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

POST-HEARING BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

INTRODUCTION

On July 7, 2006, Union Electric Company d/b/a AmerenUE ("AmerenUE or simply "UE") filed with the Missouri Public Service Commission tariffs seeking a general rate increase in its retail electric rates. The Commission suspended those tariffs on July 11, 2006, and set two weeks of evidentiary hearings to be held in this case during the weeks of March 12 and March 19, 2007.

The primary purpose of this post-hearing brief is to summarize the important points brought out at the evidentiary hearing. As such it, contains a significant number of citations to and quotes from the transcripts of the evidentiary hearings in this case References to the transcript are noted as (Tr. [page number]). This brief will only address in detail the issues on which Public Counsel is sponsoring witnesses and testimony.

PINCKNEYVILLE AND KINMUNDY

This issue pertains to the cost at which AmerenUE acquired from its affiliate Ameren Generating Resources (AEG) the gas-fired generating stations at Pinckneyville and Kinmundy.

This transaction was completed on May 2, 2005. AmerenUE acquired the Pinckneyville facility for $502/kW and acquired the Kinmundy facility for $412/kW. Both of these prices appear to be well above the market value of the facilities. This issue in this case is the first time the Missouri Public Service Commission will have the opportunity and the responsibility for determining the value of assets that UE got through this affiliate transaction.

Some previous cases touched on Pinckneyville and Kinmundy but certainly did not establish a value for rate-making purposes in Missouri. The Metro East case was not designed to evaluate the value for rate-making purposes of Pinckneyville and Kinmundy. It was designed to allow the Commission to use a cost benefit analysis for purposes of the Metro East transfer. The case at FERC was not about establishing value for rate-making for Missouri retail rates. It was about establishing whether or not this purchase would have any impact on market power.

UE does not dispute that the purchase of Pinckneyville and Kinmundy was from an affiliate and subject to the Commission's Affiliate Transaction Rules. According to those rules, UE's Cost Allocation Manual covering calendar year 2005 (Exhibit 438) should demonstrate its valuation of the assets subject to that transaction. It does not; there is no useful information in it with respect to valuing that Pinckneyville and Kinmundy transaction. (Exhibit 438; Tr. 3281, 3285)

The evidence adduced at the hearing clearly showed that the price paid by UE for these two generating stations was above market value and not compliant with the Commission's affiliate transaction rule. Public Counsel, in the direct testimony of Ryan Kind at page 35, recommends using for ratemaking purposes the blended cost of $193.80/kW of the recently acquired Audrain, Goose Creek, and Raccoon Creek Plants.

UE witness Voytas admitted that the price of combustion turbines declined steadily from 2002 through 2005. (Exhibit 435; Tr. 3085) He also agreed that the prices in 2002 were not comparable to the prices in 2006. (Tr. 3097-3098).

Mr. Voytas conceded that he only directed one Question and Answer in his testimony to Public Counsel witness Kind. (Tr. 3088) As a result, most of the points that Mr. Voytas attempted to make in his testimony in responding to Staff witness Rackers simply do not apply to Mr. Kind's approach to valuing Pinckneyville and Kinmundy. (Tr. 3090-3117)

Although Mr. Voytas was adamant that the price at which NRG offered to sell its Audrain in 2002 was an "indicative proposal," he admitted that he did not know if UE could have closed a deal with NRG at that price. (Tr. 3114-3115) Mr. Voytas considered that that plant had only "salvage value," but included it in a table in his testimony with a value of $508/kw. Mr. Voytas conceded that he was not familiar with the specific units shown in his table. (Tr. 3121).

In response to questions from Commissioner Murray, Mr. Voytas conceded that the best proxy to use for determining the value of Pinckneyville and Kinmundy is the RFP issued in July of 2005. (Tr. 3169) The prices for the purchase of the three units acquired through that RFP were established in the second half of 2005. (Tr. 3244)

Mr. Voytas attempted to show the value of Pinckneyville and Kinmundy using a table of sales of other CTs. Of course, there are some readily apparent problems with his list, not the least of which is that some of them are affiliate transactions rather than arms-length transactions. (Tr. 3174)

Mr. Kind offered the Commission two approaches to valuing Pinckneyville and Kinmundy. His main approach results in a value of approximately $194/kw and his secondary proposal serves merely to set just another reference point at $312/kw. (Tr. 3235) In establishing

a price that should be used for ratemaking purposes, Mr. Kind did not rely just on the units in those two approaches, but instead "considered a whole lot of transactions that have taken place over the last few years and any general knowledge in that area." (Tr. 3240)

PENO CREEK

In the years leading up to the time when Peno Creek was constructed, Ameren was trying very hard to enact Missouri legislation that is commonly referred to as Genco legislation, and as a result, held off for a long period of time building needed capacity. When it became clear that the Genco legislation was not going to pass in Missouri, UE needed the capacity and needed it in a hurry. And what happened was, as is common when you try to building in a hurry, you pay more for it.

The evidence will clearly show that the Peno Creek station was built on a very quick turnaround under an "engineer/procure/execute" contract for which UE paid a very high price, and that's reflected in the actual as-built cost of Peno Creek.

.Public Counsel recommends that the gross value of this plant reflected in AmerenUE's revenue requirement be reduced from the gross plant amount associated with the $550/kW all inclusive construction cost to $390/kW. (Kind Direct, p. 30). The source of the $390/kW figure is a benchmark figure presented by AmerenUE for the cost of constructing new gas-fired generation in Case No. EA-2000-37. Public Counsel witness Ryan Kind explains the rationale for applying this figure to the Peno Creek plant:

> At the time UE added the Peno Creek units they were building this new generation facility in a rush make up for a generating capacity deficit at UE that they had created due to their pursuit of the Ameren HoldCo strategic objective of building all new generation in AEG (Genco) and attempting to get Missouri legislation passed that would permit them to transfer UE's generation to the Genco. UE's ratepayers should not be forced to absorb higher generation costs

> because of the pursuit of non-regulated strategic initiatives by UE's parent company, Ameren HoldCo. (*ibid*.)

AmerenUE does not dispute that Peno Creek was built on an expedited basis. Common sense, as well as the evidence produced by Public Counsel, should convince the Commission that there are costs associated with a significant construction project built on a "hurry-up" basis. Because of UE's failure to plan ahead to address its capacity needs, it was put in the awkward – and ultimately expensive – position of needing to have capacity installed in just a year. Because of that timetable, its options were limited to aero-derivative CTs; the cheaper (Tr. 3319) large-frame CTs were off the table because the lead times in ordering them were longer than UE could afford to wait.

Mr. Voytas testified under oath at the FERC in Case No. EC-03—053-000 that at the time UE built Peno Creek, a CT should cost $450/kw. (Exhibit 440; Tr. 3324) He also testified that when you construct facilities like Peno Creek on in a compressed time frame, there are additional costs involved. (Exhibit 440; Tr. 3324-3325) Those costs are clearly shown in the $550/kW that AmerenUE paid to construct the plant.

Although UE argues that there were system benefits to constructing an aero-derivative CT as opposed to a cheaper large-frame CT (that it could not have built anyway under its self-imposed time limits), it never quantified those benefits. (Tr. 3328-3329) Furthermore, although UE now alleges that there were load-following benefits from using aero-derivatives, there is no mention in the resource planning documents from that period of time of an urgent need for additional load following capability. (Tr. 3359-3360)

It is interesting to note that, on this issue, UE chose not to respond in prefiled testimony to Public Counsel witness Kind's assertions that the rush to build Peno Creek caused added costs. (Tr. 3336)

Mr. Kind explained the background that led to that rush in response to questions from Commissioner Gaw:

> [By Mr. Kind] The point is if they'd been doing prudent resource planning and if they had not switched away from this idea of instead of building any new generation within UE, let's build for all in the Genco, then they could have planned several years prior to this resource need. And I think one of the most remarkable things you'll see in my testimony is the quote from one of their senior vice presidents, Paul Agathan (ph.), in May of 2001 when they were making a final push to get the Genco legislation passed.
> He asserts that AmerenUE nor any other IOU in Missouri has any plans to build generation capacity. It was almost a threat at that time. And then we see one month later suddenly when the Genco legislation fails, all of a sudden they need to rush and -- and start doing resource planning again at UE.
> [By Commissioner Gaw] Q This was in what year?
> A 2001.

The Commission should adopt Public Counsel's much more reasonable $390/kW figure for the purpose of establishing Peno Creek's value in rate base, rather than the inflated value UE was forced to pay because of it inadequate planning.

RETURN ON EQUITY

Zone of Reasonableness:

The Commission, in its two most recent major rate cases (ER-2006-0314 and ER-2006-0315), has confirmed its reliance on the "zone of reasonableness" analysis. The zone of reasonableness in this case, if the Commission uses the figures from calendar year 2006, is from 9.5 percent to 10.5 percent. More recent numbers would put the zone at 9.36 to 10.36 percent.

In Case No ER-2006-0314, the recent Kansas City Power and Light Company case, the Commission threw out the testimony of a witness who fell outside of the zone of reasonableness essentially because they found that witness not to be credible, and so there was no reason to evaluate the method by which the witness came to his result. The Commission should follow that example here and eliminate the testimony of the two UE witnesses. The two UE witnesses

testified that the proper return on equity is 12.0 and 12.2 percent. In this case, only Public Counsel witness King and MIEC witness Gorman are within the zone of reasonableness; Mr. King proposes a return on equity of 9.65 percent and Mr. Gorman proposes a return on equity of 9.8 percent.

If the Commissioner is being consistent, that should be the end of the discussion. The Commission threw out a consumer witness for being too low in ER-2006-0314; it should throw out the company witnesses in this case for being too high On the off chance that that doesn't happen, the discussion of this issue continues below.

The Analysis of Public Counsel witness King:[1]

The Commission should look at the unvarnished, unmanipulated DCF results that are sponsored by Public Counsel witness Charles King, and note that Mr. King is one of the few witnesses in this case who fall into that zone of reasonableness. Based on the analyses presented in the testimony of Public Counsel witness Charles King, the Commission should find that the appropriate return on equity (ROE) is 9.65 percent.

Mr. King's return on equity is based on his Discounted Cash Flow (DCF) analysis. The DCF analysis, in turn, is based on a group of comparable companies. Mr. King arrived at his list of comparable companies by starting with the companies examined by AmerenUE witnesses VanderWeide and McShane. Mr. King eliminated four companies on Dr. VanderWeide's electric utility list that were more heavily involved in gas distribution than electric service. He also eliminated MDU Resources because it is most heavily involved in non-utility activities, including construction, mining, and gas and oil production, and OGE Energy because it is predominantly a gas pipeline company (although it does have some electric utility operations).

[1]Because there was little cross examination on the analyses of the witnesses, this section is largely unchanged from Public Counsel' rehearing brief.

TXU was eliminated because it has written down its equity to the point that it displays unreasonable financial risk.

Mr. King then examined the proportion of revenue of each company derived from non-regulated activities. Because AmerenUE derives virtually all of its revenue from regulated services and predominantly its electric operations, Mr. King established a threshold of 60 percent regulated utility revenue as a basis for inclusion in the comparison groups to be used in his analysis. The end result of this effort is two comparison groups, an electric utility group of 25 companies and a gas distribution group of 16 companies. (King Direct Testimony, Schedule CWK-3). Mr. King's DCF analyses of the appropriate return on equity for AmerenUE's electric operations relied on the group of 25 electric utilities.

Mr. King's selection of comparable companies is far superior to those taken by the two AmerenUE witnesses. Dr. VanderWeide's group is way too broad. It includes several utilities which have only limited involvement in regulated utility activities and receive most of their revenue from unregulated activities. As Mr. King notes in his rebuttal testimony:

> Only regulated companies realize their profits through the application of an allowed rate of return to the book value of their assets. A [non-regulated or mostly non-regulated] company experiences a totally different profit dynamic, one driven by competitive markets, not by regulation.

The other AmerenUE witness, Ms. McShane, errs by straying too far in the other direction. Her group of proxy companies is too narrow, unnecessarily limited by her criterion that only utilities with nuclear generation be included. Twenty years ago, the ownership of nuclear plants was a very distinguishing characteristic because it usually meant that the utility had incurred very sizable debt and had assumed a significant safety risk. The newest nuclear plant is now over 20 years old, and the debt obligations and perceived safety risks associated with nuclear generation have receded in importance.

Mr. King described his application of the DCF model as follows:

> In developing the equity returns for the comparison groups, I shall apply the Discounted Cash Flow ("DCF") procedure. I consider the DCF procedure to be the most credible test of a market return. I shall present two versions of this test. The first, which I shall describe as the "classic" DCF, employs the forecasts of investment analysts in estimating the growth component of the DCF formula. The other procedure employs both analysts' forecasts and a forecast of the annual growth of Gross Domestic Product in the "out" years beyond 2012. Additionally, I shall consider the Capital Asset Pricing Model ("CAPM") as a check on the DCF results. Finally, I shall examine the trend in rates of return allowed by public utility commissions to electric utilities during the past 16 years. (King Direct Testimony).

It is important to note that Mr. King does not rely on the CAPM model except as a "sanity check" for his DCF analyses. Both AmerenUE witnesses give the CAPM analysis weight equal to that of their DCF analyses. There is simply no justification for this undue reliance on the deeply-flawed CAPM. The AmerenUE witnesses also rely on risk premium analyses. These suffer from at least as many flaws as the CAPM, most notably in the ease with which they are manipulated to achieve a desired ROE recommendation. This manipulation can be done by the analysts' choice of risk premiums and return estimates. The AmerenUE witnesses appear to have chosen both components with the goal of producing the highest possible ROE. Mr. King points out:

> Even if one accepts the calculation of the historical risk premiums, the witnesses appear to have padded their return estimates. Ms. McShane does so by averaging the higher gas company risk premium with the electric company indicator. Dr. VanderWeide does so by averaging the risk premiums of electric companies with those of S&P's 500 companies. If either witness had accepted the historical electric utility premiums, their return indications would have been lower. (King Rebuttal Testimony).

The DCF approach is the exclusive method that Public Counsel witness King relied on in his calculation of AmerenUE's cost of equity. Mr. King offers an understandable translation of the DCF equation in his direct testimony:

> The formula says that the return that any investor expects from the purchase of a stock consists of two components. The first is the immediate cash flow in the form of a dividend. The second is the prospect for future growth in dividends. The sum of the rates of these two flows, present and future, equals the return that

> investors require. Investors adjust the price they are willing to pay for the stock until the sum of the dividend yield and the annual rate of expected future growth in dividends equals the rate of return they expect from other investments of comparable risk. The DCF test thus determines what the investing community requires from the company in terms of present and future dividends relative to the current market price. (King Direct Testimony).

None of the witnesses disagree with the basic formula or approach of the DCF model, and it will not be discussed in any detail herein. The nuances of its application, of course, are at the heart of the issue in this case – as they in most rate cases. Virtually all cost of capital witnesses set forth the DCF equation in their testimony in the same way, cite the same portions of Hope and Bluefield,[2] yet nonetheless arrive at ROE recommendations that are wildly divergent – making ROE the biggest issue in most rate cases. Yet it is the issue that most regulatory commissions devote the least critical evaluation to, preferring to "pick" the testimony of the witness that sponsors an ROE closest to the regulators' preconceived notion of a proper return.

Mr. King used the least subjective approach and the least subjective components in deriving the growth factor in his classic DCF analysis:

> According to the DCF theory, the relevant measure of "g" should be the growth in dividends. Dividends, however, are largely a function of management discretion, and in the near term they do not necessarily reflect the underlying driver of earnings. In the long run, however, any rate of dividend growth that differs significantly from earnings growth is unlikely to be sustainable. For this reason, it is generally accepted that the growth rate of earnings per share ("EPS") is the most reliable indicator of the "g" factor.
>
> The classic DCF calculation employs predictions of EPS growth, usually in the three to five year time horizon. Investment analysts routinely attempt to forecast the future earnings of traded companies. Value Line provides such forecasts based on the research of its own and other organizations' analysts. Another commonly cited source is the Institutional Brokers Estimation System, or I/B/E/S, now part of Thomson Financial's research program. I/B/E/S does not conduct independent research but surveys investment analysts for their predictions of

[2] Federal Power Commission et. al vs. Hope Natural Gas Company, 320 U.S. 592, at 601 (1944)

> future earnings growth. I have used the forecasts from these two sources for my development of the classic DCF return. (King Direct Testimony).

The results of Mr. King's classic DCF analysis is 9.9 percent.

Significantly, Mr. King could have arrived at a much lower ROE recommendation for AmerenUE if he relied on the company-specific DCF analysis of AmerenUE. That analysis resulted in an ROE of only 8.3 percent. Mr. King, without hyperbole, simply discards that result because it is principally due to Value Line's prediction that Ameren's earnings will increase only 1.5 percent on average over the coming five years. Rather than rely on the predictions of one source, Mr. King constructs his entire approach on the theory that the more data points from the more sources, the more robust the result will be.

Mr. King does not rely on the Capital Asset Pricing Model (CAPM) because, as the Interstate Commerce Commission has found, it is "conceptually and technically flawed." Like the company-specific DCF, including his CAPM results in Mr. King's final recommendation on ROE would have led to a significantly lower ROE recommendation. Mr. King does, however, rely on two variations of the DCF approach.

Because an arguable weakness in the "classic DCF" formulation is that it assumes that the rates of earnings growth predicted by investment analysts will continue indefinitely, Mr. King also performed a "two-step DCF" analysis. This type of analysis is relied upon by the Federal Energy Regulatory Commission. In this two-step DCF analysis:

> [t]he first step is the same analysts' forecasts used in the classic formulation. The second step is an estimate of long-term nominal rate of growth in Gross Domestic Product ("GDP"). This procedure acknowledges that disparities between the short-term rate of growth and the growth in the overall economy cannot last forever. Ultimately, earnings growth will trend toward the rate of increase in the total market.

The result of Mr. King's two step DCF analysis of AmerenUE's ROE is 9.4 percent. Because the two DCF analyses are by far the most reliable (and the most relied upon by state

commissions), Mr. King weights the results equally. The result of the classic DCF was 9.9 percent, and the result of the two-step DCF was 9.4 percent. The average, and the best estimate of the required ROE for AmerenUE, is 9.65 percent.

Public Counsel witness King also made an adjustment to eliminate the double-leveraging effect of the way AmerenUE reflects its capital structure. As Mr. King discusses in his direct testimony:

> [AmerenUE's proposed] capital structure reflects the implicit assumption that the equity component is the proportion of capital that is held by the shareholders of AmerenUE's parent, the Ameren Corporation. That is not the case. A small proportion – 5.2 percent -- of AmerenUE's "equity" takes the form of long-term debt at the parent company level. And an even smaller portion – 0.5 percent – takes the form of parent company short-term debt. The effect is to overstate the equity portion of AmerenUE's capital as it ultimately reaches Ameren Corporation's shareholders. To correct for this "double leverage" effect, I adjust AmerenUE's capital structure in columns D and E of Schedule CWK-1.

In rebuttal testimony, AmerenUE witnesses Nickloy and VanderWeide try to discredit Mr. King's double-leveraging adjustment. In his rebuttal testimony, AmerenUE witness Nickloy implies that it is necessary to track funds across Ameren Corporation's balance sheet to justify the double-leverage adjustment. In his surrebuttal Schedule CWK-SR-1, Mr. King demonstrates that the double-leverage adjustment is thus necessary to ensure that the actual equity investors in AmerenUE receive only the authorized rate of return on their investment. Mr. King also refutes AmerenUE witness VanderWeide's unfounded criticism of Mr. King's adjustment.

Other Citations to the Transcript:

UE witness VanderWeide believes that authorizing UE to earn a return within the zone of reasonableness would be considered "punitive." (Tr. 2874) Apparently, according to Dr. VanderWeide, having just recently granted the highest ROE in the country, the Commission is stuck at that level, and anything less will be seen as punitive. The Commission should not be

swayed by this reasoning. Missouri has long been known as the Show-Me State; Dr. VanderWeide would rather it be known as the ROE State.

MIEC witness Gorman offers a much more reasonable view on what could be considered a punitive ROE.

> [By Mr. Thompson] Q. One last question, if I might. With respect to your recommendation of 9.8, were you present last night when Dr. Van DerWeide testified?
> [By Mr. Gorman] A. Yes.
> Q. And do you recall that he stated that an award at that level would be punitive?
> A. I do.
> Q. Do you believe that an award of 9.8 would be punitive?
> A. I do not, and the reason I reached that conclusion is -- is recent evidence in Illinois. Illinois, the Ameren Illinois utilities were awarded a roughly 10.0 percent return on equity. That return on equity was disclosed to the analyst participating in their conference call Ameren senior executives held with security analysts around February 15th of this year. Not a single analyst in the transcript of that call stated any concern or voiced any -- any -- any concern about the viability of the company and the ability to maintain stock prices with a return on equity of 10 percent.
>
> I would also note that if 10 percent were punitive, Ameren would have filed for rehearing on that issue in Illinois, and it's my understanding that they did not after reviewing their rehearing petition. If this company has a fiduciary responsibility to their shareholders, one would reasonably expect that if they were awarded a punitive return on equity, they would seek to adjust it in the rate hearing. They did not.
>
> For those reasons, I believe the 10 percent is not punitive as evidenced from recent discussions Ameren has had with security analysts and actions of Ameren senior management itself.
>
> I would also note that a 10 percent is reasonably consistent with many rate filings around the country. 9.8 percent is somewhat below that 10 percent authorized return on equity, but a somewhat reduction to their last authorized return on equity reflecting the 2006 calendar year is consistent with the trend in declining authorized returns on equity. (Tr. 2934-2935)

Staff witness Hill also points out that his recommended 9.25 percent ROE would not be punitive. In fact, according to Standard and Poor's benchmarks, UE would stay at "a bond rating of between A and triple B, right where there are now." (Tr. 3038)

In cross examination, one of the UE attorneys seemed to suggest that he agreed with the Commission's approach in rejecting the testimony of those witnesses that fall outside of the zone of reasonableness:

> [By Mr. Cynkar] Q. Dr. Woolridge's is outside the zone of reasonableness, is it not?
> [By Mr. Gorman] A. Yeah, it's below the -- the low end, yes.
> Q. And Mr. Hill's is also outside the zone of reasonableness, is it not?
> ...
> Mr. Hill's recommendation is outside the zone of reasonableness, is it not?
> A. With that chart it is --
> Q. Okay.
> A. -- particularly on that chart.
> Q. Sir, I just need a yes or no question, very, very simple. **And so then, Dr. Woolridge's and Mr. Hill's testimony here should be rejected, correct?**
> A. As should Dr. Van DerWeide's and Ms. McShane's. (Tr. 2938-2939; emphasis added)

Because so many of the witnesses, by the Commission's standards, are unreasonable, it is reasonable for Commissioner Appling to focus on the 9.8 percent ROE offered by MIEC witness Gorman. (Tr. 2872, 2994) After all, Mr. Gorman's ROE number and Public Counsel witness King's are the only two within the zone. Mr. Gorman's recommended return on equity is the fourth highest out of six presented in the case (Tr. 2994). It is the highest of the non-UE witnesses (Tr. 2995) It is also the highest recommended ROE that falls within the zone of reasonableness. (Tr. 2995)

Staff witness Steve Hill had some instructive insights on the state that was formerly known as the one that granted the highest ROEs in the country, Wisconsin.

> [By Commissioner Clayton] Q. Wisconsin's been consistently above the 11.0 mark, hasn't it, for several years?
> [By Mr. Hill] A. They've been the highest, yes, sir.
> Q. They've been the highest in the country?
> A. Yes, sir, for many years but they've begun to change that. The Commissioners believed 20 years ago that **if they awarded high returns and got high bond ratings, they would be rewarded by lower rates. That has turned out to be not the case**, and so they're reassessing their position on that. (Tr. 3009; emphasis added)

Dr. VanderWeide agrees that only regulated companies have their earnings determined based on book value capital structures. (Tr. 2865) So does Staff witness Hill (Tr.3017). Mr. Hill goes further:

> [By Commissioner Gaw] Q. How do you -- how do you account for that 300-basis-point spread in your opinion?
> [By Mr. Hill] A. Well, I think it's pretty simple. There's 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 [Hope] gas decision. I think it's just simply wrong.
> ...
> [T]he differences between market value and market value capital structures or book value and book value capital structures are meaningful. But comparing market capital structure to a book value capital structure is not meaningful because financial risk is really -- it's not a balance sheet issue. It shows up in the balance sheet, but what generates financial risk is the income statement.
>
> Now, if you have -- say -- and I explained this in my testimony, but if you have a certain amount of debt that creates an interest expense, okay, that's a fixed cost, and to the extent that your revenue stream is variable, any fixed cost you have is gonna make your bottom line more variable than your revenue stream, okay?
>
> If you increase those fixed costs, if you add debt, then the variability of your bottom line increases. That is -- that's the definition of financial risk, okay? So we all agree that if you add debt, your financial risk goes up.
>
> Okay. Now, the problem with the company's position, one of the problems, is that there's not a financial risk difference when you measure the capital structure with -- with book value or with market value, because the amount of debt is the same in either case. Even though Ameren has a 52 percent common equity ratio on a book value basis and whatever it was, let's say 65 percent on a market value basis, the amount of debt in both cases and the amount of interest expense -- interest expense, excuse me, in both cases is exactly the same. There's not a financial risk difference there.
>
> Now, that -- there -- that adjustment is also wrong because it really tries to base rates on fair value, market value. And the Hope case says very clearly that that's improper. That's putting the cart before the horse. You can't start out with fair value and hope to come up with fair value. So what they're doing is really trying to, I think, reverse 50 years of regulatory history beginning with the Hope case which sort of put the kibosh on fair value regulation, said no, no, that's -- fair value's not correct, that's not the correct standard.
>
> But this tries to re institute that by looking at market value and trying to base rates on market value which is effectively fair value, and I think that's wrong.(Tr. 3017; 3033-3035)

Perhaps most significantly, UE chose not to inquire **at all** of Mr. King. (Tr. 2908)

METRO EAST

This issue relates to the question of whether AmerenUE has complied with conditions in "the Metro East case."[3] On February 10, 2005, the Commission issued its "Report and Order on Rehearing" in that case, which contained the following conditions:

> [P]re-closing liabilities that are directly assignable to UE's Illinois retail operations, or to the transferred assets, must transfer to CIPS as a condition of the Commission's approval of the transfer.[4]
>
> …
>
> [T]he Commission will exclude 6-percent of any such liabilities arising from pre-closing events and conditions from UE's rates as a condition of its approval of the transfer, unless AmerenUE, in a future rate case where it seeks to recover 6-percent of such liabilities, is able to prove that benefits directly flowing from the Metro East transfer are greater than 6-percent of these liabilities … [I]n addition to unknown environmental and other liabilities, this includes general corporate liabilities and pre-closing natural gas costs not directly assignable to UE's Illinois retail operations.[5]
>
> …
>
> As a condition of its approval of the transfer, the Commission will exclude from rates 6-percent of any costs incurred by UE in the Sauget remediation unless, as with the other liabilities discussed above, UE can meet its burden to establish that such costs are outweighed by transfer-related benefits.[6]
>
> …
>
> AmerenUE may seek recovery in a future rate proceeding (a rate increase or an excess earnings complaint) of up to 6% of the unknown generation-related liabilities associated with the generation that was formerly allocated to AmerenUE's Metro East service territory, if it proves by a preponderance of the evidence that the sum of the Missouri ratepayer benefits attributable to the transfer in the applicable test year is greater than the 6% of such unknown generation-related liabilities sought to be recovered.[7]
>
> …
>
> Union Electric Company, doing business as AmerenUE, as a condition of the approval herein contained, shall not recover in rates any portion of any increased costs due solely to transmission charges for the use of the transmission facilities

[3] Case No. EO-2004-0108
[4] Case No. EO-2004-0108, Report and Order on Rehearing, page 61.
[5] Case No. EO-2004-0108, Report and Order on Rehearing, page 62.
[6] Case No. EO-2004-0108, Report and Order on Rehearing, page 63.
[7] Case No. EO-2004-0108, Report and Order on Rehearing, Ordered paragraph number 7.

herein transferred to AmerenCIPS to the extent that the costs in question would not have been incurred had the facilities not been transferred.[8]

AmerenUE did not even address these conditions in its case-in-chief, even though it acknowledged that it is seeking to recover more than 94% of the unknown generation-related liabilities associated with the generation that was formerly allocated to AmerenUE's Metro East service territory (Response to Public Counsel DR Number 2018). AmerenUE also acknowledged that it is seeking to recover more than 94% of the test year costs incurred by UE that were related to the Sauget remediation (Response to Public Counsel DR Number 2022).

AmerenUE did belatedly put some testimony on this issue in the rebuttal testimony of Gary Weiss. Mr. Weiss' testimony fails to satisfy the Commission's condition in the Metro East case that AmerenUE prove that the benefits outweigh the costs.

> [By Mr. Kind] A Basically, I was involved in the -- in the Metro East transfer case. I was aware of the conditions that the Commission imposed on approval of that transaction. And I was aware that a lot of those conditions involved that if Ameren wanted to recover certain costs in a rate case, they needed to come and make an affirmative showing to this Commission that, in fact, the savings from the Metro East transfer exceeded the level of costs they were trying to recover. So my -- my initial start on this issue was through discovery, I said, since there was nothing in the company's direct testimony that addressed this issue, I thought, well, should I presume they're not trying to cover it -- recover any costs associated with the Metro East transfer where the conditions were imposed? And I thought, well, no, I'll do some discovery. And through discovery, I found out that there was about this $137,000 that they were trying to recover that they pursued to the conditions in the Metro East transfer they could not recover unless they made an affirmative showing to this Commission that the benefits of that transfer exceeded the -- the level of cost that they were trying to recover. Now, I interpret that as being the net benefits of the transfer when I refer to benefits. So I wrote direct testimony that basically stated they're trying to recover this category of costs and this category of costs, and they've got no direct testimony addressing the conditions in the Metro East transfer. And then -- then there was some response from that from one of UE's witnesses, Mr. Weiss. And I was not at all satisfied that his response met the purpose that the Commission had specified for recovery of these costs in the Metro East transfer order, so I pointed that out in my surrebuttal testimony.
> [By Commissioner Gaw] Q Okay. And the -- the categories that you're referring to are what?

[8] Case No. EO-2004-0108, Report and Order on Rehearing, Ordered paragraph number 8.

A Mostly has to do with -- I think they're categorized as environmental liability. And, basically, there's a couple named categories of cost. One of them is -- has already been mentioned here today. It's the asbestos costs, asbestos lawsuits, you know, from workers who formerly worked in -- in UE generating plants. And the idea --
Q Yes.
A -- the idea was that, well, UE formerly was responsible for just 94 percent of those costs prior to the transfer. Now there's another 6 percent --
Q Right.
A -- under savings in the transfer to justify that. There's another category of costs. I'm not sure if that's confidential or not off the top of my head.
MR. BYRNE: I don't know.
A And that's a smaller category. I mean, there's actually two other categories. But there's one other that's more than just a few dollars. But -- but the main one is the -- is asbestos. And, frankly, I -- one of the things I hoped to get out of this case was for the Commission to say, one -- you either say Ameren, you know, you haven't proved your case and hopefully to set up, you know -- put Ameren on notice that when they come in in a rate case next time, they better try and support this stuff in their direct testimony if they're including the cost of -- in their case that they want to recover from ratepayers.
Q (By Commissioner Gaw) So in this -- in this case, the issue is not a high dollar issue in comparison with some other issues, correct?
A That's correct.
Q So what you're trying to -- what Public Counsel is suggesting is to the Commission, you need to -- you need to make this -- this clear at this point in time because -- because -- do you believe it could become a more expensive issue down the road?
A I certainly do. I certainly do. (Tr. 3017)

EEInc

This issue concerns the ratemaking treatment to be afforded AmerenUE's actions leading up to, and in response to, the expiration of a long-standing power supply arrangement that it had with EEInc., the owner of a coal-fired generation station near Joppa, Illinois (the Joppa plant). Pursuant to that arrangement, AmerenUE had been receiving available power from the Joppa plant at cost for many years until the arrangement expired at the end of 2005. This arrangement was formalized in a long series of Power Supply Agreements (PSAs) through the years. The PSAs had always been renewed or extended for fifty years, until AmerenUE decided not to continue the arrangement when the last PSA was due to expire at the end of 2005.

Public Counsel witness Kind summarizes Public Counsel's recommendation on the ratemaking treatment for EEInc.:

> Any new rates that result from this case should reflect UE's entitlement to 40% of the output from the Joppa plant. Including 40% of the Joppa plant output as a resource available to serve UE's regulated Missouri retail load will lower UE's cost of service (revenue requirement) because the Joppa plant is one of the lowest cost plants in the U.S. The low production cost nature of the Joppa plant is illustrated in one of the workpapers for UE witness Warner Baxter's testimony which shows that the productions costs at Electric Energy, Inc. ($15.94/MWh) were well below the production costs at UE ($17.69/MWh) for the time period from 2002 through 2005. The first page of this 3 page workpaper is attached as Attachment 5. In addition to the low production costs of EEInc.'s generation facilities, the EEInc steam generation facilities are almost fully depreciated. Page 205 of the EEInc 2005 FERC Form 1 (see relevant excerpts from this report in Attachment 6) shows gross steam production plant of $370,618,403 and page 219 of the same report shows accumulated depreciation for this plant of $330,593,417.
>
> …
>
> UE's 40% share of the EEInc Joppa plant has been an important part of UE's generation portfolio for decades. UE's ownership interest in EEInc and the provision of power from the EEInc Joppa plant to UE's Missouri retail customers began about 50 years ago. (Kind Direct, pp. 22, 24).

For decades, AmerenUE's ratepayers have been paying their full share of the cost of service for the power they have been receiving from the Joppa plant. In addition to paying the full cost of service, AmerenUE's ratepayers have provided the following support to EEInc.:

- Full payment of UE's share of all capital costs, on a front-loaded basis over the life of the plant, through the point of nearly full amortization (even if the payments were levelized rather than front-loaded during the amortization period, now that the investment is almost fully amortized the effect is still "front-loaded" in that full payment was made before the plant's useful life has ended);
- Payment for pollution control and other modernization investments which extend the life of the plant and help maintain the plant's ability to generate low cost energy for many years to come (ratepayers should not be paying for life extensions and then not receiving the benefits thereof);
- Cost responsibility for surplus capacity whether or not UE's ratepayers needed that capacity; and
- Responsibility for certain financial obligations extended by UE to EEInc. See the Commission approval, issued on June 24, 1977 in Case No. EF-77-197, of a request by UE, for the approval of the financial responsibility necessary to permit EEInc to proceed with improvements to the Joppa plant. In this decision, the MPSC stated that UE was "assured of a continuous source of

> economical power" in return for the guaranty of EEInc's financial obligations. See the Application of Union Electric Company for authority to "guaranty" certain financial obligations of Electric Energy, Inc., 1977 Mo. PSC LEXIS 23, 21 Mo.P.S.C. (N.S.) 425, 427 (1977). (Kind direct, pp. 25-26).

AmerenUE could have continued to receive power at cost-based rates had it been willing to put the interests of its ratepayers ahead of the interests of the shareholders of its corporate parent Ameren Corporation. As the last PSA was about to expire at the end of 2005, there were three shareholders in EEInc: AmerenUE, its corporate parent Ameren Corporation, and Kentucky Utilities (KU). KU, wanting to continue providing the low-cost power from the Joppa plant to its customers, sought to continue the decades-old arrangement. Although KU owns only 20 percent of the stock in EEInc., it would have been successful of AmerenUE had taken the same interest in the welfare of its customers as KU did in its customers. But AmerenUE sided with its corporate parent rather than its fellow regulated utility in deciding how to follow up the expiring PSA. KU never had a chance with only 20 percent of the vote. Although it tried to continue the historical arrangement, it eventually had to throw in the towel. Had AmerenUE sided with KU, AmerenUE ratepayers as well as KU ratepayers would continue to receive power from the Joppa plant at cost.

The most telling single statement in the whole huge record in this case is Mr. Rainwater's casual admission concerning EEInc: "Well, I guess it's my decision as the CEO of Ameren to nominate someone to the EEInc board and then the board would accept the nomination. **Of course we control the board.**" (Rainwater Deposition, p. 90; emphasis added). Everybody knows that, but most of the UE witnesses bent over backwards talking about which "hat' they wear at EEInc board meetings. It is refreshing that Mr. Rainwater did not try to dissemble on such an obvious and important point.

Staff witness Schallenberg was equally frank in his discussion of control:

[By Commissioner Gaw] Q. Maybe you can check in a minute. I'm just curious about how UE was -- and SIPS were able to predict the votes that would be cast by EEI's board of directors four or five years after the date of these schedules being filed. I'm wondering if you could shed some light on that for me.
[By Mr. Schallenberg] A. I can tell you the president -- the president of AmerenUE is the president of Ameren at this point in time.
Q. So what does that have to do with anything?
A. Well, in essence, whatever the president decides, he can impose from UE.
Q. Now, Mr. Schallenberg, that is not the testimony that we've had by some of these witnesses prior to this. The testimony that I've been hearing is that the EEI board of directors is completely independent of that individual. What causes you to make that statement?
A. Well, under the bylaws, you have to be on the board, you come up for election every year.
Q. Okay.
A. So if I don't believe you are going to vote -- say, for example, hypothetically that I am that president and I want -- I want EEInc to do X. Then all I need to do is nominate and vote, and assuming I have a majority or can get a majority, that will be the board. And if you are not going to vote what way, then I'll nominate someone against you and vote my shares accordingly. I mean, that's not something sinister. That happens all the time.
Q. You mean that happens in the real word of corporate business?
A. Yes, it does.
...
Q. Now, if I understand Staff's position on this is that the decisions that were being made in the Ameren group, affiliates of Ameren, the holding company, does Staff believe that those decisions were being made as a part of some overall Ameren holding company plan in regard to the use of EEI's energy and capacity?
A. I know I do. I mean, I can't say that all of the Staff has gone through and specifically examinedthat question, but I can -- I can testify today that I do.
Q. Is that one of the basis from your standpoint of why Staff believes that it's appropriate to consider whether or not an extension or a continued use of EEI's energy was possible?
A. Yes. I mean, clearly it's possible since I know 20 percent of the owners were consistent with that desire as well, and there's only three --
Q. That 20 percent being whom?
A. Kentucky Utilities.
Q. Okay. Finish your answer, if you would.
A. And I know that because of the way the ownership evolves at the time of the contract expiration, whatever two owners want, they're going to have a majority. (Tr.2753-2755)

Mr. Schallenberg also pointed that UE – unlike KU – did nothing to see what kind of a deal it could get. In fact, UE began to replace the power from Joppa "way before the term terminated." (Tr. 2761).

It is also refeshing that Mr. Rainwater did not try to deny that, when he was on the EEInc board, he talked to other Ameren representatives about EEInc business outside of the quarterly board meetings. (Tr. 1879) UE witness Naslund acts like the EEInc board is a secret society and he is not allowed to talk to anyone about it other than at board meetings (Naslund Deposition, p. 41, 111, 114)

UE witness Baxter admitted that members of UE's management have the same sort of fiduciary duty:

> Q. And do you, as a member of Union Electric management, have that same sort of [fiduciary] duty?
> A. Well, as a member of Union Electric management, certainly. (Tr. 207-208)

Although Mr. Baxter tried to avoid answering, Commisioner Murray persisted and honed in on why that is important:

> Q. So really, with the statement that AmerenUE had a fiduciary duty to protect the shareholder interest of AmerenUE by not extending that cost base contract, that ability to protect the shareholder interest could only exist because the additional cost of fuel would be paid by the ratepayers and not the shareholders; is that right?
> A. Well, Commissioner, I guess the way I see it is that the EEInc board made that decision. That was a decision by the EEInc board and AmerenUE didn't make that decision. It was a decision by that board.
> Q. But -- okay. But AmerenUE -- you stated at some point, and I realize I'm going back to another issue, but it's -- it's -- to me it's somewhat interrelated here. I believe you stated yesterday that AmerenUE had a fiduciary duty to shareholders?
> A. It certainly does.
> Q. And in exercising that fiduciary duty you did not seek the continuation of the cost base purchases?
> A. I guess, Commissioner, it -- it -- it -- it was an EEInc board decision, and so AmerenUE didn't have a decision to make. EEInc did not extend the right to AmerenUE to -- to -- to extend that cost base contract. It was not an AmerenUE decision, it was a decision by the EEInc board. And so AmerenUE simply didn't have a cost base alternative in the first place.
> Q. Is it true that the revenue -- increased revenue from EEI sales would go only to shareholders and not to ratepayers? Is that a true statement?
> A. That -- it would -- that's correct, it would be a shareholder -- those would be shareholder returns. (Tr. 489-490).

But Mr. Baxter admitted that UE could have requested renewal of the contract:

> [By Commissioner Murray] Q. Okay. I understand that from the EI standpoint, but from AmerenUE's standpoint, did not AmerenUE have the opportunity to at least request the renewal of the contract?
> [By Mr. Baxter] A. Well, certainly I guess AmerenUE had that opportunity to request it…. (TR 256).

The EEInc bylaws bear out Mr. Baxter's understanding. The bylaws give UE "rights to its 40 percent of the output of the Joppa unit." (Tr. 2776)

Mr. Baxter admits that carbon legislation is likely.

> [By Commissoiner Gaw] Q. [D]o you follow the discussions of legislation in Congress regarding energy issues?
> [By Mr. Baxter] A. I certainly do.
> Q. Do you -- do you believe that the discussion regarding additional restrictions on carbon emissions is a factor that should be considered when you're evaluating whether or not certain plants continue to exist or new plants are being built?
> A. Absolutely.
> Q. And tell me how much carbon emission you have out of the Callaway nuclear facility.
> A. None.
> Q. So if we are looking at the potential for additional carbon restriction, would you say that that's a negative, a neutral or potential positive for the continuation of the Callaway facility?
> A. Commissioner, that's certainly a positive.
> …
> I think it is a likely scenario….
> …
> I think, Commissioner, based upon my understanding of discussions with key legislative personnel, I think it is a more likely than not assessment hat within the next three to five years you will have carbon legislation passed.(Tr. 265-266)

Mr. Baxter acknowledged that he did not see – and did not know of – any analysis of the impact on Ameren Corporation of the relative magnitude of the increased margins to EEI compared to the increased costs to UE. (Tr. 274-276; 278). Neiter did Mr Rainwater. (Tr. 1946) Mr. Baxter also acknowledged that Mr. Naslund would be the one who would know whether an analysis had been done:

> Q. Would you be surprised if Mr. Naslund … indicated that there hadn't been any real analysis done regarding the termination or not reupping the EE, Inc. contract on behalf of AmerenUE?
> A. I -- if that's what he said, I bet that is -- that is certainly a possibility.
> Q. And he'd be the one to know because he's the EE, Inc. board member?

A. Yes, certainly…. (Tr. 355-356).

UE witness Naslund admitted that it is impossible to know the exact value of the current EEInc arrangement, but that one can determine with certainty the value of a cost plus contract. (Tr. 2577-2578) Mr. Naslund also admitted that he did not have enough information and understanding of capacity markets to evaluate the trade-offs between EEInc's historical mode of operations and the new market-based sales. (Tr. 2592-2596)

UE witness Moehn also understands the significance of carbon legislation on the future operations of the Joppa plant:

> [By CommissionerMurray] Q Is it possible that the rates under the PSA could have been applied today or applied next year would ever be higher than market based rates?
> [By Mr. Moehn] A **Sure.** I mean, at this -- I suppose that, yeah, something could happen to -- to cause their cost structure to -- to be higher than market.
> For example, if you had carbon legislation, for example, that was a very stringent carbon legislation, that clearly could maybe take them out of the -- of the marketplace, although they are a low cost producer. (Tr. 2296; emphasis added)

Unlike the other UE witnesses who understand the important implications of the possiblitiy of carbon legislation, Mr. Naslund never even considered the possibility when he voted to change the way EEInc has done business for fifty years:

> [By Mr. Mills] Q. Now, when you were evaluating the power supply agreement that you eventually entered into, what likelihood did you assign to the possibility of a carbon tax being imposed in the next five years?
> [By Mr. Naslund] A. There was no assignment of carbon tax.
> Q. Okay. So the agreement you entered into is essentially based on the assumption that there will be no carbon taxes within the term of that agreement?
> A. Carbon tax was not a consideration in that agreement.
> Q. Was it a consideration in your consideration of the agreement?
> A. No, it was not.
> Q. Did the board discuss that possibility?
> A. No, it was not discussed.

Mr. Naslund never concerned himself with the possible consequences to EEInc from refusing to consider what the minority shareholder, Kentucky Utilities, wanted. Nor did he

concern himself with the possible impacts to EEInc from concerns of Missouri regulators. (Tr. 2645)

Perhaps most significantly, Mr. Naslund never considered that the market prices he was so drawn to bring with them considerable risk. As Staff witness Schallenberg points out:

> [By Mr. Schallenberg] A. ... I'm not sure how stable this market is that EEInc believes that it sold into with AEM.
> [By Commissioner Gaw] Q. Yes.
> A. And I don't know in terms of liabilities that you can get into. If we use the Aquila experience, they made a lot of money up front, lost a lot of money at the tail end, got a lot of penalties and fines for market behavior, lawsuits and things like that.
> So I don't know in that baseline going forward for 15 years that EEInc, you know, that that won't actually flipflop and end up being a drain on Ameren Corp's total earnings.(Tr. 2775)

The steps that the EEInc board should have taken, but didn't, as they looked forward towards the expiration of the power supply agreement at the end of 2005 are really pretty straightforward:

> [T]here's a couple steps in ... the way the EEInc board [should have] evaluated its choices between continuing to sell at cost-based rates versus making a sale at market-based rates. And if they had chosen to make a sale at market-based rates, of course, it would be important for them to make a decision whether selling to an AE -- an AEM, which was affiliated with the non-regulated activities of Ameren was the best way in order to maximize the value of their assets. So I see it as the steps that the EEInc board should have taken in order to carry out their fiduciary duties. Prior to that vote in September which I just identified, there should have been an analysis done to evaluate the tradeoffs between selling power under a long-run contract at cost-based rates versus selling it at market-based rates.
> And I think in order for them to have made that assessment, they could not make a credible assessment of the tradeoff between those alternatives without doing two things. One would be to issue an RFP for market-based sales. Not just assume it's going to go to the affiliate of the entity that owns 80 percent of the EEInc stock, they would have issued an RFP for market-based sales. And second, they would have -- they would have done some work to see whether it was possible to work out the affiliate transaction rules with the Missouri Public Service Commission. Without that knowledge, it's really not possible, I don't think, to assess the tradeoffs.
> Of course, part of the assessment then of those tradeoffs, once you -- if you had gotten to the point of evaluating how do we maximize the value of this sale under market-based rates through issuing an RFP, and what are our options if we were to make a cost-based sale and it would be subject to the Missouri affiliate rule?

> Then, of course, there's the additional analysis that needs to be done on what are the -- what are the future trends in market prices that we expect over like a 15-year period if that's the period over which you want to sell it, and take into account the risk tradeoffs between having a cost-based sale, which would give you a certain essentially close to guaranteed return over that period of time, versus selling into the market where the return might be great for the first year or two, but could be very poor in some of the later years. And I -- I've seen no evidence that any such evaluation was ever done by the EEInc directors. (Tr. 2800)

And Staff witness Schallenberg testified unequivocally that UE never discussed the possibility of getting a waiver with Staff. (Tr. 2780)

Mr. Naslund does agree that a regulated utility, if it has varying resources avalable, has an obligation to source the lower cost generation.(Tr. 2627)

There are several intriguing features of the EEInc arrangements that seem off-kilter, but apparently never raised any flags at UE. One is the fact that, despite owning twice as big a share as KU, UE has the same number of board members as KU. Another is the fact that UE is represented on the EEInc board by two people: a UE employee and a non-UE employee. As if that is not odd enough, it is made even more off-kilter because it is the non-UE employee who votes UE's shares. (Tr. 2655)

Mr. Naslund made it very clear that his understanding of his fiduciary duty as an EEInc board member was largely guided by Alan Kelley, Chairman of the EEInc board and president of AEM. (Tr. 2581-2582) Somehow Mr. Naslund has missed the irony in the fact that that AEM profits (Tr. 2773) from the arrangement that Mr. Naslund's sense of fiduciary duty drove him to. Mr. Naslund's sense of what he should do was so strong that he never considered any alternatives, nor did he consider any of the possible drawbacks.

Furthermore, he testified that the board never evaluated the services or price from AEM, much less considered any alternatives:

> [By Commissioner Gaw] Q. ... The question is whether or not the deal with AEM was a good one and what you did to evaluate how good a deal that was for EEI..

You've already testified that that is your belief of what you were supposed to be doing at that point. What evaluation was made about how good of a deal you got from AEM?
[By Mr. Naslund]A. My evaluation as the director was purely based on profitability of the company, not what portion was going to AEM.
...
Q. When you're selling -- and you're telling me that it is not a concern of the board members as to whether or not -- as to the amount or the percentage of money that was going to AEM in this transaction? That was not a board level concern?
A. That is correct.
Q. And you did not evaluate at the board whether or not there might be some other entity that could provide this service, No. 1, better, correct?
A. Are you talking the marketing service?
Q. Yes. You didn't evaluate that?
A. No. We relied on the officers of our company to make that recommendation.
Q. I'm asking whether you evaluated it, and the answer to that is no?
A. Is no.
Q. You didn't evaluate whether or not the price that you were receiving from AEM for its services was better than others that you might have been able to receive from other entities, correct?
A. No. I'm not sure I would agree with that. The price -- the price in the contract that we received at EEI is the Cinergy hub price.
Q. I'm not talking about the price.
A. Since it -- since it was in that --
Q. I'm not talking about the overall price. I'm talking about the price being charged by AEM formarketing this energy.
A. No. That piece, no. (Tr. 2602-2604)[9]

Mr. Naslund was also totally unaware of the conflict by AEM representatives in presenting themselves as the only power marketer on behalf of EEInc:

[By Commissioner Gaw] Q. So at least two of the principals on the team in charge of drafting this agreement work for or, in one case, was an officer of the entity in which the PSA was entered into with? Well, that's bad English, but they represented -- they were working for EEI, I got that right, on this team, correct?
[By Mr. Naslund] A. Yes, they were.
Q. And they were also working for the other side of the fence, the company with whom the agreement would eventually be signed?
A. That's correct.
Q. Anybody ever think about that maybe being a little bit of a conflict? Did you ever think about that maybe being a little bit of a conflict of interest as a board member of EEI?

[9]Although this section of the transcript was marked as Highly Confidential, as Commissioner Gaw noted (Tr. 2608), there was much discussion that was not confidential. The cited portion is not.

A. I did not. (Tr. 2608)[10]

While UE is adamant that the EEInc board members' fiduciary duties required them to act precisely as they did, the fact is they never considered any alternatives that might have benefitted EEInc and UE. (Tr. 2692)

Shareholder Vote:

What is especially interesting about the question of whether a shareholder vote is required in order for EEInc to change from supplying power to its sponsors at cost-based rates to selling into the market is that it makes the whole "fidicuary duty" issue a huge red herring. If the shareholders are given the right to vote on a change in allocation precentages or a change in business purpose, then what the board members did or thought they were required to do is totally irrelevant.

Article 2 of the EEInc bylaws (Exhibit 2 to the Svanda deposition, which is Exhibit) deals with shareholder votes. It provides that all major corporate actions shall be decided by the vote of holders of 75 percent of the outstanding stock. It defines major transactions as including decisions to allocate the sale of the generating capacity of EEI among the EEI stockholders in a manner other than in accordance with their percentage of the ownership of EEI stock. (Tr. 2778). Major corporate actions also include a material change in the business purpose or objectives of EEInc. Staff witness Schallenberg testified that changing from the way that EEInc has operated over the last 50 years to selling at market rates is a change in business purposes triggering the need for a shareholder vote.

[10]Although this section of the transcript was marked as Highly Confidential, as Commissioner Gaw noted (Tr. 2608), there was much discussion that was not confidential. The cited portion is not.

Of course, there never was a shareholder vote. (Tr. 2779, 2804) Even at the very end of the hearing, when UE had perhaps been worried about the shareholder issue and had had several days to look into it, UE admitted "I know of no such vote by the shareholders." (Tr. 4393)

OFF-SYSTEM SALES

AmerenUE's revenue requirement should include a baseline amount of off-system sales margins at a level that reflects the best estimate of the ongoing level of off-system sales margins. The testimony at the evidentiary hearing made it clear that the best estimate is UE's own estimate used in its budget process. UE witness Baxter testified:

> A. I want them to reflect in the budget what they believe is their -- their expectations of what they may be able to make. However, a budget is -- reflects several assumptions, and so it's important for us to understand the various assumptions upon which that budget is reflected.
> However, the budget isn't established to say this is going to be true, period. We understand as we prepare the budget there are sensitivities and variabilities that could occur during the course of a year.
> Q. Should the budget assumptions be reasonable?
> A. Yes, in some respects they should be reasonable, but also in some respects budgets could be coined as aggressive and some as not aggressive. It just depends. (Tr. 156-157)

This description ties in neatly with Mr. Rainwater's description:

> [By Mr. Mills] [I]s that the way it's set up every year, that there is a threshold and then a target for management?
> [By Mr. Rainwater]A. Yes, it is.
> Q. Is there another level up above that?
> A. Yes. There's a maximum as well.
> ...
> Q. Okay. And that third level, the maximum, would that be considered a stretch goal?
> A. Yes, it would. (Tr. 2145)

Mr. Rainwater had further discussion on the three budget levels with Charman Davis:

> The way that I've tried to describe the program is that there are three levels: Threshold, target and maximum. The target really is the budget. That's the

> primary target that the company is aiming at. That's what we consider a good level of performance. (Tr. 2148)

So as not to reveal Highly Confidential infrormation in this brief, Public Counsel will simply refer the Commission to Exhibit 421HC and ask the Commission to set the off-system sales margin level at the middle number shown in the Margins section of page 38 – not the top "stretch goal" and not the bottom "threshold number." That's the target; that's the number management is expected to achieve. That's the number that should be used for ratemaking.

State witness Brosch explained why the use of a budget number is appropriate for calcultaing the amount of off-system sales revenues to be included in setting rates:

> [T]he simulation of energy costs and off-system sales is a modeling exercise that's based upon a number of input values, one of which is the anticipated representative ongoing price for off-system sales, and that's not a known historical point in time fact, but instead is reasoned estimate of what that representative value is going forward. And for that reason, in this area of off-system sales I was looking for an updated representative value to recommend to the Commission, and that's why I used a budget value here. (Tr. 2700-2701)

A deferred accounting tracker mechanism should be used to accumulate variations from the baseline level between rate cases. The accumulated deferral amount should be reflected in the revenue requirement in AmerenUE's next rate case. In addition, the tracker must account for the Taum Sauk plant. Given AmerenUE's stated intention that its shareholders rather than its ratepayers should bear the costs of the Taum Sauk disaster, "it will be necessary to impute the revenues from margins on the additional sales of capacity and energy that would be possible if the Taum Sauk Plant was still operating." (Kind Rebuttal)

A tracking mechanism is necessary because of recent changes in the AmerenUE system and the environment in which it operates that have greatly increased the difficulty in estimating the expected future level of off-system sales margins. Public Counsel witness Ryan Kind lists many of these changes in his direct testimony:

Recent generation resource changes include the following:

> • The addition of thousands of megawatts (MWs) of gas-fired peaking capacity to UE's generation portfolio over the last few years.
> • The announcement made by the Ameren Corporation (Ameren HoldCo) that it will terminate the Joint Dispatch Agreement (JDA) between UE and AEG at the end of this year.
> • The dispute over whether UE will continue to use its 40% share of the output from the 1,000 MW EEInc. Joppa plant to serve its native load customers.
> • The extra 6% share of UE's generation resources that are now available to serve UE customers in Missouri as a result of UE transferring the Illinois portion of its service territory to AmerenCIPS in the Metro East transfer case.
>
> …
>
> Recent changes in the load that UE serves include the following:
> • Removal of the load associated with UE's former Illinois service territory as a result of the Metro East transfer.
> • The addition of several hundred MWs of retail load as a result of adding Noranda as a retail customer.
> • Ameren HoldCo's announcement that it will terminate the Joint Dispatch Agreement at the end of this year.
>
> …
>
> Recent regional wholesale electric market changes include the following:
> • The evolution of energy markets at the Midwest ISO (MISO) that has already occurred and further developments, including an ancillary services market, that are likely in the near future.
> • Further opening of the Illinois retail market with the newly developed Illinois Auction process which offers new off-system sales opportunities for UE.
> • Changes in regional electric market wholesale prices and margins related to changes in the fuel costs for gas-fired generation.

These changes are cumulative in nature; that is, rather than canceling each other out, they add to each other. Each increases the uncertainty in predicting the future and decreases the reliability of the past as an indicator of the future. Because of these uncertainties and because of the importance of the other issues in this case, it will be very difficult for the Commission to set a level of margins in base rates that is likely to accurate reflect actual future levels. A tracking mechanism will ensure that both ratepayers and shareholders will be treated fairly if actual results differ substantially from the projections made by production cost models.

Although Public Counsel generally opposes a FAC for AmerenUE in this case, if the Commission determines that UE should be permitted to have a fuel adjustment mechanism, the

fuel adjustment mechanism should include off-system sales margins that vary from the baseline level included in base rates.

Off-system sales margins as included in the revenue requirement calculation should include capacity sales. Regulatory capacity is defined by UE witness Schukar as

> Regulatory capacity in the way that it is marketed is capacity that is available to supply to the marketplace. There's no energy specifically associated with it, nor is there a price associated with the energy. And in most cases when you're in the Midwest ISO it must be deliverable within the Midwest ISO. (Tr 1247)

Because there is no energy associated with regulatory capacity, the revenues equal the margins. (Tr. 1253) Even thought capacity sales have already been made (Tr. 1582), no revenue offsets have been included in this case by any of the parties for capacity sales as offsetting the revenue requirement for the company. (Tr. 1583) These offsets should be made (Tr. 1583)

Staff witness Proctor supported the concept of using UE's budget numbres for off-system sales margins for inclusion in the ratemaking process:

> [By. Mr. Mills] Q ... [I]n general does UE have better access to its data than you do?
> [By Dr. Proctor] A. Yes.
> Q. Okay. Does it have more control over how it operates its system than you do?
> A. Yes.
> Q. Does it have more control over how it markets its power than you do?
> A. Yes.
> Q. So wouldn't its budgeted off-system sales numbers deserve some real consideration?
> A. Well, I -- that was what I was concerned about when I saw what their budgeted numbers were for 2007 is what's -- to me, this is -- this was an indication of where they thought their profits and sales were going. So do they have a better idea than I do of where they're going? The answer is yes. I think it's an important consideration. (Tr. 1584)

FUEL ADJUSTMENT CLAUSE

This is a case of first impression for this Commission. There's not been fuel adjustment clauses in Missouri for about 30 years. Senate Bill 179 was enacted just a few years ago to permit the

Commission to allow fuel adjustment clauses for electric utilities. It does not require the Commission to allow fuel adjustment clauses for electric utilities. There was enough discussion in the legislature among interested parties, including AmerenUE, including Public Counsel, including the Commission, including just about everybody who's interested that it would be beyond belief to think that the legislature didn't know what they were doing when they made it permissive rather than mandatory. AmerenUE doesn't really dispute that. However, they don't offer the Commission any guidance on how the Commission should decide whether or not a utility should get an FAC. In fact, I don't believe from AmerenUE's point of view that there are any reasons that would allow the Commission to reject a fuel adjustment clause. Certainly AmerenUE -- if there are any utilities in Missouri which should not get a fuel adjustment clause, AmerenUE would have to be at the top of the list. Its fuel prices are less volatile than any other utility, its ability to sell in the off-system sales market is probably just about as strong as any other utility, its financial situation is stronger than any other utility. All of these factors mitigate against awarding AmerenUE a fuel adjustment clause.

The Commission was given the discretion and should exercise that and decide whether each utility should have a fuel adjustment clause. Some of the factors to evaluate whether a utility should be awarded a fuel adjustment clause are listed in the testimony of Public Counsel witness Ryan Kind. One of those is, does the utility have a need for an FAC because it would face a substantial threat to its financial viability if it did not have the ability to recover costs of fuel through a fuel adjustment clause. Certainly AmerenUE does not meet that criteria. It has operated at a very satisfactory profit over much of the last few decades. Even the one year that AmerenUE witness Baxter talked about last year as disappointing was -- was a 9 percent return roughly, and that was a year in which there was a number of negative impacts: Two massive storms, the impact of the Taum Sauk disaster the December of the year before. For a company to

be able to earn 9 percent in the face of those kinds of challenges indicates to me a pretty strong company without a fuel adjustment clause. I think adding a fuel adjustment clause would simply be gravy. Another one of the big factors that the Commission should consider when deciding whether to award an FAC is the degree to which the utility is subject to volatility in the fuel and purchased power market. AmerenUE, with its reliance on hydropower, hopefully in the relatively near future, pumped hydro, coal and nuclear, has much less exposure to the most volatile fuel costs, which are those of natural gas, than utility -- than the other utilities in Missouri. Its fuel costs, although they may be rising slowly because of increases in coal prices, are not nearly as volatile as other utilities. In fact, they are hardly volatile at all.

And another factor that the Commission should consider in deciding whether to award a fuel adjustment clause is whether the utility has the ability and has, in fact, shown -- shown that it can and will take steps to hedge its exposure to fuel costs volatility. Again, UE has done both of those things. It has the ability to hedge its fuel costs, it has done so effectively in the past. There's no reason to think that it can't do so effectively in the future. Because it faces less volatility because it has the ability to hedge against what little volatility it does face, the use of a fuel adjustment clause for UE is simply not necessary. UE witness Lyons admitted that one of the only areas in which it faces exposure is a diesel fuel surcharge on the cost of coal transportation, and even that exposure can be hedged with heating oil contracts. (Tr. 610) Furthermore, the costs of that hedging program are going to be built into rates in this case. (Tr. 680)

When UE is itself a consumer faced with a fuel adjustment clause imposed by rail carriers, it "manage[s] with it," but certainly does not sound happy about it. From UE's perspective, it creates "added costs and there's volatility." Mr Baxter refused to answer whether it was a "consumer-friendly rider." (Tr. 468).

One of UE's principal arguments about why it should get a fuel adjustment clause is that costs related to fuel are largely outside of its control, yet Mr. Baxter admitted that UE negotiates with coal producers, it negotiates prices for nuclear fuel, and it negotiates rail transfer prices. (Tr. 530-531). If it can negotiate, it can influence prices. And Ameren uses a lot of coal, so its ability to negotiate is strong. UE witness Lyons admits that it can take actions to affect the prices it pays for commodities, and that it could take those actions whether or not it has a fuel adjustment clause.(Tr. 662) However, he acknowledged that the incentives are different depending on whether a FAC is in place.(Tr. 663)

UE argues that it needs a fuel adjustment clause because its fuel costs are volatile. However, its definition of volatile doesn't match the dictionary definition of volatile. UE witness Lyons agreed that "regardless of whether or not the **changes are predictable and regular**, if there are changes, you consider that to be volatile?" (Tr. 758; emphasis added) Webster's New Universal Unabridged Dictionary (Deluxe Second Edition 1979) defines volatile as "changeable; fickle; transient."

UE argues that the annual prudence reviews will provide adequate consumer protections. But UE did not make any serious attempt to figure out the amount of Staff resources and time it will take to do an adequate prudence review. (Tr. 624-634) UE witness Lyons, the chief witness on the FAC, wasn't even aware that gas ACA audits – much simpler than a FAC audit for an electric utility – can take years to complete. (Tr. 628) And UE witness Mayo, testifying at the staggering rate of $525/hour, was almost comical with his hurriedly-constructed back of the envelope calculations and his after-hours conversations with the mysterious "Will." (Tr. 864-869)

UE argues that a FAC is very important because it will lower UE's cost of borrowing.. Yet Mr. Lyons, UE chief FAC witness in this case, and one of its principle negotiators in the

FAC Rule Roundtables, has never even calculated the impact of a FAC on UE's cost of debt. (Tr. 646).

Even though another one of UE's arguments is that it will have to file more frequent rate cases if it is not awarded a FAC, it has no concrete plans to file another rate case, regardless of whether it gets a FAC in this case. (Tr. 649)

UE admits that spot prices for Powder River Basin coal have been dropping since early 2006 (Tr. 617) And despite this, UE premises its request on the outrageous prediction that coal and transportation costs will be **25-50 percent higher in just five years.** (Tr. 654-655)

Senate Bill 179, the Commission's FAC rules, and case law all support Public Counsel's position that the Commission has discretion to approve, disapprove, or modify a utility's FAC proposal. UE admits that Senate Bill 179 is permissive, and the legislature could have made it mandatory. (Tr. 597).

In exercising that discretion, the Commission should consider at least the following factors:

- Will the rates resulting from the exercise of its discretion to approve, modify or reject applications to establish a FAC be "just and reasonable"?
- Does AmerenUE have a need for a FAC because it would face a substantial threat to its financial viability if it did not have the ability to recover any increased costs of fuel and purchased power in between rate cases without a FAC?
- Would permitting AmerenUE to use a FAC be consistent with the Commission's rules for FACs?
- Is AmerenUE's power supply cost structure vulnerable to changes in fuel and purchased power costs and if so, is this vulnerability due to factors beyond its control?
- Has AmerenUE taken prudent action to hedge its vulnerability to increases in fuel and purchased power costs through (1) appropriate planning and acquisition of supply and demand-side resources and (2) appropriate hedging of generation fuel costs?
- Are AmerenUE's fossil fuel prices and wholesale markets expected to have substantial volatility over the next few years ?

Upon consideration of all relevant factors, the Commission should determine that approving a FAC for AmerenUE will not be in the public interest.

Public Counsel has offered a thoughtful and thorough review of the policy considerations the Commission should evaluate in deciding whether to allow a utility a FAC. AmerenUE's position is that the Commission has no discretion to disapprove an application for a FAC, so long as the application follows the Commission's rule. The Commission's rule was not designed to be comprehensive. Nor was it designed to be a checklist such that, if all the boxes are checked, a proposed FAC is necessarily in the public interest. Nonetheless, that is AmerenUE's position in this case. The Commission should reject that position, and reject AmerenUE's proposed FAC.

Without in any way wavering from Public Counsel' position in opposition to granting UE a FAC in this proceeding, Public Counsel witness Kind explained a number of necessary corrections to UE's most recent FAC proposal (Exhibit 104):

> [By. Mr. Kind] A ...I and the Office of Public Counsel that I represent are still opposed to having a fuel adjustment clause result from this case.
> [By Mr. Mills]Q. Can you go through and describe the particular items that you believe should be clarified on Exhibit 104?
> A. Yes, I can. Be glad to. The first change that I want to discuss is on Tariff Sheet 98.3, and it has to do with the definition at the top of that page, which carries over from the preceding page, which is Item A, Sub I, and it's -- that item talks about various categories of costs associated with fossil fuel or hydro plants. And the change on 98.3 is where in the fifth line down, starts with the word, transportation, says, transportation, fuel hedging costs. Wanted to just drop the word fuel so that we would just be dealing with hedging costs, the idea being that there is hedging going on that the companies involved with with respect to sales of energy, possibly sales of capacity as well, that aren't related to purchases of fuel.
>
> So I deleted the world fuel there, and that would include then costs associated with other hedging activities. And then I think we need also another item to reflect potential revenues associated with all hedging activities, not just in the fuel area. Again, and the way that I'm going to suggest including that is by changing the definition towards the bottom of that page for what's abbreviated as OSSR, off-system sales revenues, and I would like to then include in that category -- just basically include revenues associated with hedging.
>
> So I have another change as well to that category, and again, it's just for clarification purposes, to hopefully avoid any future disagreements amongst the parties and make -- if there is any disagreement, we can find out about it here today rather than later. So I wanted to suggest, then, changing that definition OSSR so that it would read -- and I'll just read it as it's changed. Mostly I'm just tacking some things on to the end of what's already there.

And so it would read, off-system sales revenues from the jurisdictional portion of off-system sales, and then after the word sales insert of energy and/or capacity. After capacity begin parentheses and state, including, but not limited to, sales of regulatory capacity, close parentheses. After the close parentheses, that's where I would tack on, and hedging revenues, and then the end of what's already there is just there would be another comma after hedging revenues, and then the words, if applicable. I'm actually unsure of why the company put the words if applicable there, because I think their proposal is just that off-system sales would be included. Maybe that's something they could clarify. It seems to me that the only possible purpose for the words if applicable being there would be if for some reason the company thought there might be a time period during the existence of the FAC when there are no off-system sales revenues occurring, but I can't foresee that happening myself.

So anyway, maybe I'll just read that through one more time to make it clear what I'm proposing. Off-system sales revenues from the jurisdictional portion of off-system sales of energy and/or capacity, begin parentheses, including but not limited to sales of regulatory capacity, end parentheses, and hedging revenues, and then the two words, if applicable.

Q. in your understanding of what if applicable is, would it be clearer to say, if any?

A. Yes, I think that would be much better language to use there.

Q. Would you like to propose that change?

A. Yes, I would very much like to propose that change. So propose ending that with if any, as opposed to if applicable. That seems to be probably more consistent the intent of the company's proposal in this case.

After that, there's just one other thing that I really just was sort of confused about here and I guess I'm going to suggest a change, and we can see what the company's response to that is, which is on the next page 98.4, Sheet No. 98.4, where there's the table there that has the various -- on the right side of the table there's the list of percentages coming from Column A, and you get to the very bottom of that, the last line in Column B, which is across from the greater than 135 million below NBFC dollars states 100 percent of Column A.

I'm thinking the intent there was to be -- I'm sorry. It says 100 -- there is no percentage. It says 100 in Column A, and I think it should be zero percent is what the -- seems like that would be consistent with the company's proposal.

Q. Because it was the company's proposal that if there were -- if it was greater than 135 million below, that they would not share any of it?

A. Correct. (Tr. 1660-1664)

The Commission should be considerable sobered by Dr. Mayo's cautious assessment that it is "risky to make changes to regulatory regimes that have been working fairly well." (Tr. 859) The regulatory regime under which UE has been operating has indeed been working well. UE's ratepayers have had the benefit of relatively low and stable rates, and UE has had the benefit of

relatively high and stable returns. It would be a bold and perhaps foolhardy step to change that regime.

SO2 ALLOWANCES/SO2 PREMIUMS/2006 STORM COSTS

The Commission should include a normalized level of revenues from SO2 allowance sales in the revenue requirement. Public Counsel recommends that the Commission use $23,993,951 as the normalized level of SO2 allowance sales in this case (Kind Surrebuttal, Attachment 1). This amount was derived by calculating a five-year average of the amount of annual net revenues that AmerenUE has received from emission allowance sales over the five-year period ending December 31, 2006. While UE argues that things might change in the future, it admits there is only a possibility that some development in the future might make it possible that UE will sell fewer allowances. (Tr. 3446)

If the Commission decides to reflect a level of SO2 allowance sales revenues in rates – which Public Counsel strongly recommends – that level should reflect a reduction of $634,000 for the premium paid to Dynegy for exercising its option early. (Tr. 3268-3269; 3453) Just a few years ago, UE witness Moore testified in the Metro East case that UE planned to sell $30 million of allowances in each of the years 2004, 2005, and 2006. (Exhibit 446; Tr. 3483)

As with any revenue stream or expense that shows considerable volatility, the Commission should not rely on test year levels (or any short period of time) to establish rates that will be charged in the future. The best way to approximate going-forward revenue levels is to normalize past revenues from a representative past period. For AmerenUE's SO2 allowance sales, an appropriate representative period is five years. In order to get the most recent data, which will be most representative of going-forward levels, the Commission should look at a five

year average of the five years ending December 31, 2006. As Public Counsel witness Kind noted in his surrebuttal testimony:

> The level of allowance sales that UE made in each of the five calendar years over the five year period varies considerably from the test year sales level ($3.9 million) so there was an obvious need to normalize the level of allowance sales to make the amount in the test year more representative of the level of sales that has occurred preceding the test year, and in the test year update period.

The actual test year level of less than $4 million is not even 20 percent of the five year average. The test year level is clearly not representative of the level that can be expected in the future when rates set in this case are in effect.

Although UE is insistent that "there are no emission allowance sales currently budgeted" (Tr. 3516), it is currently selling allowances, and already has sold some in 2007. (Tr. 3483)

One of the most troubling aspects of the whole SO2 allowance sales issue is UE's propensity to use the allowances – which are created through the operation of ratepayer-funded coal plants -- as a sort of line of credit to be tapped whenever the company's earnings-per-share numbers drop. (Tr. 3430) Even though the huge sale of allowances in the fourth quarter of 2006 was crucial in terms of getting UE management incentive compensation (Tr. 1893), UE does not want to use it in calculating the amount of revenue to include for setting rates. That is just fundamentally unfair.

DEPRECIATION

General:

On page 6 of his Direct Testimony (Exhibit 69-Direct Testimony of William Stout), Mr. Stout presented the definition of "Depreciation" he used, which he claimed was the Federal Energy Regulatory Commission (FERC) definition. However it is not the FERC definition. Mr. Stout's definition changed a key phrase that in the FERC definition is "from causes which are

known to be in current operation" to a much different phrase "from causes which can be reasonably anticipated or contemplated." (Exhibits 452 and 453; Tr. 3677-3680)

In contrast, the OPC witnesses and the Staff witnesses addressed depreciation consistent with the FERC definition of depreciation.

Fossil and Hydro Life Span Issue:

Public Counsel has not made a specific overall recommendation on this issue. However the OPC has addressed some of the sub issues.

To understand the difference in the Staff and Company position, let us consider the Osage hydro plant, which includes Bagnell Dam, which is the dam that creates the Lake of the Ozarks. The Staff position effectively is that they do not foresee the dam being retired in the foreseeable future, although they do allow for interim retirements, upgrades, etc. (Exhibit 402, Dunkel Surrebuttal p. 8) On the other hand, AmerenUE assumes Bagnell Dam/Osage will be fully retired in the year 2046. (Exhibit 73, Wiedmayer Rebuttal, Schedule JFW-E2-2) The Staff position clearly reflects the most likely scenario.

On page 14 of his Direct Testimony (Exhibit 69-Direct Testimony of William Stout), Mr. Stout points out that AmerenUE has retired the Mound, Cahokia, and Venice I production plants. However these plants were built in the early decades of the electric utility industry, in the early part of the 1900's, before the modern efficient plant designs were fully developed.[11] The plants built in the early decades of the electric industry were very fuel inefficient, as indicated by high "heat rates." According to the U.S. Department of Energy, the average U.S. utility industry heat rates were as follows: 20,700 in year 1932, 18,600 in year 1941, 11,699 in year 1955, 10,760 in

[11] The Cahokia plant was built in 1928, and the first Venice unit was built in 1942, (page 11, Dunkel Direct Testimony (Exhibit 400-Direct Testimony of William Dunkel)).

year 1960, 10,494 in 1970 and 10,241 in year 2005.[12] One of the steam production plants that AmerenUE now has was built in the late 1950s, one in the 1960s, and two in the 1970s[13], and therefore they are almost as fuel efficient as a new steam production plant would be, as shown by this data. In addition, "betterments and replacements" occur "almost every year of a power plant's life span in varying degrees of magnitude."[14]

On pages 4 to 6 of the Rebuttal Testimony of Mr. Stout (Exhibit 70-Rebuttal Testimony of William Stout), he claims that the depreciation expense of a production plant would increase drastically in its last 5 year of life, if the production plant depreciation treatment that has been adopted by the Commission in the past and is proposed by the Staff in this case were adopted. However, AmerenUE retire the Venice I plant in 2002, and the depreciation rates did not go up in the last few years of that plant's life. In fact the overall depreciation expense went down $20 million per year in the last few years of Venice I's life.[15]

Callaway Relicensing:

The most revealing response on this issue cam from UE Chief Nuclear Officer, Chuck Naslund. When asked point-blank by Commissioner Appling: "You-all are gonna extend this thing?" Mr. Naslund replied: "That certainly would be our plan, Commissioner." The ultra-fine distinction that UE tries to draw is that although it "plans" to extend Callaway's license, it hasn't yet "decided" to.

The Commission should find that it is more likely than not that Callaway will be relicensed for an additional 20 year term. Depreciation rates are, by definition, set based on

[12] Page 11, Dunkel Direct Testimony (Exhibit 400-Direct Testimony of William Dunkel).
[13] Can be determined from page 2, line 13-14, of the Rebuttal of Birk (##Lewis-we do not have this exhibit number##).
[14] Stout Direct Testimony, page 11, lines 7-12 (Exhibit 69-Direct Testimony of William Stout).
[15] Schedule WWD-21-1, attached to the Dunkel Surrebuttal Testimony (Exhibit 402-Surrebuttal Testimony of William Dunkel).

estimates of future events. The Commission should use the best estimate available to set depreciation rates for Callaway. If the Commission finds, based on the evidence in this case, that it is more likely than not that Callaway will be relicensed, then the Commission should set rates based on a 2024 retirement. On the other hand, if it finds that it is more likely that Callaway will be relicensed, it should set rates based on a 2044 retirement date.

A series of questions from Commissioner Gaw to Warner Baxter points out that the future is not really in question – especially since UE has not given any thought to replacing its output:

[By Commissioner Gaw] Q. And your testimony is that the future of the Callaway plant is very much in question today; is that your testimony?

> [By Mr. Baxter] A. No, no, Commissioner.
> …
> Q. And again, when does that [current Callaway] license expire?
> A. 2024, I believe.
> Q. All right. And so you have currently some plans for some other replacement for that – for that facility?
> A. No, not at this time, Commissioner.
> Q. Is there any -- any contemplation of moving toward some different reactor or generating unit to replace Callaway subsequent to 2024?
> A. No, not at this time, Commissioner.

Mr. Baxter admits that carbon legislation is likely and that it would favor extending Callaway's license if it were to come about:

> Q. [D]o you follow the discussions of legislation in Congress regarding energy issues?
> A. I certainly do.
> Q. Do you -- do you believe that the discussion regarding additional restrictions on carbon emissions is a factor that should be considered when you're evaluating whether or not certain plants continue to exist or new plants are being built?
> A. Absolutely.
> Q. And tell me how much carbon emission you have out of the Callaway nuclear facility.
> A. None.
> Q. So if we are looking at the potential for additional carbon restriction, would you say that that's a negative, a neutral or potential positive for the continuation of the Callaway facility?

A. Commissioner, that's certainly a positive.
…
I think it is a likely scenario….
…
I think, Commissioner, based upon my understanding of discussions with key legislative personnel, I think it is a more likely than not assessment hat within the next three to five years you will have carbon legislation passed. (Tr. 265-266)

Another huge hole in UE's story about how Callaway might not be relicensed is the fact that UE is seriously pursuing studies of the possibility of adding a second unit at the Callaway site:

[By Commissioner Gaw]Q. Tell me if I'm wrong with this perception. Have there been discussions in the media with some of your officials from Ameren regarding the possibility of adding an additional nuclear facility at the Callaway location?
[By Mr. Baxter] A. There have been discussions associated with -- there have been -- there are tests going on around the Callaway nuclear unit site as to the possibility of adding a future nuclear -- and whether that would be an AmerenUE unit or someone else building a unit on that site, those are just assessments, and decisions have not been made at this point in time. (Tr. 266-267).

Mr. Baxter testified that Mr. Naslund would be the one who would really know:

Q. You do understand that the way the issues are framed in this case, the Commission is essentially going to have to decide that question [of whether it is more likely than not that Callaway will be relicensed]?
A. I understand that.
Q. And you can't offer them any guidance?
A. Well, you asked me where I think it could be, and I think as I look at the understanding of the issues, as Mr. Naslund has pointed out in this case, it wouldn't be appropriate for me to sit there and place anything more than 50/50. Now, if Mr. Naslund comes in here and believes it's more likely than not based upon his understanding of the plant's operations, his understanding of the relicensing process, his understanding of the risks and concerns of the Callaway plant, then, you know, I stipulate that's where my opinion would be too because he is the expert.
Q. So if Mr. Naslund said after the recent upgrades to the Callaway plant that that made the plant good for the next 20 years and then 20 years after that, would that give you any indication that the plant may be good for another 40 years?
A. If that's what Mr. Naslund, indeed, said.
…
Q. If he did, indeed, say that, what would your opinion be on my question about whether it's more likely or not that it will be relicensed?
A. I think that would certainly weigh more towards that you would relicense the plant. (Tr. 366-367)

Mr. Baxter also testified that it will be Mr. Naslund, Mr. Rainwater, and Mr. Voss who will ultimately make the decision about whether or not to seek relicensing. Mr Naslund is a self-described "nuclear guy:"

> Q. Now, you've described yourself in the past as a nuclear guy; is that fair? You consider yourself a nuclear guy?
> A. Well, I'm also a fossil guy now, but yeah.
> Q. and tell me what you mean by that phrase.
> A. Well, I have -- I have 26 years experience building, starting up, I was over Callaway's startup, and operating Callaway nuclear plant. So my career is predominantly marked as a nuke.
> Q. Would that include being a supporter of building out more nuclear plants around the country?
> A. Absolutely.
> Q. And when you say absolutely, does that mean you're enthusiastic about the idea of building more nukes?
> A. Yes, I am.
> Q. Is that enthusiasm shared by other senior executives at AmerenUE?
> A. Yes, it is.
> Q. And by whom?
> A. Gary Rainwater, Tom Voss, my boss, Warner Baxter. You know, I would say the entire senior team of Ameren.

All of the people who will be instrumental in deciding whether or not to relicense Callaway are enthusiastic about nuclear power. It is simply not credible that they will not do everything they can to extend the license at Callaway.

The evidence is clear that it is more probable than not that Callaway will be relicensed. There are several facts that support this conclusion:

> (1) Relicensing is now clearly the industry practice. As Staff witness Warren Wood stated on page 3 of his Surrebuttal (Exhibit 246-Surrebuttal Testimony of Warren Wood) "In fact, as of December 15, 2006, less than ten of the 104 nuclear power plants with operating licenses in the U.S. that are eligible for license renewal have not either sought, or indicated they will seek, license renewal. Callaway is one of these plants."
>
> (2) The reason utilities relicense their nuclear plants is that it make great economic sense to do so. The application for, and NRC review of, the 20 year renewal cost less than 1% of the existing investment in the nuclear unit.[16]

[16] Dunkel Surrebuttal, pages 4-5 (Exhibit 402-Surrebuttal Testimony of William Dunkel).

(3) The Nuclear Regulatory Commission (NRC) has never refused to renew the license of a commercial reactor for the additional 20 years.[17]

(4) AmerenUE's witness in this case pertaining to Callaway, Mr. Naslund, in an interview with KOMU TV following the major infrastructure work recently completed at Callaway stated "After the first 20 years of operations, we've rejuvenated the plant and it's basically ready for the next 20 years **and the 20 beyond that."** (emphasis added).[18] A recording of Mr. Naslund making that statement is attached to Mr. Wood's Surrebuttal Testimony (Exhibit 246-Surrebuttal Testimony of Warren Wood).

(5) In response to concerns about carbon gas emissions contributing to global warming, AmerenUE has committed to the U.S. Department of Energy to "increase generation at our nuclear" plant. Callaway is the only nuclear plant owned or partially owned by AmerenUE or any AmerenUE affiliate.[19]

(6) In October, 2006, Callaway's sister plant, Wolf Creek, applied for a license. As Mr. Naslund has admitted "Callaway is more similar in design and construction to Wolf Creek than to any other operating nuclear generating station in the United States."[20] And Mr. Naslund also stated he was not "aware of any reason why Callaway would be any less able to satisfy NRC requirements for relicensing than Wolf Creek."[21]

Even rank-and-file UE employees know from reading UE newsletters and keeping up with UE news that the plant has been upgraded and is ready to go for another forty years. Len Valentine, a tractor trailer operator for UE for the last fifteen years, testified at a local public hearing in St. Louis about his understanding of the recent expenditures at Callaway.

> MR. MILLS: You talked about the Callaway plant. And you seem to have knowledge about that. Are you fairly knowledgeable about that plant?
> MR. VALENTINE: Only what I see and can pick up on my own and from information that is put out by the company on what types of work they are doing at power plants, stuff like that.
> MR. MILLS: Tell me again what the $350 million was for.
> MR. VALENTINE: Steam generators.
> MR. MILLS: And did they replace all the steam generators?
> MR. VALENTINE: There's two.
> MR. MILLS: And they replaced them both?
> MR. VALENTINE: Well, I shouldn't say -- there's high pressure and low pressure.

[17] Dunkel Direct, page 4 (Exhibit 400-Direct Testimony of William Dunkel).
[18] Dunkel Direct, page 3 (Exhibit 400-Direct Testimony of William Dunkel); Warren Wood Surrebuttal, page 2-3 (Exhibit 246-Surrebuttal Testimony of Warren Wood).
[19] Dunkel Direct, page 5-6 (Exhibit 400-Direct Testimony of William Dunkel).
[20] Dunkel Direct, page 7 (Exhibit 400-Direct Testimony of William Dunkel); Tr. Page 4209, and Hearing Exhibit 463.
[21] Tr. Page 4209 and Hearing Exhibit 463.

MR. MILLS: But they replaced the steam generator?
MR. VALENTINE: Yes.
MR. MILLS: And that's the bulk of the $350 million was for new stream generators?
MR. VALENTINE: Well, there was a lot of other maintenance that went -- but the bulk of it, yes.
MR. MILLS: And how long are those projected to last?
MR. VALENTINE: Let's see the Callaway plant has been in service, I think, going on thirty years now and it's the first time that they -- I'm not going to say it's the first time they've been -- had maintenance done on them, but it's the first time they've been replaced. Supposedly by replacing them it will increase the life of the plant, which was -- at the time it was built around forty years -- life of the plant.
MR. MILLS: So the addition of the steam generators was to make the plant last beyond the original forty-year life?
MR. VALENTINE: That's correct.

From a tractor trailer driver to the Chief Nuclear Officer to the Company's hired depreciation expert, all **almost** concede that that it is likely Callaway will be relicensed. In fact regarding the Callaway relicensing, Mr. Stout admits "this may well occur."[22]

AmerenUE argues "there is a possibility that the license will not be extended"[23] However AmerenUE is using the wrong standard. UE asserts that no decision has been made to relicense the plant, but that fact is immaterial. Just because no decision has been made yet does not relieve the Commission of the obligation to make its best prediction of what that decision will be at the time it is made. All the evidence in the case points to the likelihood of relicensing; it is much more probable than not that Callaway will have its licensed renewed.

On page 9 of his Direct Testimony (Exhibit 47-Direct Testimony of Chuck Naslund), Mr. Naslund tried to create reasonable doubt by stating "The single most critical consideration in determining whether or not relicensing may be feasible is the condition of the reactor vessel itself. Extensive monitoring is in place to measure neutron and brittlement of the vessel wall."

[22] Stout Rebuttal Testimony, page 15, lines 19-20 (Exhibit 70-Rebuttal Testimony of William Stout).
[23] Direct Testimony of William Stout, page 30, lines 3-8 (Exhibit 69-Direct Testimony of William Stout).

However later test results forced Mr. Naslund to admitted this was not a problem. He admitted the test results show: "Callaway's reactor vessel is good for greater than 80 years' life, meeting the NRC standard for relicensing the vessel for 60 years' use."[24]

In his Rebuttal Testimony (Exhibit 48-Rebuttal Testimony of Chuck Naslund) Mr. Naslund again tried to create some doubt by stating the reactor vessel head "will have to be replaced to allow a license extension."[25] However a later data response by AmerenUE shows this will not prevent relicensing. AmerenUE states: "there are funds budgeted in 2013 for Reactor Vessel Head replacement."[26]

In his Surrebuttal testimony (Exhibit 48-Surrebuttal Testimony of Chuck Naslund), Mr. Naslund again tried to create some doubt by claiming there could be a "lack of adequate water supplies in the Missouri river to cool the plant."[27] However discover demonstrated there was no substantial basis for this claim. When asked to "Provide copies of any documents that support the claim that there may be a 'lack of adequate water supplies in the Missouri river to cool the plant' prior to 2044." The AmerenUE response in its entirety was "None exist."[28]

On page 15 of his Rebuttal testimony (Exhibit 70-Rebuttal Testimony of William Stout), referring to the Staff proposal, Mr. Stout claimed that significant interim retirements were not "reflected in the interim survivor curves for the nuclear accounts." This is a false claim. The interim survivor curves for the nuclear accounts that the Staff used include over $670 million in interim retirements between 12/31/2005 and the final retirement in 10/2044.[29]

---

[24] Transcript page 4215-4216. Also Exhibit 467.
[25] Naslund Rebuttal Testimony, page 3, lines 14-16 (Exhibit 48-Rebuttal Testimony of Chuck Naslund).
[26] AmerenUE response to OPC 5058. Page 4, Dunkel Surrebuttal Testimony (Exhibit 402-Surrebuttal Testimony of William Dunkel).
[27] Page 2, lines 16-19, Naslund Rebuttal Testimony (Exhibit 48-Rebuttal Testimony of Chuck Naslund).
[28] AmerenUE response to OPC Request 5056(c). Dunkel Surrebuttal Testimony, page 5 (Exhibit 402-Surrebuttal Testimony of William Dunkel).
[29] Dunkel Surrebuttal page 4, also Schedule WWD-14-2 (Exhibit 402-Surrebuttal Testimony of William Dunkel). Transcript page 3694-3695, also Hearing Exhibit 456.

AmerenUE claims it is not yet time to decide about a relicensing.[30] However in this case the Commission must decide whether to use 2024 or 2044 as the final retirement year. The annual depreciation expense is approximately $28 million higher if 2024 is used than if 2044 is used.[31]

The preponderance of the evidence clearly indicates that it is more likely than not that the license for the Callaway plant will be renewed. The Commission should use 2044 as the final retirement date for the Callaway depreciations rate calculations.

Future Inflation Rates:

The net salvage percents to be used to estimate future inflated removal costs should incorporate expected future inflation rates, not the past inflation rates. Expected future inflation should be used. This issue has to do with the calculation of the amount to be included in rates for future costs of removing plant at the end of its useful life. Because there is a lot of plant at issue, and because some of it will be removed far in the future, the choice of the inflation rate makes a big difference in the calculation of rates in this case. Public Counsel witness William Dunkel outlines the issue in his direct testimony:

On page 54 of the Commission Report and Order[32] in the Empire District Electric case the Commission found that the net salvage costs should be recovered from customers over the life of the asset. Since the removal cost (negative net salvage) occurs at the end of the asset life, this means that customers pay for net salvage years or decades before the Company incurs the removal cost. In order to calculate how much to currently charge customers, it is necessary to estimate how much the future removal costs will be inflated by future inflation.[33]

[30] Stout Direct, page 30, lines 3-8 (Exhibit 69-Direct Testimony of William Stout).
[31] For example, see Attachment 1 to the "Nonunanimous Stipulation and Agreement Regarding Certain Depreciation Issues" March 19, 2007.
[32] Case No. ER-2004-0570, Report and Order Issued March 10, 2005.
[33] Exhibit 400-Direct Testimony of William Dunkel page 19 and Exhibit 401-Rebuttal Testimony of William Dunkel page 10

As part of this calculation, Company calculated historic net salvage percents that effectively incorporate the historic inflation that had occurred in the past, between the time the investment was installed and the time it was retired.[34] The Company then assumed the future net salvage ratio would be similar to the past net salvage ratio, which effectively assumed that future inflation would be similar to past inflation.[35]

The problem is that past inflation was much higher than expected future inflation. The U.S. inflation was over 11% in 1974, over 11% in 1979, over 13% in 1980, and over 10% in 1981. During that 10 year period 1973-1982, the purchasing power of the dollar was cut more than in half. When all 43 years of the average life in the Poles account is considered, inflation over their life has average 4.3% per year, for the poles that have retired in the last ten years, as shown on page 3 of Schedule WWD-10 (attached to Exhibit 400-Direct Testimony of William Dunkel).[36]

These very high historical rates of inflation are incorporated into the historic net salvage data Mr. Wiedmayer used as the basis for his Future Net Salvage proposals in this proceeding. As a result, Mr. Wiedmayer's proposed Future Net Salvage recommendations have the built-in assumption that in the future, the U.S. will experience extremely high rates of inflation.

However, according to the Survey of Professional Forecasters, a survey of 53 professional forecasters surveyed by the Federal Reserve Bank of Philadelphia, **future** inflation over the long-term is expected to be 2.5% per year.[37]

---

[34] Exhibit 400-Direct Testimony of William Dunkel page 22 and Schedule WWD-6

[35] (Exhibit 400-Direct Testimony of William Dunkel pages 20-21, AmerenUE response to OPC 5006 (c), Schedule WWD-7 and WWD-8)

[36] Page 24-25, Exhibit 400 (Direct Testimony of William Dunkel). For example, for a Poles (account 364) installed in 1962, the CPI-U index was 30.20 in 1962. When retired 43 years later the CPI-U index was 195.30. The ratio is 195.30/30.20=6.5 times. This is an average annual inflation rate of 4.44% (check: (1.0444)^43=6.5). The other years are similar, as shown on page 3 of Schedule WWD-5.

[37] Page 25, Exhibit 400 (Direct Testimony of Dunkel) Federal Reserve Bank of Philadelphia – Economic Research – Survey of Professional Forecasters, Release Date: November 13, 2006. This document was obtained at the Federal Reserve Bank of Philadelphia website http://www.phil.frb.org/files/spf/survq406.html, visited December 4, 2006. This 2.5% is the forecast future annual inflation measured in CPI-U.

In response, on page 11 of his Rebuttal Mr. Stout (Exhibit 70-Rebuttal Testimony of William Stout) summarizes our position, and agreed with all of the above. He states:

> "Messrs. Selecky and Dunkel and others have an expectation that future rates of inflation will be less than they have been over the past 30 or 40 years given the high levels of inflation during the 1970's and early 1980's. Based on this expectation, they have considered the amount of inflation reflected in the historical percents as compared to the amount of inflation that they expect to occur prior to future retirements. This is an appropriate exercise."

His defense was to claim that in the future the "average age of retirement" will allegedly be much higher than it was in the past, and therefore there would be more years of inflation in the future than had occurred in the past.[38] For example his Schedule WMS-SR1-1 (attached to Exhibit 71-Surrebuttal Testimony of William Stout) shows the average "age of retirement" as 25 years for the past year 1995, but 35 years for the future year of 2020. According to Mr. Stout the alleged greater number of years in the future "average age of retirement" would offset the lower annual inflation rate in the future.

However Mr. Stout had calculated the future "average age of retirement" much differently than he had calculated the past "average age of retirement."

He was asked "if an investment was one year old when it retired, would it be included in the average age of retirement shown on your chart?" Mr. Stout answered "yes" for the past year of 1995, but "no" for the future year of 2020. He also stated that five-year old and ten-year old retiring investments **would be included** in the "average age of retirement" for the past year of 1995, but would be **excluded** from the calculation of "average age of retirement" for the future year of 2020.[39] Mr. Stout's defense is based on an "apples to oranges" schedule and has no weight.

[38] Exhibit 71-Surrebuttal Testimony of William Stout, pages 8-9, and WMS-SR1-1.
[39] Transcript pages 3692-3693.

The net salvage percents to be used to estimate future inflated removal costs should incorporate expected future inflation rates, not the past inflation rates.

For the Poles account, Account 364, when the past high inflation rates are replaced by the 2.5% expected future inflation rate, the -135% net salvage percent AmerenUE proposes be used for the future becomes -74%.[40] Overall, replacing the past high inflation rates with the future expected 2.5% annual inflation rate produces an annual depreciation expense which is $20,060,630 less that the Company proposal.[41]

INDUSTRIAL DEMAND RESPONSE

Public Counsel does not oppose industrial demand response programs. But it does have serious reservations about the specifics of the program the UE has proposed and the "fixes" that the Missouri Energy Group (MEG) has proposed. One of the biggest flaws is that UE has not figured out how to evaluate the program. UE witness Mill admits that if an evaluation program is not in place at the outset of a program, there is a risk that data needed for evaluating the program will not be captured. (Tr. 4171) UE witness Hanser testified that evaluation is "a fairly complicate process." (Tr. 3889)

One of the benefits that UE alleges for its IDR proposal is that it can be advantageous in "a local emergency." (Tr. 3906) But UE admits that such a benefit will only come about in a certain concatenation of circumstance:

> [By Mr. Mills] Q. So if by chance there is a local emergency and if by chance one of the customers that happened to sign up for this program was in that vicinity, then there may be some benefit to that; is that what you're saying?
> [By Mr. Hanser] A. That's right. (Tr. 3906)

[40] Schedule WWD-11-1, part of Exhibit 400, (Direct Testimony of William Dunkel)
[41] Schedule WWD-11-1, part of Exhibit 400, (Direct Testimony of William Dunkel)

Even the MEG, perhaps historically as well as currently the most vocal advocate for IDR on UE's system, admits that there would be little value to UE from the IDR if UE already has excess capacity. (Tr. 4056)

UE witness Mill admitted that according to what "the words say" (Tr. 4170) in the Commission's Promotional Practices Rule and Filing Requirements Rule, the evaluation plan for a program is required and must be filed with the proposed promotional practice.

TAUM SAUK REGULATORY CAPACITY

One issue that arose during the evidentiary hearing that the parties did not know about when they created the List of Issues is the fact that the quantification of UE's "hold harmless" commitment with respect to the Taum Sauk plant fails to account for regulatory capacity that is already being sold and will continue to be sold. (Tr.) Public Counsel calculated a value for that capacity using UE's value for regulatory capacity of $2.00/kw month (Tr. 3902), and a capacity value for Taum Sauk of 430 MWs. (Exhibit ; Lyons Direct FAC Testimony; Attachment D) This value is shown on the most recently filed Reconciliation.

Respectfully submitted,

OFFICE OF THE Public Counsel

By:_____

Lewis R. Mills, Jr. (#35275)
Public Counsel
P O Box 2230
Jefferson City, MO 65102
(573) 751-1304
(573) 751-5562 FAX
lewis.mills@ded.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been emailed to all parties this 21st day of April 2007.

By:_____