmerenUE had also set out for further consideration a proposal under which OSS margins would have been shared between the Company and its customers, subject to a cap on the Company's sharing participation. In the February 5, 2007 Rebuttal Testimony of Mr. Schukar, AmerenUE has provided a detailed explanation of how fuel, purchase power, and MISO costs and revenues would be allocated between native load and off-system sales to implement AmerenUE's initial treatment of OSS margins and to also track these margins for business reporting purposes.

Q. How have other parties reacted to AmerenUE's proposal?

A. A number of parties have raised concerns (1) over the allocation of costs and revenues between native load and off-system sales; and (2) the OSS sharing grid AmerenUE had set forth for consideration. The February 5, 2007 Rebuttal Testimony of Mr. Schukar already addressed these concerns to the extent they had been raised in the parties' December 2006 testimonies. However, similar concerns over the sharing grid and MISO cost allocations were raised again, for example, in the February 2007 Rebuttal Testimony of Staff witness Dr. Proctor.

Q. Given that many (there are 16 parties, most of which didn't file testimony) parties were concerned over OSS cost allocations and criticized the OSS sharing grid, has the Company modified its proposal to address these concerns?

A. Yes we have. While we continue to believe, based upon the updated analysis of normalized test-year OSS margins and their relationship to AmerenUE's fuel prices as discussed by Mr. Schukar in his February 27, 2007 Surrebuttal Testimony, that our original proposal to treat OSS margins outside the FAC and the alternative sharing proposal we offered in Direct Testimony are appropriate and acceptable, we have developed a compromise position. The compromise proposal was developed to address the various parties' concerns over the allocation of fuel, purchased power, and MISO costs between native load and off-system sales, and by making this proposal, we adopt Mr. Brubaker's recommendation to implement the FAC such that OSS margins are netted against native load fuel and purchased power costs. The netting of OSS margins against native load fuel costs will be achieved simply by crediting total OSS revenues against total fuel costs (i.e., native load and OSS fuel costs). This netting would avoid the allocation of fuel costs and MISO charges to native load and off-system sales – at least for the purpose of the FAC calculations.

To maintain an appropriate level of incentives, AmerenUE proposes that the Company be able to retain a portion of the benefits if net fuel costs (i.e., total fuel costs net of OSS revenues) fall below a "base" level equal to the normalized test year levels. If AmerenUE were able to reduce net fuel costs below this base level, it would be able to retain the shares of incremental savings shown in the table appearing on the next page.

Range of Net Fuel Costs Relative to Normalized Test-Year Level (Base)	Company Sharing Amount	Maximum Reward ($millions)	Customer Benefit ($millions)
Zero to $10 million below base	75%	$7.5	$2.5
$10 million to $35 million below base	10%	$2.5	$22.5
$35 million to $60 million below base	20%	$5.0	$20
$60 million to $85 million below base	30%	$7.5	$17.5
$85 million to $110 million below base	40%	$10	$15
$110 million to $135 million below base	50%	$12.5	$12.5
Greater than $135 million below base	0%	$0	All
	Total:	$45	$90+

Given that AmerenUE fuel costs are expected to *increase* by over $66 million over the next two years, as Mr. Cassidy recognized in his Rebuttal Testimony, this sharing grid provides a very ambitious target for reductions in net fuel costs and, as a result, strong incentives for the Company to achieve performance gains to reach at least the first savings/sharing band (e.g., by maintaining high plant availability to maximize OSS margins). The relatively high 75% sharing portion provides incentives consistent with the challenge AmerenUE faces to reach even this first sharing band. In each of these sharing bands, AmerenUE could earn up to the shown amounts per year if it was able to reduce net fuel costs sufficiently below test year levels. This would also mean that if net fuel costs could be reduced by $135 million annually, this sharing grid would provide customers with $90 million of these savings while the Company would retain $45 million (which translates to slightly less than a 100 basis point return on equity). All net savings in excess of $135 million, if any, would further add to customers' $90 million in benefits. The bottom line of this mechanism is that the Company will not receive even $1 of benefits from OSS margins in excess of test year levels until it has completely overcome all fuel price increases (again, $66 million in just the next two years).

Q. Would the sharing grids proposed by Messrs Brubaker or Binz also be reasonable?

A. No. While Mr. Brubaker's proposal to share net fuel costs both above and below a base level may appear reasonable at first blush, as Mr. Schukar explained on pages 4-7 of his February 5, 2007 Rebuttal Testimony, applying such sharing grids to net fuel costs (i.e., total fuel costs net of OSS margins) creates an inherent and substantial cost recovery bias against AmerenUE in light of increasing Company and industry-wide fuel costs and continued load growth. This would also lead to more frequent rate cases, provide poor efficiency incentives, and raise credit concerns. The sharing grid proposed by Mr. Binz on page 28 of his December 29, 2006 Direct Testimony suffers from the same shortcomings. The Company's proposed sharing grid avoids this inherent bias and appropriately provides for full recovery of prudently incurred costs under the FAC, as provided for in SB 179.

Q. Why would these sharing grids raise credit concerns?

A. Given the recent increases and volatility of fuel and purchase power costs, credit rating agencies have been very concerned about credit implications of fuel and purchased power cost recovery risks, particularly for the few utilities who do not have access to an FAC or for utilities with only a "weak" adjustment mechanism.[4] Characteristics of "weak" adjustment mechanisms include mechanisms that allow only the partial pass-through of fuel costs (e.g., pass-through mechanisms with dead bands), that are based on historical fuel prices (as opposed to projected prices), that allow for only infrequent rate adjustments, that accumulate significant deferrals, or that cap FAC rates or accumulated deferrals. By virtue of being based on historic costs rather than projected costs, the Missouri FAC rules already are viewed as relatively unfavorable by credit rating agencies. The proposal AmerenUE has presented includes further customer protection measures -- the 4% annual cap on average retail rate increases, recovery

[4] See, for example, Fitch Ratings, "U.S Electric Utilities: Credit Implications of Commodity Cost," February 13, 2006. Standard & Poor's, "Fuel And Purchased Power Cost Recovery In The Wake Of Volatile Gas And Power Markets--U.S. Electric Utilities To Watch," March 22, 2006.

extended from 3 to a 12-month period, and only three adjustments per year -- that further weaken the FAC from a credit perspective. If Messrs. Brubaker's or Binz's specific proposals were implemented, the FAC design would raise quite severe credit concerns, given the deadband in their proposals and the fact that the sharing grids would not allow for full recovery of AmerenUE's already known increases of fuel costs. Approval of such a weak and unusual FAC would be poor regulatory policy because it would fail to fully achieve a key benefit of FACs; that is, the strengthening of the relative credit quality of Missouri utilities and the resultant lower borrowing costs (which translates into lower revenue requirement) that allow utilities to finance the large capital investments necessary to continue to provide safe and adequate electric service at reasonable rates.

Q. But isn't Mr. Brubaker's proposal similar to the FAC sharing mechanism that the Wyoming commission has implemented for one of its utilities, as Mr. Binz noted in his Direct Testimony?

A. The Wyoming mechanism pointed out by Mr. Binz has certain similarities with Mr. Brubaker's proposal, such as the deadband and the apparent symmetry of the sharing grid. These similarities lead to similar credit concerns associated with that type of proposal. But there are also important differences that would make the implementation of a Wyoming-type of sharing grid in Missouri of significantly larger concern. For example, Wyoming utilizes projected costs, not historic costs as in Missouri. Using projected costs makes is much easier to deal with already-known fuel price increases. Moreover, the Wyoming mechanism applies only to purchase power costs (which credit rating agencies have noted as a concern and which are only a small part of AmerenUE's total production costs), and not to fuel costs, as advocated by Messrs. Brubaker and Binz. It is also unclear that the Wyoming utility which now operates under this mechanism faces any known increases in its purchase power costs.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

FAC Cost Basis, Adjustment Frequency, and Sharing Mechanisms in Non-Restructured States

State	Type of Rider	Historic or Projected Costs	Frequency of Adjustment	Sharing of Fuel or Purchased Power Costs?
Alabama	F,PP	Projected	Quarterly	No
Alaska	F,PP	Projected	Quarterly, Annually	No
Arkansas	F,PP	Projected	Annually	No
Colorado	F,PP	Projected	Quarterly	No
Florida	F,PP	Projected	Annually	No
Georgia	F,PP	Projected	Monthly	No
Hawaii	F,PP	Projected	Monthly	No
Idaho	F,PP	Projected	Annually	Yes - around base (IP)
Indiana	F,PP	Projected	Quarterly	No
Iowa	F,PP	Projected	Monthly	No
Kansas	F,PP	Projected	Monthly	No
Kentucky	F,PP	Historic	Monthly	No
Louisiana	F,PP	Historic	Monthly	No
Minnesota	F,PP	Historic	Monthly	No
Mississippi	F,PP	Projected	Quarterly, Annually	No
Missouri	F,PP	Historic	Up to Four Times a Year	
Nebraska [1]	F,PP	Projected	Monthly	No
New Mexico	F,PP	Projected	Monthly	No
North Carolina	F,PP	Projected	Annually	No
North Dakota	F,PP	Projected	Monthly	No
Oklahoma	F,PP	Projected	Quarterly, Semi-Annually	No
South Carolina	F,PP	Projected	Annually	No
South Dakota	F,PP	Historic	Monthly, Quarterly	Yes - around base (MDU)
Tennessee	PP	Projected	Monthly	No
Utah	[2]	[2]	[2]	[2]
Vermont	[3]	[3]	[3]	[3]
Washington	PP	Projected	Annually	Yes - around base (PSE)
West Virginia	F,PP	Projected	Annually	No
Wisconsin	F,PP	Projected	Monthly	Yes - around threshold
Wyoming	PP	Projected	Monthly, Annually	Yes - around base

Source: *The Brattle Group* (based on interviews with State Commission Staff, reports by Regulatory Research Associates and NARUC, and EIA and State Commission websites)

Notes: Authorized riders are F: Fuel and PP: Purchased Power.

[1] Nebraska does not have any investor-owned utilities, but Nebraska Public Power District has an inactive Production Cost Adjustment.

[2] Utah has no FAC in place, but PacifiCorp has been allowed to recover replacement power costs through temporary rate increases.

[3] In Vermont, FACs are prohibited.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT OF MARTIN J. LYONS, JR.

STATE OF MISSOURI)
) **ss**
CITY OF ST. LOUIS)

Martin J. Lyons, Jr., being first duly sworn on his oath, states:

1. My name is Martin J. Lyons, Jr. I work in the City of St. Louis, Missouri, and I am employed by AmerenUE as Vice President and Controller.

2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony on behalf of Union Electric Company d/b/a AmerenUE consisting of 25 pages and Schedule MJL-5, all of which have been prepared in written form for introduction into evidence in the above-referenced docket.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.

Martin J. Lyons, Jr.

Subscribed and sworn to before me this 27th day of February, 2007.

Notary Public

My commission expires: May 19, 2008

CAROLYN J. WOODSTOCK
Notary Public - Notary Seal
STATE OF MISSOURI
County
My Commission Expires: May 19, 2008