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-2008-0318

STATE OF MISSOURI STATEMENT OF POSITION

Pursuant to the Commission's Order Adopting Procedural Schedule and Test Year, the State of Missouri submits this Statement of Position.

This statement will address only the four issues in which the State intends to actively participate at the hearing: (1) Return on Equity; (2) Fuel Adjustment Clause; (3) Off System Sales (Margins; Taum Sauk Capacity Sales); and (4) Callaway Unit II License. The failure to address other issues does not indicate agreement with UE's position. To the contrary, the State generally supports the Staff, OPC, and Intervenors unless otherwise stated.

Return on Equity

Each of the experts that have provided testimony asserts – unsurprisingly – that his or her analysis is the best. The distinctions they draw are extremely technical and liberally sprinkled with competing citations to the academic literature. Determining which is the most credible would be a difficult, if not impossible task for anyone not steeped in the arcana of financial theory. If one

steps back from the fray, however, it is possible to see various areas of agreement that lead to a practical resolution of the differences.

First, each expert acknowledges that calculating the appropriate return on equity is a subjective exercise. There is no *right* answer, merely a range of possibilities.

Second, each proposed return on equity falls within the Commission's zone of reasonableness. Therefore, based on the past practice of the Commission, any of the proposed returns could be deemed appropriate.

Third, the proposed returns range from a low of 9.5%, for Staff witness Hill, to a high of 10.9%, for UE witness Morin. LaConte (MEG) and Gorman (MIEC) both recommend a return of 10.2%.[1] The mean and average of the proposed returns, therefore, is also 10.2%.

Fourth, the return approved by the Commission in UE's last rate case was also 10.2%. The order in that case was issued May 22, 2007, approximately 18 months ago.

Fifth, the median return on equity allowed for electric utilities is 10.25%. (Hill Direct at 5) Taking all these factors into consideration, there is no persuasive evidence in the record that would compel the Commission to second guess the decision it made such a short time ago. Therefore, the Commission should allow UE a 10.2% return on equity.

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[1] Morin suggests that the return should be increased to 11.15% if UE does not get a fuel adjustment clause. LaConte suggests a return of 10% if the Company gets a fuel adjustment clause. Hill suggests a return of

Some of the Company's witnesses argue that the return on equity should be increased due to the recent turmoil in the financial markets. The only thing we know for sure, however, is that the risk-free rate that forms the undisputed base of the return on equity has gone down by approximately 70 basis points since the return recommendations were made. (LaConte Surrebuttal at 3) Seventy basis points is the difference between the Company's recommended return and the current return of 10.2%.

The Company's witnesses speculate that the risk premium will need to be higher to attract capital in the present market. That may or may not be true, but there is no evidence to support that conclusion. Moreover, no one in this case or in the general market can accurately predict all of the impacts of the current market turmoil, or how long the turmoil may last. Trying to set a return on equity based on the events of the last two months, which were unusual by any standards, and speculation about what the future may bring would fly in the face of rate making principles.

Fuel Adjustment Clause

Like the return on equity, the Company has failed to present any evidence of a change in circumstances since the last rate case that would compel the Commission to a different conclusion regarding a fuel adjustment clause. Therefore, the Commission should not approve the clause in this case.

9.37% with a fuel adjustment clause. Gorman opines that the return on equity should be lower if a fuel adjustment clause is allowed, but does not quantify the adjustment.

Traditional rate case principles disfavor any mechanism that is designed to address only one item in the vast number of income and expense items any company will have. All data must be compared over the same time period to avoid a mismatch of revenue and expenses which could allow rates to be set at a level that would provide an excessive return to the utility. Both costs and revenues are constantly in flux and neither can ever be predicted with certainty. Some costs may be going up, while others may be going down. Revenue may be higher or lower than forecast due to shifts in customer usage, abnormal weather, and other factors. Test year regulation prevents any cost or revenue factor from being considered in isolation.

Although fuel adjustment clauses have become relatively commonplace, that does not mean every utility should have one. The Commission has laid out a three-part test to determine when a fuel adjustment clause is appropriate. A fuel adjustment clause may be allowed if fuel costs are:

1. Substantial enough to have a material impact upon revenue requirements and the financial performance of the business between rate cases;
2. beyond the control of management, where utility management has little control over experienced revenue or cost levels; and
3. volatile in amount, causing significant swings in income and cash flows if not tracked. (Case ER-2007-0002 Order at 20)

UE has not met this standard.

No party disputes that the Company's fuel costs are substantial. However, most non-UE parties do assert that the Company does have substantial control over those costs and that the vast majority of such costs are not sufficiently volatile to cause "significant swings in income and cash flows."

More than 76% of UE's energy is generated from coal-fired plants (Voss Direct at 17) Coal represents approximately 82% of all of the Company's fuel costs. (Direct Testimony of Timothy D. Finnell, Attachment A-2) As a relatively coal intensive utility, AmerenUE is less exposed than most of its peer companies to fluctuations in the price of natural gas and oil fuel.

A very large percentage of the Company's costs of coal are hedged. Therefore, the Company has exercised effective control over the largest portion of its fuel costs. It has not met its burden on the second prong of the test.

The Company attempts to meet the third prong of the test by extensive testimony regarding the "uncertainty" of projected fuel costs. Of course projections of future fuel costs are "uncertain" – that is the nature of projections. No one can know what the future will bring, therefore no one can ever be certain of the future. This tautology is the sum and substance of the Company's testimony.

But the Commission standard does not reference "uncertainty." Instead, it focuses on volatility, *i.e.*, whether the prices fluctuate rapidly and create significant swings in income and cash flows. Although the Company's witnesses

attempt to equate "uncertainty" with volatility, there is simply no evidence that price fluctuations in the cost of fuel have created swings in income and cash flows.

The evidence does establish that there have been steadily rising fuel costs over the past few years. It may be that such costs will continue to rise – or not. Regardless, rising fuel costs do not justify a fuel adjustment clause. The Commission's view of this argument was succinctly stated in its ER-2007-0002 order: ". . . rising, but known, fuel costs are the worst reason to implement a fuel adjustment clause." (P. 23)

If the Commission does determine that a fuel adjustment clause is appropriate, it should ensure that the Company has appropriate incentives to minimize its net fuel costs. The 95/5 sharing mechanism proposed by the Company does not achieve this objective. The Company's exposure is immaterial when compared to its total revenues and expenses. Therefore, the Commission should adopt the 50/50 proposal of OPC or the 80/20 proposal by the State[2] and MIEC.

<u>Off System Sales</u>

<u>Off System Sales Margins</u>

Witness Dauphinais, testifying for MIEC, has made a persuasive case that the Company has understated its off system sales margins by failing to account for a clear, known, and measurable growth trend in spot market prices since 2002. By

[2] State witness Cohen also proposed an asymmetrical FAC mechanism in which the Company would remain at risk for 15% of all cost increases, but receive only 5% of any cost decrease.

doing so, the Company has understated revenues from off system sales by a substantial amount (estimated by Dauphinais at $12.2 million). The Commission should adopt the Dauphinais recommendation.

Taum Sauk Capacity Sales

The State of Missouri agrees with OPC witness Kind with regard to the adjustment for lost Taum Sauk capacity sales for both the prior period and the current period. The adjustments proposed by Kind should be applied to UE's rates.

Kind's proposed adjustment is simple and effective. He takes the unchallenged market price for capacity sales in 2006 and 2007 and applies it to the 440MW that UE would have had available if it had not caused the Taum Sauk disaster. (Kind Direct, Attachment C) And in the current case period, he uses the current, and unchallenged, rate for capacity sales. His calculation is also very close to UE witness Finnell's Taum Sauk capacity sales value of $4.9 million. (Finnell Rebuttal at 13) That is the best and only way to adequately compensate ratepayers for UE's inability to make capacity sales from the Taum Sauk plant.

UE admitted that it is responsible for the failure of the Taum Sauk upper reservoir and the immense destruction it wrought. UE and this Commission committed to hold ratepayers harmless from all effects of UE's negligence, including UE's inability to make capacity sales from Taum Sauk. That lost ability has meant that UE has been unable to market any capacity, and assured that UE could not make any capacity sales. Since the ability to sell was lost, an adjustment

must be made that reflects the entire amount that UE should have had the ability to sell.

The prior period adjustment is necessary due to the Taum Sauk disaster and the failure to address this issue in the previous case. In UE's previous rate case, ER-2007-0002, OPC and the State argued that ratepayers should be credited for capacity sales lost due to the Taum Sauk disaster. The Commission denied that adjustment due to insufficient information. But it did open a new case to pursue this issue (ER-2008-0015), which was consolidated with this case. Ratepayers still have yet to be credited for UE's self-created inability to make capacity sales. And now the information from which to make that adjustment is much better and virtually unchallenged.

UE tries to evade its hold harmless commitment by arguing that it may not have made capacity sales from Taum Sauk since it did not sell all of its available capacity from other plants. (Schukar Rebuttal at 20) And UE did include 3 months of capacity sales from Taum Sauk in its test year. That misses the point: Taum Sauk removed the ability to make those sales, not the market for the sales. This Commission and UE need to hold ratepayers harmless from all ramifications of that loss of ability to make capacity sales. It does not matter what UE did or did not sell from other plants because the key injury to ratepayers was the loss of ability to sell capacity.

Both Staff and UE mistakenly assume that because UE did not sell 100% of its capacity, none could have been sold from Taum Sauk. Neither addresses the

effect that an additional 440 MW would have on marketing efforts or on other potential sales UE was unable to make. Nor does either offer any evidence that UE would not have sold any capacity from a functioning Taum Sauk plant. Lastly, neither disproves the possibility that Taum Sauk's capacity could have been sold had it been available. In sum, UE has been unable to make capacity sales, and it must hold ratepayers harmless from that self-created inability. To do so, an adjustment must be made that reflects the entire amount that UE would have been able to sell, which has been set out by Kind.

Callaway Unit II License

The Company has not filed any testimony attempting to justify inclusion of the amount spent on applying for a license to construct and operate a second nuclear power plant in its cost of service. Nor has it indicated a willingness to keep the costs in construction work in process, as the Staff recommends. The silence is deafening.

Section 393.135, RSMo, prohibits inclusion in rate base of any "cost associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service." Callaway Unit II does not even come close to complying with the statute. Therefore, the amount spent on the license application cannot legally be included in the cost of service.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was mailed electronically this 13th day of November, 20087, to all counsel of record.

__*/s/ H. Todd Iveson*___
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