Exhibit No.:
Issues: *EEInc. and 4 CSR 240-10.020*
Witness: *Robert E. Schallenberg*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Rebuttal Testimony*
Case No.: *ER-2007-0002*
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

ROBERT E. SCHALLENBERG

UNION ELECTRIC COMPANY
D/B/A AMERENUE
CASE NO. ER-2007-0002

Jefferson City, Missouri
January 2007

****Denotes Highly Confidential Information****

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

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

AFFIDAVIT OF ROBERT E. SCHALLENBERG

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Robert E. Schallenberg, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 28 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Robert E. Schallenberg
Robert E. Schallenberg

Subscribed and sworn to before me this 31st day of January 2007

TONI M. CHARLTON
Notary Public - State of Missouri
My Commission Expires December 28, 2008
Cole County
Commission #04474301

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

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REBUTTAL TESTIMONY OF

ROBERT E. SCHALLENBERG

UNION ELECTRIC COMPANY

d/b/a AMERENUE

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REBUTTAL TESTIMONY

OF

ROBERT E. SCHALLENBERG

UNION ELECTRIC COMPANY

d/b/a AMERENUE

CASE NO. ER-2007-0002

Q. Please state your name and business address.

A. Robert E. Schallenberg, 200 Madison Street, Jefferson City, Missouri, 65102.

Q. By whom are you employed and in what capacity?

A. I am the Director of the Utility Services Division of the Missouri Public Service Commission (MoPSC).

Q. Please describe your educational background.

A. I am a 1976 graduate of the University of Missouri at Kansas City with a Bachelor of Science degree and major emphasis in Accounting. In November 1976, I successfully completed the Uniform Certified Public Accountant (CPA) examination and subsequently received the CPA certificate. In 1989, I received my CPA license in Missouri. I began my employment with the Missouri Public Service Commission as a Public Utility Accountant in November 1976. I remained on the Staff of the Missouri Public Service Commission until May 1978, when I accepted the position of Senior Regulatory Auditor with the Kansas State Corporation Commission. In October 1978, I returned to the Staff of the Missouri Public Service Commission. Most immediately prior to October 1997, I was an Audit Supervisor/Regulatory Auditor V. In October 1997, I began my current position as Division Director of the Utility Services Division of the MoPSC.

Q. Please describe your responsibilities and experience while employed at the MoPSC as a Regulatory Auditor V?

A. As a Regulatory Auditor V for the MoPSC, I had several areas of responsibility. I was required to have and maintain a high degree of technical and substantive knowledge in utility regulation and regulatory auditing. Among my various responsibilities as a Regulatory Auditor V were:

1. To conduct the timely and efficient examination of the accounts, books, records and reports of jurisdictional utilities;

2. To aid in the planning of audits and investigations, including staffing decisions, and in the development of Staff positions in cases to which the Accounting Department of the MoPSC was assigned, in cooperation with Staff management as well as other Staff;

3. To serve as lead auditor, as assigned on a case-by-case basis, and to report to the Assistant Manager-Accounting at the conclusion of the case on the performance of less experienced auditors assigned to the case, for use in completion of annual written performance evaluations;

4. To assist in the technical training of other auditors in the Accounting Department;

5. To prepare and present testimony in proceedings before the MoPSC and the Federal Energy Regulatory Commission (FERC), and aid MoPSC Staff attorneys and the MoPSC's Washington, D.C. counsel in the preparation of pleadings and for hearings and arguments, as requested; and

6. To review and aid in the development of audit findings and prepared testimony to be filed by other auditors in the Accounting Department.

The MoPSC relies on the Regulatory Auditor V position to be able to present and defend positions both in filed testimony and orally at hearing. I have had many occasions to present testimony before the MoPSC on issues ranging from the prudence of building power plants to the appropriate method of calculating income taxes for ratemaking purposes. I have worked in the area of telephone, electric and gas utilities. I have taken depositions on behalf of the MoPSC in FERC dockets. Attached as Schedule 1, is a listing of cases and issues on which I have worked at the MoPSC. My responsibilities were expanded to assist in federal cases involving the MoPSC as assigned.

Q. Have you previously submitted testimony in proceedings before the FERC?

A. Yes. I submitted testimony in Docket Nos. RP94-365, RP95-136, RP96-173, et. al. These dockets were cases involving Williams Natural Gas Company (WNG). WNG provides gas transportation and storage services for local distribution companies serving the western portion of Missouri. WNG provides service to Missouri Gas Energy which serves the Kansas City area. My testimony in Docket No. RP94-365 involved a prudence challenge of the costs that WNG sought to recover in that case. I also filed testimony regarding certain cost of service issues in Docket No. RP95-136, WNG's rate case before the FERC. These issues included affiliated transactions between WNG and its parent. I filed testimony in Docket No. RP96-173, et. al., on the issue of whether the costs in question met FERC's eligibility criteria for recovery under FERC Order No. 636.

I submitted testimony in Docket No. RP96-199. This case is Mississippi River Transmission (MRT) Corporation's rate case. MRT provides gas transportation and storage services for local distribution companies serving the eastern portion of Missouri. MRT provides service to Laclede Gas Company which serves the St. Louis area. My testimony in

Docket No. RP96-199 involved cost of service issues. These issues included affiliated transactions between MRT and its parent.

EXECUTIVE SUMMARY

My rebuttal testimony addresses two matters that Union Electric Company, d/b/a AmerenUE (AmerenUE) raised in its Direct Testimony. The first matter is related to the specific issue identified as "Impact On Revenue Requirement Reflecting 4 CSR 240-10.020" in the Direct Testimony of AmerenUE witness Gary S. Weiss at pages 29-30. AmerenUE is presenting an interpretation of this rule that has monumental rate impacts (i.e., $ 387 million). This is a novel issue. Since AmerenUE first raised this issue in the immediate prior Staff earnings complaint case, Case No. EC- 2002-1, no other utility has sponsored a similar position nor filed for rates to be based on the rule interpretation which AmerenUE supports in this case. My testimony will show that the AmerenUE position is based on an interpretation of the rule, not on the actual language of the rule. AmerenUE did not file to increase rates to the level directly related to its rule interpretation of the rule. However, AmerenUE sponsors this issue as a contingency to allow it to receive the entire amount of its requested rate increase, $361 million, in the event that the MoPSC finds that adjustments are warranted in the areas (e.g., rate of return, Electric Energy, Inc, off-systems sales, fuel, etc.) that directly support the rate increase being sought by AmerenUE. My testimony will show that AmerenUE has not acted in a manner consistent with the rule interpretation now being pursued by it, nor filed its prior rate cases utilizing the methodology that AmerenUE now alleges has been required by this rule for approximately sixty (60) years.

The second matter is addressed in the "Expiration of AmerenUE's Power Purchase Agreement with Electric Energy, Inc." section of the Direct Testimony of AmerenUE witness

Michael L. Moehn at pages 10-16 and in the Direct Testimony of AmerenUE witness Robert C. Downs. The Electric Energy, Inc. issue is also addressed in the Direct Testimonies of 1) Michael L. Brosch on behalf of State of Missouri; 2) Ryan Kind of behalf of the Office of the Public Counsel; and 3) Kevin C. Higgins on behalf of The Commercial Group. I will refer to this issue as EEInc. The power plant / generating station that actually produces the power is located in Joppa, Illinois, is referred to as the Joppa station or power plant and is owned by EEInc.

EEInc. is a prudence issue. EEInc. is owned by three entities or Sponsoring Companies. These Sponsoring Companies are AmerenUE, (40%), Ameren Energy Resources Company (40%), and Kentucky Utilities Company (20%). AmerenUE had the right to use its allocated capacity and energy from EEInc. to serve its Missouri native load customers at cost based rates, but chose to vote to direct this capacity and energy to serve the market and incur higher costs than to serve its own customers. AmerenUE acted imprudently by engaging in actions which increased its costs of fuel and purchase power to serve its Missouri customers as well as reduced the amount of off-systems sales revenues that were available to offset AmerenUE's other incurred costs, which are also recovered by AmerenUE from its Missouri customers.

One of AmerenUE's directors on EEInc., Charles D. Naslund, stated in a deposition that this decision was based on ** _____
_____
_____
_____
_____

[redacted] **

EEInc. was not operated as a below-the-line investment and its debt was primarily supported by the purchase power payments paid by Union Electric and its customers, not the equity investment by Union Electric. The Power Supply Agreements were critical to the operation of EEInc. due to the owner decision to finance EEInc. with high debt levels and minimal equity investments. Union Electric received in rates from its customers rate treatment similar, if not better, for its share of the Joppa generating station as the other generating units owned by Union Electric. These payments were based on the ownership of the plant as well as a fifteen (15%) return on equity. The EEInc. Power Supply Agreement required Union Electric with the other Sponsoring Companies and the Department of Energy to make monthly payments for power which would enable EEInc. to recover all of the Joppa generating station's cost-of-service, which includes operating expenses, taxes, and interest plus generate a prescribed rate of return on equity capital of 15% net of federal income tax.

The obligations of Union Electric with the other Sponsoring Companies and the Department of Energy were absolute, unconditional, and could not be discharged or affected by the failure, impossibility or impracticality of EEInc. to generate or deliver electricity.

IMPACT OF RULE 4 CSR 240-10.020

Q. What Ameren UE witnesses will you address in this section of your rebuttal testimony?

A. I will address pages 29 and 30 of the Direct Testimony of Gary S. Weiss on behalf of Union Electric and schedule GSW-E-19.

Q. What is the value of this issue?

A. There are three different values that can be assigned to this issue because there are three different interpretations that can be given to the rule. The value of this issue depends on the interpretation of the rule ultimately adopted by the MoPSC.

Q. What are the three different interpretations of the rule and the related value for each interpretation?

A. First, AmerenUE interprets the rule to require that income be imputed into Staff's cost of service equivalent to 3% of the depreciation reserve amount **and** the depreciation reserve is no longer deducted from rate base. AmerenUE interprets that this rule must be applied to it in this manner and in any rate increase proceeding. Mr. Weiss assigns a value to AmerenUE's rule interpretation of $386,744,000 thus justifying a $747,453,000 overall rate increase as shown on lines 5 through 7 of page 30 of his Direct Testimony. Mr. Weiss goes on to state that despite AmerenUE's interpretation of this rule, AmerenUE is not proposing to recover the full amount of the revenue requirement that it is legally entitled to but is still entitled to the full $360,709,000 rate increase required by the rule until the

MoPSC finds adjustments to AmerenUE's revenue requirement exceeding the $386,744,000 value of this issue. There is an inconsistency between the AmerenUE position on this issue and the testimony of Mr. Robert C. Downs that I will discuss later in this testimony.

A second rule interpretation is that AmerenUE has made a showing to the MoPSC or the MoPSC has decided on its own "that the rate [of three percent (3%) per annum] is not reasonably and equitably applicable to it [i.e., to AmerenUE]" as provided in subsection (4) of the rule. This interpretation would result in no adjustment to the cost of service in this case or any other rate proceeding involving AmerenUE.

A third interpretation is that the rule requires the parties in this case to impute income into their cost of service determinations equivalent to 3% of the depreciation reserve amount that meets the provisions of the rule. I estimate this amount to be $134,294,027. ($4,476,467,556*.03) based upon the depreciation reserve amount reflected in the Staff's schedules. This amount would increase the amount of the excess earnings/revenues contained in the Staff's complaint case and decrease the AmerenUE revenue requirement in the rate increase case filed by AmerenUE by $134,294,027.

Q. What does this rule state?

A. The MoPSC rules states as follows:

> 4 CSR 240-10.020 Income on Depreciation Fund Investments
>
> PURPOSE: This rule prescribes the use of income on investments from depreciation funds and the means for accounting for that income.
>
> (1) In the process of determining the reasonableness of rates for service, income shall be determined on the depreciation funds of the gas, electric, water, telegraph, telephone and heating utilities pertaining to their properties used and useful in the public service in Missouri and shall be applied in reduction of the annual charges to operating income of those utilities.

(2) The income from the investment of moneys in depreciation funds shall be computed at the rate of three percent (3%) per annum of the principle amount of the depreciation funds.

(3) The principle amount of depreciation funds of any such utility, for the purposes of this rule, shall be deemed to be the equivalent to the balance in the depreciation reserve account of any such utility regardless of whether or not any such depreciation reserve account may be represented by a segregated fund ear-marked for that purpose: provided however, that the principal amount of the depreciation funds may be adjusted by the portion(s) of funds which may have been provided under circumstances other than by charges to operating income or otherwise, these adjustments to be subject to the approval of the commission. The terms depreciation funds and depreciation reserve accounts shall be deemed to include the terms retirement funds and retirement reserve accounts.

(4) The rate of three percent (3%) per annum referred to in section (3) shall be applied in the case of each gas, electric, water, telegraph, telephone and heating utility of Missouri; provided, however, that modification of the rate may be made upon the commission's own motion or upon proper showing by a utility that the rate is not reasonably and equitably applicable to it.

(5) Affected utilities shall prepare and include in their annual reports to the commission commencing with their annual reports for the year 1945, and in such other reports that may be required by the commission from time-to-time, schedules showing for the year or period covered by such reports, the income from the investment of moneys in depreciation funds. The schedules referred to shall be in the form prescribed by this commission and shall include, among other things that may be prescribed: the principle amount of depreciation funds as represented by balances in depreciation reserve accounts; any adjustments of such depreciation funds and accounts with complete details and explanations thereof; and, the amount of the income from the investment of moneys in depreciation funds computed at the rate of three percent (3%) per annum, or such other rate as may be prescribed by order of this commission.

(6) The commission shall retain jurisdiction in this matter for the purpose of making any change(s) in the interest rate prescribed in section (2) that may be warranted.

AUTHORITY: sections 392.280 and 393.260, RSMo (1986). *Original rule filed Dec. 19, 1975, effective Dec.29, 1975.

*Original authority: 392.280 RSMo (1939), amended 1987 and 393.260, RSMo (1967).

Q. Mr. Weis, in his testimony, states that the "rule generally requires that in the process of setting a utility's rates, the Commission must provide the utility's customers with a 3% annual credit to reflect income from investment of the money in the utility's depreciation reserve account". Does the rule contain language that supports this statement?

A. Yes. However, the rule contains no language that requires the MoPSC to calculate the company's revenue requirement consistent with the methodology contained on Mr. Weiss' Schedule GSW-E-19. The rule does contain language that requires the imputation of income equivalent to 3% of the depreciation reserve amount into a case that meets the qualifications of the rule absent a modification of the rate made by the MoPSC's own motion or upon proper showing by a utility that the rate is not reasonably and equitably applicable to it. The rule only requires the imputation of 3% income on the depreciation reserve balance.

The rule makes no mention regarding the required treatment of the depreciation reserve in the determination of rate base in rate cases that utilize the 3% income imputation. This feature is critical to AmerenUE's position on this issue. It is not a matter of regulatory practice that an item that is used to impute income or interest cannot be used in the determination of rate base. Both AmerenUE and Staff impute interest on customer deposits amounts and include the customer deposits balance in their respective rate base determinations. Depreciation reserves are commonly used in the determination of rate base. I infer from the fact that Mr. Weiss uses the word "generally" in his Direct Testimony that AmerenUE acknowledges that it is utilizing an interpretation to support its position on this issue in lieu of the existence of specific rule language to support AmerenUE's position.

Q. Did Mr. Weiss provide the basis for AmerenUE's interpretation of the rule?

A. No. There is neither support in Weiss' Direct Testimony nor any mention of reliance on a legal interpretation of the MoPSC's rule. Mr. Weiss does provide a quantification of AmerenUE's interpretation in his testimony. I could find no material in his work papers related to this issue.

Q. When did Staff first become aware of this issue?

A. Staff became aware of this issue in Case No. EC-2002-1 when AmerenUE raised the issue in that case.

Q. Did the Staff conduct any research regarding this rule after it became aware of AmerenUE's position?

A. Yes.

Q. What research did the Staff conduct?

A. The Staff conducted research in two areas. First, the Staff researched the development of the rule. Second, the Staff researched the history of the rule related to Union Electric.

Q. How was the rule developed?

A. The genesis of the rule is the MoPSC'ss Report and Order in Case No. 10,723, which was effective January 31, 1946. This Order cancelled General Order 38-A. The MoPSC issued an Order on December 19, 1975 directing the Secretary of the MoPSC "to refile with the Secretary of State of Missouri on or before December 19, 1975, a certified copy of all general orders, rules or orders required by Chapter 536, RSMo 1969 to be on file therein." On December 19, 1975 the MoPSC's Secretary filed certified copies of the MoPSC's rules and regulations with the Secretary of State. This material included the

Report and Order in Case No. 10,723. The Report and Order in Case No. 10,723, the MoPSC's December 19, 1975 Order, and the transmittal letter from the Commission Secretary are attached as Schedule 3 to this testimony.

Q. What is the history of AmerenUE's compliance with this rule?

A. AmerenUE conducted its business as Union Electric doing the relevant time period for this issue. AmerenUE could not identify any rate case in which it filed using the method contained in 4 CSR 240-10.020 or any annual report filed in compliance with the requirements of this rule. Schedule 4 attached to this testimony is a copy of Staff Data Request No. 179 in Case No. EC-2002-1 and Union Electric's response.

Staff reviewed Union Electric's annual reports for the period 1949 through 1958. Union Electric filed a "Special Depreciation Schedule" in its annual reports to the MoPSC in 1949, 1950, and 1951 but not in the 1952 annual report and thereafter. This "Special Depreciation Schedule" shows an income amount based on a 3% rate as stated in the MoPSC's Report and Order in Case No. 10,723. In its 1952 annual report, Union Electric no longer filed this special depreciation schedule but continued to cross out any reference that an asset account (e.g., Utility Plant) balance was less a reserve amount. Union Electric provided its reserves as a footnote to its balance sheet. In its 1958 annual report, Union Electric reported reserves as offsets to plant balances consistent with the process used today. In other words, the utility's rate of return is multiplied by net rate base, including original cost less accumulated depreciation, to calculate the return component of the utility's revenue requirement. Schedule 5 attached to this testimony is a copy of the Union Electric annual report material that I reviewed.

Q. Do you agree with Mr. Weiss' statement on page 29 of his Direct Testimony that "[i]n recent years, instead of following this rule, the Commission has subtracted accumulated depreciation from utilities' investment in rate base in calculating the return that is provided to the utilities' shareholders"?

A. No. I would assert the statement is inaccurate in terms of the period of time inferred by the use of words "[i]n recent years". I do not believe an approximately 50-year period (i.e., 1958 to 2007) can be accurately described as "[i]n recent years." I would also assert the suggestion in Mr. Weiss' Direct Testimony that the Commission was the actor in the subtraction of depreciation reserve from utility investment is misleading. Union Electric has filed its cases consistent with the methodology of subtraction of depreciation reserve from the utility investment during my tenure with the MoPSC.

Q. What interpretation of the rule do you believe is appropriate?

A. I believe that the MoPSC has modified the rate for Union Electric through either its own motion or upon proper showing by Union Electric that the 3% rate is not reasonably and equitably applicable on or around the 1958 or 1959 time period.

Q. What is the basis for your opinion?

A. I hold this opinion based on two facts. First, Union Electric began reporting the current method (i.e., plant less reserve) in the 1958-1959 timeframe. The MoPSC prescribed the form of its annual report. (4 CSR 240-10.020 and Sections 393.140(4) and (6).) The MoPSC, at least implicitly, adopts the form of its annual report. By 1952, the MoPSC did not require Union Electric to report the income associated with the depreciation reserve as specified by the rule. This would be an indication that the MoPSC made the decision to no longer follow the process described in the rule. When I joined the MoPSC

Staff in 1976 as an auditor, the MoPSC had a group of auditors review the annual reports for accuracy and compliance with the MoPSC rules. I believe that the previously discussed reporting changes in annual reports in the 1952 time frame would have been in response to some action by the MoPSC.

Second, the MoPSC would have at least implicitly if not explicitly accepted a Union Electric showing "that the rate [i.e., 3%] is not reasonably and equitably applicable to it" when it accepted Union Electric's first rate case using the depreciation reserve as a reduction to rate base. I do not know what case this was, but I believe that it occurred before Union Electric's Case No. ER-77-154. I have attached a copy of the MoPSC Report and Order in that case as Schedule 6. This Report and Order shows that the MoPSC used a net plant or depreciation reserve as an offset to plant balance in both its determination of fair value rate base on page 36 of the Report and Order and original cost rate base on Appendix A, Sheet 2 attached to the Report and Order.

Q. If the MoPSC decides not to adopt this conclusion, then which interpretation of 4 CSR 240-10.020 do you believe is most appropriate?

A. The interpretation that requires the Staff to impute income into its cost of service equivalent to 3% of the depreciation reserve amount that meets the qualifications of the rule, with the depreciation reserve used as a reduction to rate base.

Q. Why do you hold that opinion?

A. It has been recognized, since at least 1946, that customers are entitled to a reasonable and equitable return for the use of the funds that they provided in the form of depreciation reserves. If the MoPSC believes that it must impute a 3% income from the depreciation reserve, then the MoPSC should decide what treatment of the depreciation

reserve produces the most reasonable result. The rule does not state that the depreciation reserve cannot be used as a rate base offset as asserted by AmerenUE on this issue. The question that must be determined under this scenario is whether the return that customers receive should be more or less than AmerenUE's return on its investment. I believe it is reasonable to assume that customers should receive a greater return than AmerenUE given the customers' higher borrowing and opportunity costs.

Q. Has the Company included any testimony stating that the application of the 3% to its depreciation fund with the exclusion of the depreciation reserve as a reduction to rate base produces a reasonable and equitable amount?

A. No. Mr. Weiss only addresses the issue from the perspective that the Company's proposed treatment of the depreciation reserve is the only option. Mr. Weiss provides no testimony that such an approach is a just and reasonable result.

Q. Did the Commission attempt to rescind this rule?

A. Yes. On June 7, 2001 the Commission issued an "Order Finding Necessity For Rulemaking" regarding a proposed rescission of Commission Rule 4 CSR 240-10.20 - Income Depreciation Fund Investments in Case No. AX-2001-634. Laclede Gas Company, Missouri-American Water Company, Missouri Gas Energy, UtiliCorp United, Inc., and Union Electric Company filed comments and requested a hearing on this matter. Most of the comments were against rescission of the rule. Sprint supported the rescission but it was received after the published response time had expired. The Commission withdrew the proposed rescission as a result of the majority of comments.

ELECTRIC ENERGY, INC. (EEInc.)

Q. What portions of the Company's direct testimony regarding this issue are you addressing?

A. I will be addressing the Direct Testimony of AmerenUE witness Michael L. Moehn contained on pages 10 through 16 and any matters of fact raised in the Direct Testimony of AmerenUE witness Robert C. Downs. I am also aware of the Direct Testimony of: 1) Michael L. Brosch on behalf of the State of Missouri; 2) Ryan Kind on behalf of Office of the Public Counsel; and 3) Kevin C. Higgins on behalf of The Commercial Group.

Q. Were you aware of this issue prior to this rate case?

A. Yes. I was aware that AmerenUE intended to terminate on January 1, 2006 its use of the capacity and energy associated with its forty percent (40%) ownership of EEInc. to serve AmerenUE's customers at cost based rates. I first became aware of AmerenUE's intent sometime before the filing of Case No. EO-2004-0108. The case was filed August 25, 2003 and is sometimes referred to as the Metro East Case. I have been able to trace the genesis of this issue to the 1999 time frame after Union Electric Company merged with Central Illinois Public Service Company (CIPS). Prior to the merger, Union Electric intended to use the capacity and energy associated with its forty percent (40%) ownership of EEInc. to serve its native load customers.

Q. What is Staff's position regarding this issue?

A. It is Staff's position that AmerenUE engaged in an imprudent decision to sell the power from the capacity and energy associated with its forty percent (40%) ownership of EEInc. into the open market instead of seeking to use this capacity and energy to meet its obligations to its Missouri customers at cost based rates. This Ameren decision was not

based on any analysis that showed that such a decision was beneficial to either the reliability or costs of AmerenUE's utility operations in Missouri. AmerenUE's decision was based on the fact that AmerenUE could make more money by selling its power into the Illinois market than it could from selling its power to its Missouri customers. The critical element for this AmerenUE decision to produce the result desired by Ameren's senior management is that the MoPSC must authorize AmerenUE to charge Missouri customers higher rates to reflect the increased cost of service caused by AmerenUE incurring 1) higher fuel and purchase power costs to replace the energy formerly provided by the EEInc Joppa unit and 2) lower levels of off system sales that offset AmerenUE prudently incurred electric operations costs. It is important to note that AmerenUE's overall financial results were not impaired by this decision as it still records an increase in income from EEInc. to offset the increase in fuel and purchase power expense and loss of off-system sales recorded elsewhere on AmerenUE's financial statements. This decision was based on generating higher profits for AmerenUE's affiliated holding company, Ameren, at the expense of Missouri consumers. Missouri consumers should not be burdened to pay higher costs that AmerenUE would avoid if dealing with a non-affiliated entity. It should be noted that Kentucky Utilities, voted against the new market based rates Power Sales Agreement between EEInc. and Ameren Energy Marketing (AEM). Kentucky Utilities is the only EEInc. owner not affiliated with Ameren Corporation.

Q. What portions of Mr. Moehn's Direct Testimony, in particular, on this issue will you be addressing in your rebuttal testimony?

A. I will address the following portions of Mr. Moehn's Direct Testimony:

1) page 10, lines 14-15, where he states; "This agreement expired by its own terms on December 31, 2005."

2) page 10, lines 15-19 where he states; "Following the expiration of the agreement, EEInc. elected to cease selling power from the Joppa Plant on a cost plus basis, and instead sought and received authority from the Federal Energy Regulatory Commission (FERC) to sell power from the Joppa Plant at market prices. Consequently, AmerenUE no longer has the opportunity to purchase power from EEInc."

3) page 12, lines 5-19 where he states: "AmerenUE's stock in EEInc. was purchased with shareholder, not ratepayer funds, and has always been treated as a 'below-the-line' item for ratemaking purposes. This treatment has never been challenged in any regulatory proceeding. By 'below-the-line' I mean the investment in the stock is not and has never been on AmerenUE's books as an asset on which a return is figured in calculating the rates paid by AmerenUE's Missouri ratepayers. This is unlike an 'above-the-line' investment, such as a power plant or transmission line, which are put into rate base. Above-the-line items affect the Company's revenue requirement because the revenue requirement is determined based upon these rate base items, including depreciation expense (which is a return of the Company's investment) and return on equity (which is a return on the Company's investment). A below-the-line investment in stock – like AmerenUE's EEInc. stock – does not allow ratepayers to share in any of the revenues derived from stock ownership, nor does it expose ratepayers to the investment risk associated with owning the stock. Rather, with regard to EEInc., ratepayers have simply paid the cost of power purchased by AmerenUE from EEInc. as provided for under power supply agreements between AmerenUE and EEInc."

4) page 15, lines 1-3, where he states: "EEInc. sought and obtained authority from the FERC to sell power from the Joppa Plant at market-based rates. The FERC authorized such sales in its order in Docket Nos. ER05-1482-000 and ER05-1482-001 issued on December 8, 2005."

5) page 15, lines 7-9, where he states: "AmerenUE's most recent power supply agreement with EEInc. was originally executed in 1987 and contained a cost plus 10% rate for the power being delivered."

Q. Do you agree with Mr. Moehn's testimony on page 10, lines 14-5, where he states: "This agreement expired by its own terms on December 31, 2005"?

A. No. The agreement expired by AmerenUE when not consistent with its rights and regulatory obligations to its customers, it chose not to seek the best terms for its system and customers. Unlike Kentucky Utilities, the sole remaining non-Ameren affiliated EEInc. owner, AmerenUE had a ownership percentage significant enough to effectively extended the contract on its existing terms. I will discuss the Kentucky Utilities' situation relative to EEInc. later in this testimony. AmerenUE has effectively modified its EEInc. situation thereby effectuating a disposition of its system, diverting the Joppa lower cost capacity and energy from continued service to its native load customers from continuing to provide the Union Electric system the economical service, which it asserted would occur as the result of its EEInc. involvement.

Counsel to the Staff has advised me of a number of MoPSC and federal agency decisions. For example, Union Electric stated to the Commission in 1952 at page 4 of its Application in Case No. 12,463, In the Matter of the Application of Union Electric Company

of Missouri for authorization to acquire additional shares of capital stock of Electric Energy, Inc:

> 7. . . . The Sponsoring Companies have also agreed to purchase, in proportion to their respective stock participations, any surplus power from EEINC's generating station not required for delivery to AEC. It is estimated that when the entire generating station of EEINC is in full scale operation there will be available to the Sponsoring Companies, at an economic cost, in excess of 1,500,000,000 Kwh of energy of which Petitioner's share will be approximately 600,000,000 Kwh.
>
> 8. Petitioner submits that its additional investment in the capital stock of EEINC will contribute to the national defense program and will be in the public interest. Upon consummation of the arrangements outlined above Petitioner's system will have an additional efficient and economic source of power to meet the expanding requirements of the public in its service areas.

The Commission's Report And Order in Case No. 12,463 states at page 3:

> Petitioner further states that when the entire generating station of Electric Energy, Inc. is in full scale operation there will be available to Petitioner as its share of the surplus power from such station approximately 600,000,000 kwh of energy per annum at an economical cost which will provide an additional efficient and economic source of power to meet the expanding requirements of the public in the service areas of Petitioner's system.

In 1977 in *Re Union Electric Company*, Case No. EF-77-197, 21 Mo.P.S.C.(N.S.) 425 (1977), EEInc. proposed to acquire and install certain air pollution control equipment. In connection therewith, EEInc. filed a petition with the Illinois Commerce Commission seeking authority to issue and sell $10 million in principal amount of its 8½ percent First Mortgage Sinking Fund Bonds for the purpose of financing the cost of the acquisition, installation and construction of such air pollution control equipment. Union Electric proposed to enter into a second amendment to the Amended Intercompany Agreement which would have the effect of extending the provisions of the Amended Intercompany Agreement to cover and include the 8½ percent Bonds, and would be assigned to the Trustee as

additional security for the Bonds of EEInc. (including the 8½ percent Bonds). Said proposed amendment would make unconditional the obligations of the Sponsoring Companies to make payments to EEInc. to enable EEInc. to pay its operating and other costs and expenses so that in the event that EEInc. would be unable for any reason to generate or deliver any power or energy to the Sponsoring Companies, the Sponsoring Companies would be obligated to continue payments to EEInc. The obligations of the Sponsoring Companies were proposed to be so enlarged so as to induce the purchase of the 8½ percent Bonds. The MoPSC stated in its Report and Order as follows:

> . . . In return for its "guaranty" of EEI's financial obligations, Applicant will be assured of a continuous source of economical power, its entitlement of the surplus power not contractually obligated to ERDA. This surplus power is more economical to Applicant than the installation of other new generation or the purchase of such power from others. . . .

Q. Do you agree with Mr. Moehn's Direct Testimony on page 10, lines 15-19 that states; "Following the expiration of the agreement, EEInc. elected to cease selling power from the Joppa Plant on a cost plus basis, and instead sought and received authority from the Federal Energy Regulatory Commission (FERC) to sell power from the Joppa Plant at market prices. Consequently, AmerenUE no longer has the opportunity to purchase power from EEInc."?

A. No. AmerenUE because of its 40% ownership share of EEInc. could continue to purchase its proportionate share of Joppa Station output. The EEInc. Bylaws provided for the allocation of capacity and energy from the generation facilities owned by EEInc. in proportion to the sponsoring companies ownership shares. This provision, however, may be changed by a seventy-five percent vote of the outstanding shares. Since AmerenUE owned forty percent (40%) of EEInc. the bylaw provision could not be changed without

AmerenUE's agreement. AmerenUE did not seek to extend its purchase power agreement with EEInc. beyond the scheduled termination on December 31, 2005 and voted to allow the EEInc. capacity and energy to be removed from its system and be directed to support Ameren's non-regulated operations.

Q. What is the provision of the Bylaws to which you are referring?

A. "Article II, Section 6. Voting." of the By Laws of EEInc. states, in part, as follows:

> . . . In the event that any holder of voting capital of EEInc. (including, for these purposes, such holder's Affiliates) owns in excess of 50% of the voting capital stock of EEInc., then all corporate restructuring transactions and other major corporate actions shall be decided by the vote of the holders of 75% or more of the outstanding shares of the Corporation entitled to vote. Corporate restructuring transactions and other major corporate actions shall include: (a) sale of all or substantially all of EEInc.'s stock (or other securities) or assets; (b) issuance of new securities; (c) change in the relative percentages of ownership of stock (or securities) of EEInc. held by the current owners of EEInc.; (d) any other change in the ownership or control of EEInc.; (e) decisions to allocate the sale of the generating capacity of EEInc. among the EEInc. stockholders in a manner other than in accordance with their percentages of ownership of EEInc. stock, in the event of such capacity available for sale to parties other than the U.S. Enrichment Corporation changes materially; and (f) a material change in the business purpose or objectives of EEInc. . . .

Q. Do you agree with Mr. Moehn's Direct Testimony on page 12, lines 5-19 that states: "AmerenUE's stock in EEInc. was purchased with shareholder, not ratepayer funds, and has always been treated as a 'below-the-line' item for ratemaking purposes. This treatment has never been challenged in any regulatory proceeding. By 'below-the-line' I mean the investment in the stock is not and has never been on AmerenUE's books as an asset on which a return is figured in calculating the rates paid by AmerenUE's Missouri ratepayers. This is unlike an 'above-the-line' investment, such as a power plant or

transmission line, which are put into rate base. Above-the-line items affect the Company's revenue requirement because the revenue requirement is determined based upon these rate base items, including depreciation expense (which is a return of the Company's investment) and return on equity (which is a return on the Company's investment). A below-the-line investment in stock – like AmerenUE's EEInc. stock – does not allow ratepayers to share in any of the revenues derived from stock ownership, nor does it expose ratepayers to the investment risk associated with owning the stock. Rather, with regard to EEInc., ratepayers have simply paid the cost of power purchased by AmerenUE from EEInc. as provided for under power supply agreements between AmerenUE and EEInc."?

A. I disagree with several statements contained in this portion of Mr. Moehn's testimony. First, Union Electric's return on its equity investment in EEInc. was not treated as a below-the-line item for ratemaking purposes. Union Electric's return on its equity investment in EEInc. is specifically recorded in the capacity charges booked above the line and recorded in the costs used to set rates. Section 3.01 of the Power Supply Agreement between EEInc. and the Sponsoring Companies, in effect with modifications from 1987 to December 31, 2005, identifies the Joppa Plant Costs. This section specifies the determination of the monthly EEInc. cost components applicable to the ownership operation and maintenance of the Joppa Plant. The Power Supply Agreement specifies a "Component D" that consists of an amount equal to (1) the product of 1.25 dollars multiplied by the total number of outstanding shares at the end of the month of capital stock of the par value of $100 and (2) the product of .0125 multiplied by Company's retained earnings at December 31 of the previous year. This Section sets the EEInc. rates to the Sponsoring Companies based upon a 15% return on equity.

The fact that the Union Electric stock investment in EEInc. has never been on AmerenUE's books as an asset on which a return is figured in calculating the rates paid by AmerenUE's Missouri ratepayers does not prove that Missouri ratepayers have not been paying a return on Union Electric's investment in EEInc. The provision of a return on Union Electric stock investment in EEInc. would result in double recovery since the return costs were already included the demand charges booked above the line. Components A and D of Section 3.01 of the Power Supply Agreement provide for the payment of EEInc.'s interest and profit constitute return in ratemaking proceedings.

Q. Is there an important fact relative to this issue not mentioned in Mr. Moehn's testimony on page 15, lines 1-3, where he states: "EEInc. sought and obtained authority from the FERC to sell power from the Joppa Plant at market-based rates. The FERC authorized such sales in its order in Docket Nos. ER05-1482-000 and ER05-1482-001 issued on December 8, 2005"?

A. Yes. A key fact in these FERC dockets was the position of Kentucky Utilities, which is omitted by Mr. Moehn's testimony. The only owner of EEInc. that is not affiliated with Ameren Corporation, Kentucky Utilities owns 20% of EEInc. Kentucky Utilities noted in these FERC dockets that it could not commit and had not committed to using the capacity presently available pursuant the Power Supply Agreement between EEInc. and Kentucky Utilities beyond the existing term of the agreement (i.e., December 31, 2005) because Kentucky Utilities' contractual rights to that capacity would expire on December 31, 2005. As previously related, under the EEInc. Bylaws, Kentucky Utilities does not own enough stock to block a change in the allocation of capacity and energy from the generation facilities owned by EEInc. in proportion to the Sponsoring Companies ownership shares.

Only AmerenUE and its affiliate Ameren Energy Resources have ownership positions large enough to block such an effort.

Despite its minority position, Kentucky Utilities attempted to negotiate with EEInc. for a Power Supply Agreement for an additional term under the best possible pricing for the purpose of serving Kentucky Utilities' native load customers. Kentucky Utilities had used the capacity available to Kentucky Utilities under the Power Supply Agreement to serve its native load customers and desired to continue to use this capacity in the future for this purpose so long as the capacity remained a least-cost resource.

Kentucky Utilities had not made a commitment that it would continue to use capacity from the Joppa Plant available under the current Power Supply Agreement to serve Kentucky Utilities' native load customers in Kentucky past December 31, 2005, and such a commitment could not be made until EEInc. provided Kentucky Utilities with an offer, the appropriate least-cost analysis was completed, and contract negotiations and document execution were completed.

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Q. Do you agree with Mr. Moehn's Direct Testimony on page 15, lines 7-9, that states: "AmerenUE's most recent power supply agreement with EEInc. was

originally executed in 1987 and contained a cost plus 10% rate for the power being delivered?"

A. Not completely. This statement is correct regarding excess power available when the Department of Energy (DOE) and the other Sponsoring Companies were not scheduling the use of their respective capacity and for a component in the demand charge. This statement is not true regarding the total cost structure for capacity and energy assigned to any of the Sponsoring Companies.

The description of the EEInc. rate structure is contained in the EEInc. FERC Form 1 Annual Report to the FERC. This same information is contained in the 2005 EEInc. Annual Report to its shareholders. The rates for the capacity and energy available to the Sponsoring Companies under the Power Supply Agreement with Modification No. 16 (Mod 16) accepted by the FERC. In general, the Power Supply Agreement provided that that EEInc. would sell the power not dedicated to DOE to the Sponsoring Companies. Mod 16 required EEInc. to make available to DOE a specified percentage of the Joppa Station's capacity. DOE was committed to 0% of the Joppa's station's capacity for 2004 and 2005.

The EEInc. Power Supply Agreement required AmerenUE with other Sponsoring Companies and the Department of Energy to make monthly payments for power which would enable EEInc. to recover all of the Joppa's Station's cost-of-service, which included operating expenses, taxes, and interest plus generate a prescribed rate of return on equity capital of 15% net of federal income tax. The EEInc. FERC Form 1 Annual Report describes the Power Supply Agreement obligations of AmerenUE with the other Sponsoring Companies and DOE as absolute, unconditional, and shall not be discharged or affected by the failure, impossibility or impracticality of EEInc. to generate or deliver electricity. This

last feature shows that the Power Supply Agreement was not an agreement by AmerenUE to buy capacity and energy for its system from an independent separate third party supplier. This Power Supply Agreement reflects the cost obligations of the owners of EEInc.

Q. Do you have an example of the terms of an earlier Power Supply Agreement between EEInc. and the Sponsoring Companies?

A. Yes. The Electric Energy, Inc FERC Form 1 Annual Report for the year ending December 31, 1984 states, at page 122, as follows under the title Notes To Financial Statements, (1) Summary Of Significant Accounting Policies, (a) Operating Revenues:

> Electric Energy, Inc.'s (EEI) principal source of operating revenue is sales of electricity to the Department of Energy (DOE) and to four electric utility companies (Sponsoring Companies). Sales to the DOE are made under the Modification 11 Power Contract (the Power Contract), which became effective April 1, 1975, and amended in its entirety the original power contract as amended through Modification 10. Relations among the Sponsoring Companies and EEI are governed by the Intercompany Agreement, as amended, and the Interim, Supplemental and Surplus Power Agreement (IS&S Agreement). These agreements and the Power Contract continue in force through December 31, 1989, unless extended or canceled as provided under their terms.
>
> The Power contract and the IS&S Agreement, and thus the rates established therein for the sale of electricity to the DOE and the Sponsoring Companies, have been accepted by the Federal Energy Regulatory Commission. In general, the Power Contract requires EEI to make available to DOE a specified percentage of the established capacity of its generating facility until the termination date of the Power Contract. Pursuant to a request by DOE, a letter agreement effective October 1, 1981, significantly reduced the percentage of power made available to DOE over the two-year period ended September 30, 1983. The IS&S Agreement provides that EEI will sell the remaining power capability to the Sponsoring Companies.
>
> Under the Power Contract and the IS&S Agreement, the Sponsoring Companies and DOE are required to make monthly payments for power which will enable EEI to pay all of its operating expenses, taxes other than Federal income taxes, and interest and provide for retirement of outstanding debt, plus generate a prescribed net of

> Federal income tax rate of return on equity capital (16.59% in 1984 and 13.685% in 1983). The obligations of each of the Sponsoring Companies and DOE are absolute and unconditional and shall not be discharged or affected by the failure, impossibility or impracticability of EEI to generate or deliver electricity.

Q. What portions of Mr. Downs' Direct Testimony on this issue will you be addressing in your rebuttal testimony?

A. My understanding is that Mr. Downs' testimony addresses no matters of fact. Therefore, I am not address addressing issues specific to Mr. Down's testimony. I have addressed Mr. Moehn's testimony which Mr. Downs' relies upon to reach some of his conclusions.

Q. Does this conclude your rebuttal testimony?

A. Yes.