BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Application of Union Electric Company, Doing Business as AmerenUE, for an Order Authorizing the Sale, Transfer, and Assignment of Certain Assets, Real Estate, Leased Property, Easements and Contractual Agreements to Central Illinois Public Service Company, d/b/a AmerenCIPS, and, in Connection Therewith, Certain Other Related Transactions.	)	Case No. EO-2004-0108

Dissenting Opinion of Commissioner Steve Gaw

Since my appointment to the Commission on April 2, 2001, I have had the opportunity to hear and decide numerous cases. Recognizing that the Commission consists of five individuals, it is a foregone conclusion that the Commission will inevitably issue certain decisions that are contrary to the views of any specific Commissioner. Originally, this Commission issued a unanimous decision, based upon the merits of this case, which concluded that this transaction was detrimental to the Missouri ratepayers unless certain conditions were imposed. Recently, the majority reversed course and issued its Report and Order on Rehearing. As I mentioned at the time of the Commission decision, I cannot recall a time when I was as disappointed as I am in the majority's decision to issue this Report and Order.

The record and pleadings in this case indicate that this decision was reached: (1) in an atmosphere of veiled threats and intimidation imposed on the Commission by the Applicant; (2) with significant evidence, some of which was available but not considered by the Commission, to conclude that this transaction could have a long-term and significant negative impact on the Missouri ratepayers of AmerenUE; (3) without reviewing and considering the pleadings and evidence of contrary parties; and (4) in a manner which arguably denies the opposing parties their due process of law. Although the majority has stated that it would protect the ratepayers from these detrimental effects in subsequent rate proceedings, such protection may be impossible if Staff's projections become reality and the detriments from this transaction exceed the benefits. For all of these reasons, I must dissent from the decision issued by the majority in the above captioned proceeding.

I. INTRODUCTION

At first glance, this case appears fairly straightforward: a regulated utility is seeking Commission authority to sell a portion of its assets. If this transaction involved a sale of a portion of an ongoing concern between businesses operating in an unregulated arena, the self-interests of the two businesses would normally ensure that the transaction protected both. The purchaser would, at a minimum, inspect the assets and books of the business it was buying and pay a price that would allow a reasonable return on its investment. Similarly, the seller would normally expect at least fair market, and would only sell if the sale made sense in its long range goals.

The factors of self interest which assure such safeguards are not present in this case. Here, there is a proposed sale of AmerenUE's business in Illinois to an affiliated company – AmerenCIPS. The parent company's (Ameren's) concern about the transaction is that it maximizes profits for Ameren, not whether its subsidiary AmerenUE or its ratepayers fare better or worse in the transaction than its subsidiary AmerenCIPS. Even if AmerenUE gets a bad deal and AmerenCIPS a good deal, AmerenUE will not be heard to protest. If the transaction is of benefit to the parent, its subsidiaries' interest and that of the subsidiaries' customers are subservient. In fact, as opposed to many cases before the Commission where the interests of the regulated utility and its customers are in conflict, here the interests are much more aligned. The Commission is the entity in this transaction that has the authority to protect the interest of Ameren UE's ratepayers and AmerenUE itself and we have a duty to do so.

II. HISTORY / BACKGROUND

On October 6, 2004, a unanimous Commission issued its first Report and Order in this proceeding. In that Order, the Commission concluded that this transaction, as proposed by AmerenUE, would be detrimental to the public interest and could not be approved without conditions. In an effort to assist AmerenUE in completing this transaction while simultaneously ensuring that public detriment would not occur, the Commission suggested several conditions which, if agreed to by AmerenUE, would allow the Commission to approve the transaction. Specifically, the Commission suggested that AmerenUE modify the transaction by:

1. Amending the Joint Dispatch Agreement ("JDA") to distribute profits from off-system sales on the basis of generation rather than load;

2. Amending the JDA to price inter-company energy transactions at market rather than at incremental cost;

3. Holding Missouri ratepayers harmless from any increased allocation of pre-closing liabilities currently born by the Illinois ratepayers of AmerenUE.

4. Refusing to waive the record-keeping portion of the Commission's affiliate transactions rules.

5. Requiring AmerenUE to continue the nuclear decommissioning contribution previously provided by the Illinois ratepayers.

6. Excluding any future transmission costs associated with the transfer to AmerenCIPS of the transmission facilities linking the Illinois generating facilities to the Missouri load.

On October 15, 2004, AmerenUE filed its Motion for Rehearing. In its Motion, AmerenUE noted that two of the conditions were not acceptable to AmerenUE, primarily the conditions related to pre-closing liabilities and amendment of the JDA to price energy transfers at incremental cost. AmerenUE noted that the imposition of these conditions threatened not only the benefits associated with the Metro East transfer, but also the actual transfer of the Pinckneyville and Kinmundy Combustion Turbine Generators.[1] In the same document, AmerenUE also sought to retreat from its previously litigated positions and instead engage the Commission itself in negotiations regarding the appropriate conditions to place on this transaction.[2] In essence by issuing this Order

[1] AmerenUE's interjection of the transfer of the Pinckneyville and Kinmundy CTs is particularly interesting given that the Company specifically argued that the transfer of these CTs is not germane to the issues in this proceeding. Specifically, AmerenUE witness Craig D. Nelson notes that "[t]he transfer of the Pinckneyville and Kinmundy plants . . . is not an issue in the present case because that transfer does not impact the question of whether the Metro East Transfer is detrimental to the public. . . I would agree that I not only 'prefer' those transfers not be an issue, but I would submit that they in fact are not an issue because they do not bear on whether or not the Metro East Transfer is detrimental." Given AmerenUE's previous contention that Pinckneyville and Kinmundy transfer was not an issue in this proceeding, one must necessarily question its motives in subsequently reversing course in the context of its Motion for Rehearing and claiming that the transfer of these units was now "unlikely".

[2] As reflected below, AmerenUE's retreat from its litigated position and offer of alternative conditions in the context of a Motion for Rehearing raises significant concerns regarding the violation of the due process rights of the Office of the Public Counsel as well as those of the industrial interveners. The Commission's subsequent refusal to provide these parties the opportunity to engage in discovery or cross-examination regarding these alternative conditions raises significant questions of fairness and due process and erodes at the basic underpinnings of the Commission's practice and procedure. Concerns regarding AmerenUE's conduct in this proceeding is further heightened when one recognizes that such conduct has seemingly become commonplace with AmerenUE. As Staff notes in its Response to AmerenUE's Motion for Rehearing, such tactics are not entirely new for this Company. In fact, Staff notes that the Company has engaged in such Commission negotiations previously in the context of Case No. EO-2002-0351. The Commission should necessarily ask itself if the cost of litigating this entire proceeding could have been lessened or avoided if AmerenUE had been forthcoming with its positions from the very beginning. As Staff notes, AmerenUE's approach should raise questions including "Has AmerenUE now made its best offer to the Commission, and if not, when might AmerenUE make its best offer, and what must occur in order for AmerenUE to make its best offer?"

without allowing a proper hearing the Commission has taken Ameren up on its offer to negotiate behaving more like a party than a decision maker.

Virtually simultaneous with its Motion for Rehearing, AmerenUE sought to interject an additional issue from another case. On October 28, 2004, AmerenUE announced that it had reached an agreement to provide electric energy and capacity to Noranda Aluminum under the terms of a 15 year contract. Similar to statements regarding the Pinckneyville and Kinmundy CTs, AmerenUE again threatened that it would not execute the Noranda agreement unless the Commission approved the Metro East transfer on terms solely acceptable to AmerenUE.[3] Given the critical economic nature of the Noranda smelting unit to the Southeast Missouri region as well as concerns regarding the long-term viability of Noranda without the access to low priced reliable electric energy, AmerenUE effectively sought to force the Commission to choose between either: (1) accepting the recognized detriments of the Metro East transfer with conditions UE then proposed and (2) the possibility of losing the Noranda smelting facility and the associated 1,100 jobs. Because of the announcement of the Noranda agreement, as well as AmerenUE's claim that the agreement was dependent on the Metro East transfer, the Commission agreed to rehear the current proceeding for the purpose of reviewing the effect of the Noranda agreement on the benefits and detriments of the Metro East transfer.

[3] See, Direct Testimony of Craig D. Nelson, Case No. EA-2005-0180, filed December 20, 2004. ("AmerenUE's commitment to being Noranda's electric supplier is conditioned upon AmerenUE completing the transfer of the Metro East service area to AmerenCIPS by June 1, 2005, and completing the transfers of the Kinmundy and Pinckneyville combustion turbine generators ("CTGs") from Ameren Energy Generating Company to AmerenUE by June 1, 2005, <u>as AmerenUE determines to be to its satisfaction and sole discretion</u>." (emphasis added).

III. PARTIES / STRUCTURE OF THE TRANSACTION / REGULATORY ENVIRONMENT

In order to understand the benefits and detriments arising out of this transaction, it is incumbent to understand: (1) the identity of the parties to the transaction; (2) the jurisdiction and attendant regulatory environment in which each party operates; and (3) the structure of the transaction.

A. Parties:

1. Ameren: a public utility holding company delivering electric and natural gas service to customers in Missouri and Illinois. Ameren conducts its regulated utility business through these subsidiaries: (1) AmerenUE; (2) AmerenCIPS; (3) Central Illinois Light Company (CILCO) and (4) Illinois Power.

2. AmerenUE: a public utility providing rate-regulated electric generation, transmission and distribution services and rate-regulated natural gas distribution services in Missouri and Illinois. Currently, AmerenUE operates approximately 8,300 MW of electric generation situated in Missouri as well as the Venice Combustion Turbines located in Metro East St. Louis, Illinois and the Keokuk generation facilities located in Iowa.

3. AmerenCIPS: a public utility providing rate-regulated electric transmission and distribution service and natural gas service in Illinois. As reflected, below, AmerenCIPS receives all of its electric capacity and energy from Ameren Energy Generating Company through a power supply agreement with an affiliate marketing entity.

4. Ameren Energy Generating Company (AEG): a non rate-regulated exempt wholesale generator. AEG was created on May 1, 2000 to hold all the generating

assets previously owned and operated by AmerenCIPS as well as substantially all of the generating assets of CILCO. Currently, AEG owns approximately 4,200 MW of electric capacity. AEG is obligated to supply, through a marketing affiliate, all of the energy and capacity needed by AmerenCIPS for its native load customers. Any power not used by AmerenCIPS is sold, through a marketing affiliate, under various long term wholesale and retail contracts.

5. Ameren Energy Marketing: a non-regulated energy marketer responsible for marketing the energy and capacity owned and operated by AEG.

B. Jurisdictions

The relevant regulatory jurisdictions are Missouri and Illinois. In 1997, Illinois passed the Illinois Electric Service Customer Choice and Rate Relief Law. As designed, this law provides for electric utility restructuring and introduces competition into the retail supply of electric energy in Illinois. As a result of this legislation, Ameren created AEG to hold all the generating assets of AmerenCIPS. Effectively, Illinois ratepayers are permitted to purchase electric energy and capacity from the cheapest provider. This electricity is then transmitted to the customer using the transmission and distribution assets of the relevant delivery company.[4]

Unlike Illinois, Missouri has not deregulated retail electric service. While Missouri once studied the effects of introducing similar electric restructuring legislation, progress towards a deregulated electric generation market was stalled and derailed by

[4] As indicated, upon the adoption of the Illinois legislation, AmerenCIPS transferred its generating assets to Ameren Energy Generating Company. As a result, AmerenCIPS no longer operates any of its own generation. All electricity provided by AmerenCIPS to its native load customers is provided by AEG or indirectly from AmerenUE through the Joint Dispatch Agreement. Unlike AmerenCIPS, however, AmerenUE has not been required to divest itself of its electric generating assets in Illinois. This difference results from a decision of the Illinois Commerce Commission which recognizes the fact that the overwhelming majority of AmerenUE's operations are in Missouri, for which it is required to maintain adequate electric generation assets.

disasters in the experiment with deregulation of electricity in California as well as the collapse of Enron and other electric trading companies. Missouri electric utilities operate under rate base / rate of return regulation. Under this form of regulation, a utility's is allowed to reflect in retail rates its reasonable operating expenses, and is given the opportunity to earn a reasonable rate of return on its electric plant in service.

As a result of the differences in regulatory schemes between Missouri and Illinois, Ameren has an incentive to divert generating costs from AEG to AmerenUE. Such diversion of generating costs provides AmerenUE the opportunity to recover such costs in its Missouri retail rates, and reduces AEG generating costs in Illinois, thereby allowing AEG to better compete and profit against other electric generators in that state. In this way, AEG generating costs, which would otherwise have exceeded the market price for electricity in Illinois and would not have been recoverable, may now be diverted to Missouri and recovered through Missouri retail rates. This diversion of generating costs from Illinois to Missouri reduces AEG's operating costs in Illinois, provides AEG a competitive advantage relative to its Illinois competitors, distorts wholesale competition in Illinois and results in inflated non-regulated profits for the Ameren Illinois affiliates, all at the expense of the Missouri regulated ratepayer.

C. Transaction

As reflected in its application, AmerenUE sought to transfer all of its electric utility service area assets located in the Metro East St. Louis, Illinois, including transmission and distribution plant and customers, as well as any associated liabilities, to its affiliate AmerenCIPS. Additionally, AmerenUE sought to transfer assets and customers related to its provision of gas service in the Metro East Service Area. In consideration of this transfer of assets, AmerenUE would receive payment and a promissory note reflecting net book value of the assets at the time of transfer.

Recognizing that AmerenUE would not transfer any generating assets to AmerenCIPS, but instead would continue to operate those facilities primarily for the benefit of the Missouri service territory, AmerenUE claims that Missouri ratepayers would receive the benefit from the additional availability of its low-cost generating facilities. In essence, Missouri ratepayers would now be entitled to receive 6% of the output from the existing AmerenUE generating facilities that was previously allocated to the Illinois service area.

Another essential part of this transaction involves the continued applicability of the Joint Dispatch Agreement ("JDA") executed between AmerenUE and AEG. As envisioned, the JDA would allow for greater efficiencies by allowing AmerenUE and AEG to jointly dispatch their combined generating resources to minimize system production costs. AmerenUE states that the JDA "sets forth detailed guidelines for assignment of energy costs associated with the generation and purchase of electric energy to satisfy AmerenCIPS and AmerenUE's native load and other AEG load obligations, and for assigning costs and revenues associated with certain off-system sales." Most importantly to the discussion of this proceeding, the JDA: (1) allocated revenues derived from off-system sales on the basis of relative load and (2) provided for inter-company transfers of energy to be billed at incremental cost.

IV. CONCERNS ARISING OUT OF TRANSACTION

A. Affiliate Transaction

The most immediate concern that arises upon a reading of the application in this proceeding is that this transaction involves a transfer of assets between two wholly owned subsidiaries of Ameren. Any transaction between two affiliated parties necessarily raises red flags regarding the relative equities of the transaction. Unlike a transaction involving two unaffiliated parties engaged in arms-length negotiations focused upon the interests of their individual shareholders and ratepayers, an affiliate transaction raises concerns that the interests of either affiliate may be subordinated by the overall corporate interest. In the case at hand, AmerenUE has not engaged in legitimate negotiations with a principal focus on the betterment of AmerenUE and its ratepayers. Instead, AmerenUE's interests, as well as that of its ratepayers, are secondary to the overall corporate interest of Ameren. This fact, that Ameren was not concerned with the interests of AmerenUE or its ratepayers is readily apparent in the following exchange:

> Q. Is this proposed asset transfer or the proposed transaction with the Metro East Illinois properties, do you believe that it is an arm's length transaction?
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> A. Clearly in one respect it is arm's length, because you have the Illinois Commerce Commission on one end of the arm and the Missouri Public Service Commission on the other end of the arm, both with conflicting interests, both wanting to make sure the transaction's fair, both keenly interested in the - - in their own retail customers in their state. So from that perspective, I think it is very arm's length.[5]

[5] Tr. 457.

Clearly, Ameren, during the course of these negotiations, was not concerned with the interests of any specific subsidiary or the retail customers of that subsidiary. Instead, Ameren was focused solely on the overall profitability of the parent company.

Recognizing the undeniable concerns associated with these transactions, the Commission promulgated its affiliate transaction rules in 2000.[6] As defined in the context of 4 CSR 240-20.015, an "affiliate transaction means any transaction for the provision, <u>purchase or sale</u> of any information, <u>asset</u>, product of service, or portion of any product or service, between <u>a regulated electrical corporation and an affiliated entity</u>" (emphasis added). The rule also provides that:

> In transactions that involve the provision of information, assets, goods or services to affiliated entities, the regulated electrical corporation must demonstrate that it –
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> 4. Adequately determined the fair market price of the information, assets, goods or services.[7]

Once determined, the rule provides that the regulated electrical corporation may only transfer these assets to an affiliated entity at the higher of the cost or the market value for such assets.[8]

Despite these clear dictates, AmerenUE attempts to circumvent the rule. Relying solely upon the purpose provision of the rule, AmerenUE argues that the rule only pertains to transactions between regulated and unregulated affiliates. AmerenUE attempts to argue, since AmerenCIPS is a regulated entity, albeit by the utility

[6] See, 4 CSR 240-20.015 and 4 CSR 240-40.015.

[7] See, 4 CSR 240-20.015(3)(C).

[8] See, 4 CSR-240-20.015(2)(A)(2).

commission of a different state, that this is a transaction between two regulated electrical utilities and that the purpose provision is not met.

AmerenUE's narrow interpretation of the Commission's affiliate transaction rule is nonsensical and avoids the obvious applicability of the rule. First, the definition of "affiliate transaction" clearly indicates that it involves any transaction "between a regulated electrical corporation and an affiliated entity". Nothing in this definition limits the affiliate entity to nonregulated affiliated entities. Second, AmerenUE's interpretation of the rule (that a transaction with AmerenCIPS is not covered because AmerenCIPS is a regulated entity) is nonsensical because AmerenCIPS is not a regulated entity according to the rule's definitions: "regulated electrical corporation" means "every electrical corporation as defined in Section 386.020, RSMo, subject to commission regulation pursuant to Chapter 393, RSMo." It defies any semblance of logic for AmerenUE to claim that AmerenCIPS constitutes a "regulated electrical corporation" for purposes of avoiding the dictates of this rule. Clearly, while regulated by the Illinois Commerce Commission, AmerenCIPS is not subject to commission regulation pursuant to Chapter 393, RSMo. Given the shortcomings of AmerenUE's argument, it is undeniable that this transaction falls within the strictures of the Commission's affiliate transaction rule.

Although the affiliate transaction rule is applicable and requires that any transfer of assets be at the greater of cost or fair market price, AmerenUE notes that it is incapable of demonstrating that it meets this requirement. As AmerenUE points out in its Application, Ameren "does not intend to engage in an arms' length transaction which would create a market value."[9] The failure, by AmerenUE, to deduce a fair market value

[9] Application for Transfer of Assets, Change in Decommissioning Trust Fund, Waiver of Affiliate Rules, and Motion for Expedited Treatment, filed August 25, 2003, at page 8.

for the Metro East service territory prior to transferring to an affiliate entity is a direct violation of the Commission's rule and renders a thorough benefit analysis virtually impossible. While the immediate impact of a failure to pay for the value of this portion of AmerenUE's business may not be clear, the importance of cash to the overall health of a company and its ability to make investments is often argued to the Commission by regulated utilities including AmerenUE. Furthermore, the Commission itself by the decision of the majority has ignored its own rule without explanation in coming to its decision.

Nevertheless, despite AmerenUE's refusal to ascertain the fair market value of the Metro East service area, one shortcoming of the transaction is readily apparent. While AmerenUE notes that it is transferring the hard assets, primarily the Metro East transmission and distribution network, at net book value, not only does it fail to receive any compensation for the transfer of the customers located in Metro East and currently served by AmerenUE, it hypocritically argues on one hand that the elimination of Metro East load is good for Missouri ratepayers and, in a separate case yet to be heard, argues that the acquisition of the Noranda load is also good for Missouri ratepayers. The value of such industrial customers is reflected in the testimony filed by AmerenUE in the related Noranda application.[10] In that docket, AmerenUE claims that adding Noranda as a regulated utility customer results in a $2 to $3/MWh cost savings. This cost savings primarily results from the addition of a 470 MWs of load with an overall load factor of 98%. As AmerenUE witness Voytas points out:

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[10] Case No. EA-2005-0180.

> This means that Noranda takes as much energy off-peak as it does on-peak. Off-peak generation costs are less than on-peak generation costs so selling this off-peak power to Noranda, some of which simply could not be sold off-system at all, generates margins for AmerenUE (and for its customers in the form of a lowered revenue requirement) that would not exist without Noranda. Thus, AmerenUE's overall native load variable production costs decrease on a $/MWh basis. The second factor concerns the embedded cost calculation. The addition of the almost 100% load factor Noranda load means that there are more MWh sales over which to spread embedded or fixed costs thereby decreasing the embedded costs on a $/MWh basis.[11]

While AmerenUE is seemingly capable of understanding the value of a high load factor customer in the context of the Noranda Application, it was apparently incapable of understanding the attendant value of the Metro East load in the context of its "negotiations" in the current transaction. Evidence clearly indicates that AmerenUE's overall load factor is 53%. In light of this load factor and the apparent value placed by AmerenUE on the addition of electric load with high load factors, it is puzzling that AmerenUE would in essence give away the 597 MW Metro East load with a 79% load factor. Clearly, if the Noranda load will "generate margins for AmerenUE (and for its customers in the form of a lowered revenue requirement)", it is logical to assume the 597 MW Metro East load with a 79% load factor may also generate margins for AmerenUE and its customers. AmerenUE's representation to this Commission that eliminating the high load factor Metro East load is beneficial to AmerenUE and its ratepayers, while simultaneously arguing that adding the high load factor Noranda load is also good for AmerenUE and its ratepayers is illogical and disingenuous.

On February 7, 2004, Staff filed a pleading designed to analyze the relative production costs for AmerenUE assuming four different scenarios:

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[11] See, Voytas Direct at page 22, Case No. EA-2005-0180, filed December 20, 2004.

1. No Metro East Transfer / No Noranda Load;

2. No Metro East Transfer / Yes Noranda Load;

3. Yes Metro East Transfer / No Noranda Load; and

4. Yes Metro East Transfer / Yes Noranda Load.

This analysis indicates that AmerenUE should be essentially neutral towards the transfer of the Metro East load to AmerenCIPS. That is to say, given the approved methodology of allocating profits from off-system sales, AmerenUE's production costs are essentially the same with or without the transfer ($58.93 / MWh without the transfer and $58.82 with the transfer). Nevertheless, despite this quantification of AmerenUE's costs, this analysis does not attempt to quantify the value of this transaction to AmerenCIPS or another entity negotiating at an arms-length basis; value that may have resulted in significant compensation to AmerenUE and its ratepayers. This value would only have become apparent if AmerenUE had attempted to deduce the fair market value of the Metro East assets and customers.

B. Joint Dispatch Agreement

During the course of completing the merger of Union Electric Company and Central Illinois Public Service Company (CIPSCO), a Joint Dispatch Agreement was executed. As initially envisioned at the time of the merger, the JDA would allow the generating resources of both entities to be committed and dispatched to jointly serve the native loads of both entities. "Thus, each hour, the actual generation of each entity will only match its respective load by chance, with the most likely outcome being the transfer of energy from one entity to meet the load of the other entity."[12] In this way, generating

[12] Proctor Rebuttal at page 14.

cost savings are created for the merged entity. Recognizing that the generating assets of both Union Electric, operating primarily in Missouri, and CIPSCO, operating in Illinois, were fully regulated at the time of the merger, the initial JDA established that all transferred energy should be priced at the incremental cost of generating.

Approximately three years later, following the passage of the Illinois electric utility restructuring legislation, AmerenCIPS sought to transfer all of its generating assets to a rate deregulated exempt wholesale generator, Ameren Energy Generating Company (AEG). Understanding that the JDA governed the generating assets sought to be transferred by AmerenCIPS, Ameren sought to substitute AEG for AmerenCIPS in the JDA. Furthermore, in its effort to meet the federal public interest test required for the transfer of regulated generating assets to an exempt wholesale generator, Ameren claimed numerous benefits of the transfer. Interestingly, in its Order, the Missouri Commission notes that the JDA would "make significant additional generating **capacity** available to UE's customers without adding corresponding construction costs to the rate base".[13]

The JDA currently provides for: (1) the allocation of profits from off-system sales on the basis of relative loads and (2) the pricing of intercompany transfers of energy at incremental cost. As a result of these two provisions, the JDA has a negative effect on the economics of the proposed Metro East transfer. As Staff Witness Dr. Proctor notes:

> The JDA has a significant impact on the economics of the proposed Metro East transfer. As a part of the transfer of the Metro East assets to

[13] In re Application of Union Electric Company, d/b/a AmerenUE, for Approval of the Transfer of Generating Assets by an Affiliate to another Affiliate, Case No. EA-2000-37, Order Approving Unanimous Stipulation and Agreement, Making Findings Under the Public Utilities Holding Company Act , and Closing Case, at page 4 (emphasis added). The Commission's reference in that Order to the availability of additional generating capacity through the JDA is particularly important given AmerenUE's claims that it does not have sufficient capacity to serve both the Metro East and Noranda loads. Furthermore, despite the availability to AmerenUE of additional AEG generation through the JDA, as professed in this Order, AmerenUE now claims that this capacity is not available to AmerenUE through the JDA.

> AmerenCIPS, the Metro East load will also be transferred to AEM (Ameren Energy Marketing). Under the current JDA, the joint unit commitment and dispatch will remain unchanged. However, the native loads for AmerenUE and AEM will change. AmerenUE's native load will decrease and AEM's native load will increase by the amount of the Metro East load. Thus, the transfer of energy from AmerenUE's generating resources to serve AEM's load will increase and the amount of energy from AEG's resources to serve AmerenUE's load will decrease. In addition, the amount of profits from off-system sales going to AmerenUE will decrease and the amount of profits from off-system sales going to AEM will increase because of the change in native loads.[14]

In order to eliminate the negative impact of the JDA on the Metro East transfer, the Staff proposed two amendments. First, Staff proposed that the JDA be amended to provide for the allocation of profits from off-system sales on the basis of generation rather than respective shares of native load. This proposed amendment was agreed to by AmerenUE and ordered by the Commission in both the original Report and Order as well as in the majority's recent opinion. Second, and of greater disagreement, is Staff's suggestion that the JDA also be amended to reflect the pricing of energy transfers at market price rather than incremental cost. As Staff Witness Dr. Proctor notes:

> The current pricing of energy transfers at incremental cost instead of market price is detrimental to the Metro East transfer in that all of the Metro East load that is currently being served by AmerenUE generation would continue to be served by AmerenUE generation at incremental cost. Thus, AmerenUE generation that is released by the transfer would not be able to be sold into the spot market at competitive prices, but would instead by sold to AEM at below market price. The energy transfer is approximately 4 million megawatt-hours per year, and at a difference between market price and incremental cost of only $2.5 per megawatt-hour, the difference is $10 million per year.[15]

Unlike the first proposed JDA amendment, Staff's proposal to modify the pricing of intercompany transfers of energy resulted in great resistance. Noticeably, while

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[14] Proctor Rebuttal at 15.

[15] Id. at 16.

AmerenUE was vociferous in its opposition to the amendment, its position was lacking in substance. Rather, than providing the Commission with evidence supporting the need for pricing intercompany transfers on the basis of incremental costs, AmerenUE simply took the position that this question should be ignored until a future rate proceeding. Ameren also asserted the difficulty of ascertaining market price absent the commencement of MISO energy markets.[16]

AmerenUE's inability to provide such a substantive rationale is not surprising given AmerenUE's position regarding other issues in this proceeding. In its testimony before this Commission, the Office of the Public Counsel (OPC) has repeatedly alleged that AmerenUE's production cost modeling is deficient because it fails to reflect the continuing availability of 400 MW of capacity and energy associated with the Electric Energy, Inc. Joppa generating facility beyond the current December 2005 expiration date.[17] OPC claims that AmerenUE and its ratepayers are entitled to a portion of the low cost power generated by this facility beyond the expiration of the current electric supply agreement. Despite its inability to see the inequity in the JDA's current methodology for transferring energy on the basis of incremental cost, AmerenUE attacks OPC for its desire to have energy from the EEI Joppa facility made available on a similar basis. Specifically, AmerenUE argues against OPC's position in its Reply Brief.

> Make no mistake, <u>OPC wants that power at the lower of cost or market</u>. . . As Mr. Nelson suspected, OPC's Protest at FERC confirms that OPC has absolutely no intention of ever supporting a waiver of the affiliate transaction rules that might allow EE Inc. and AmerenUE to arrive at a

[16] Nelson Surrebuttal at pages 5-12; Voytas Surrebuttal at page 5.

[17] Electric Energy, Inc. is a 60%-owned subsidiary of Ameren Corporation, which is 40% owned by AmerenUE and 20% owned by another Ameren subsidiary. EEI operates electric generation and transmission facilities in Illinois. Most specific to the current proceeding, EEI operates the Joppa facility, a low cost generating facility located in southern Illinois.

> fair deal for power. . . In short, OPC (and apparently Staff, now having jumped on this bandwagon contrary to Dr. Proctor's sworn testimony) is never going to support a waiver of the affiliate transaction rules and wants this power at cost. <u>In the end, though, EE Inc. will not sell power to AmerenUE at cost.</u>[18]

AmerenUE also notes that it is unlikely that FERC would ever approve a contract that provided for the transfer of energy on the basis of incremental cost.[19]

Given AmerenUE's inconsistent positions on the pricing of energy sold to AmerenUE from EEI Joppa versus that sold by AmerenUE to AEG, it is apparent that AmerenUE's real interest is in gaining a better competitive advantage for its deregulated generating operations (AEG and EEI Joppa). By allowing AEG to purchase energy at incremental cost, Ameren is able to place AEG at a competitive advantage *vis a vis* its wholesale competitors, thereby distorting the wholesale electric generation markets

As in any competitive market, the entities in the wholesale electric generation market are only able to price at the market clearing price. In order to assure long-term viability, competitors must be able to recover, out of the market price, all of their variable cost as well as some contribution to their fixed costs. If the market price does not allow an entity to recover a contribution towards its fixed costs, that entity will ultimately be faced with making significant write-offs to the asset value of these assets.[20]

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[18] AmerenUE Reply Brief at pages 33-34, See also Tr. 1925 ("The EEInc., the nature of its business is such, as an exempt wholesale generator, that it's not interested in selling power at incremental cost.").

[19] Id. at 35.

[20] This competitive reality is best demonstrated by the action of certain long-distance companies in response to the price advantage gained by new competitors providing service based upon the economies of an all-fiber network. Recognizing that it would no longer be able to recover a contribution towards fixed costs associated with an older, inefficient network, companies such as AT&T were faced with huge asset write-offs.

Against this reality of a competitive wholesale market, Ameren seeks to introduce a competitor that has a completely different cost profile. Rather than pricing based upon some contribution towards fixed cost, Ameren seeks to have AEG enter the competition with some of its power obtained at Ameren UE's incremental cost. This competitive advantage allows AEG to either inflate overall corporate profits or to engage in predatory pricing.

Ameren's need to provide this competitive advantage for AEG is readily apparent through a reading of its 2003 SEC 10K annual report (Ex. 58).

Costs of Fuel ($$ per MMBtu)	**2003**	**2002**	**2001**
AmerenUE	$.822	$.813	$.867
AEG	$1.368	$1.452	$1.421

As reflected in that document, AEG incurs incremental costs that have ranged from 63.9% to 78.6% higher than those incurred by AmerenUE. There is no question that AEG's ability to access the lower cost AmerenUE generation provides it a competitive advantage and thereby distorts the wholesale electricity market.[21] The fundamental remaining issue is, given AmerenUE's acknowledgement that the FERC would never allow it to enter into a wholesale agreement that provides for the delivery of energy from Joppa unit at incremental cost, why would FERC, if provided the opportunity to review

[21] The ability of a firm to use a cost advantage, real or otherwise, to distort a competitive market was recently displayed in the telecommunications industry. Due to its policy of incorrectly capitalizing certain costs, WorldCom was able to offer a lower price relative to its competitors while simultaneously giving the financial community the impression that it was also recovering its costs. In response, AT&T, Sprint and other competitors were required to meet WorldCom's lower, distorted price. Given that these competitors were still using appropriate accounting methodologies, the drop in prices resulted in significant reductions to the net income figures for these competitors. As a result, stock prices for these competitors dropped significantly.

the JDA, allow for the continued existence of a Joint Dispatch Agreement that provides for similar incremental pricing?

C. Shift of Burden for Environmental Liabilities

The failure of AmerenUE to engage in an arms-length transaction also resulted in another detriment to Missouri ratepayers as a result of the Metro East transfer. As discussed in Staff's testimony, in the course of negotiating this transaction, AmerenUE reviewed each environmental liability and "assigned those liabilities based on whether the liability arose due to the generation function, or as a result of the transmission function or distribution function of AmerenUE. If the AmerenUE liability was assigned to generation, those liabilities would continue on AmerenUE's books. . . AmerenUE's analysis produced no assignment of any liability to AmerenCIPS from the electric operations of AmerenUE."[22] Since these generation facilities were providing energy to both the Missouri and Illinois retail jurisdictions, it is fundamentally unfair that these pre-closing environmental costs would be retained by AmerenUE, operating now as solely as Missouri utility, with no compensation from the Illinois ratepayers that benefited from such pre-closing activities and no protection of Missouri ratepayers from these liabilities.

Recently, AmerenUE has been heard to recite the values of a "cost causer – rate payer" method of establishing rates on the question of using an accrual method versus a cash method of recovering the cost of removal of retired assets. AmerenUE insisted that those that benefit from an asset should also be responsible for all the costs associated with that asset.[23] Despite AmerenUE's stated affinity for the "cost causer – rate

[22] Meyer Rebuttal at page 13.

[23] See, Post Hearing Brief of Union Electric Company d/b/a AmerenUE, Case No. GR-99-315, at page 35. ("The standard approach accomplishes intergenerational equity by ratably allocating the entire cost of the

payer" methodology, it inexplicably rejected application of this same methodology in this proceeding.

The environmental liability issue concerns the compensation for pre-closing environmental costs, primarily asbestos-related claims, that resulted from generation units operated for the benefit of both Missouri and Illinois ratepayers. Rather than assigning the allocable share of those pre-closing liabilities to the Illinois ratepayers that benefited from the service, AmerenUE seeks to transfer this Illinois portion of the pre-closing liabilities to the Missouri retail jurisdiction. Although the final amount may not be known for years, the fact that Ameren disclosed the liabilities in its 10K (Ex. 58) indicates Ameren management's belief that such costs could be material to the Ameren shareholders.[24]

Ameren's position in this proceeding, in which the Illinois portion of the pre-closing liabilities are being transferred, is in stark contrast to its position taken in prior matters in which such pre-closing liabilities are retained by the original liable party. Ameren's 10K notes the following general discussion regarding environmental cleanup liabilities:

> We are involved in a number of remediation actions to clean up hazardous waste sites as required by federal and state law. Such statutes require that responsible parties fund remediation actions regardless of fault, legality of original disposal, or ownership of a disposal site. UE and CIPS have been identified by the federal or state government as a potentially responsible

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assets that are serving customers, including a ratable share of the net salvage costs for those assets, to those same customers." (emphasis added)).

[24] Securities and Exchange Commission Release Nos. 33-8040, 34-45149; FR-60. "Our rules governing Management's Discussion and Analysis ("MD&A") currently require disclosure about trends, events or uncertainties known to management that would have a material impact on reported financial information." (emphasis added). "The underlying purpose of MD&A is to provide investors with 'information that the registrant believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations.'"

> party at several contaminated sites. Several of these sites involve facilities that were transferred by CIPS to Genco in May 2000 and were transferred by CILCO to AERG in October 2003. At part of each transfer, the transferor (CIPS or CILCO) has contractually agreed to indemnify the transferee (Genco or AERG) for remediation costs associated with pre-existing environmental contamination at the transferred sites.[25]

Specifically in regard to Ameren's asbestos-related litigation, Ameren notes:

> The claims filed against Ameren, UE, CIPS, Genco and CILCO allege injury from asbestos exposure during the plaintiff's activities at our electric generating plants. In the case of CIPS, its former plants are now owned by Genco, and in the case of CILCO, most of its former plants are now owned by AERG. As part of the transfer of ownership of the generating plants, the transferor (CIPS or CILCO) has contractually agreed to indemnify the transferee (Genco or AERG) for liabilities associated with asbestos-related claims arising from activities prior to the transfer.[26]

Had AmerenUE engaged in actual arms length negotiations, compensation for these pre-closing liabilities would have been recognized and addressed. As Staff notes, "[i]n an arms length transaction, AmerenUE would have insisted on some form of payment at closing from AmerenCIPS to cover their portion of the liabilities with an agreement between AmerenUE and AmerenCIPS about the allocation of costs between the two companies if those liabilities become payable in the future."[27]

V. CONDITIONS

In response to the overwhelming evidence indicating that this transaction will result in: (1) a transfer of assets to an affiliate at less than fair market value, in contravention of the Commission's affiliate transaction rules; (2) a shift in electric generation costs from AEG to AmerenUE under the provisions of the JDA; and (3) a shift

[25] Ex. 58, 10K filing for Ameren Corp dated March 9, 2004, at page 166. (emphasis added).

[26] Id. at page 168 (emphasis added).

[27] Meyer Rebuttal at pages 13-14.

in pre-closing liabilities from Illinois ratepayers to Missouri ratepayers, a unanimous Commission originally suggested numerous conditions that it asserted would protect the Missouri ratepayers from net detrimental effects of this transaction. Two of these conditions required AmerenUE to: (1) amend the JDA to provide for market pricing for all intercompany transfers of energy and (2) hold Missouri ratepayers harmless for the Illinois allocated portion of any liabilities realized in the future associated with pre-closing generation activities undertaken for the benefit of Missouri and Illinois ratepayers

Without any due process safeguards or any evidentiary support in the record, the majority in its Report and Order on Rehearing made a complete about face and instead adopted AmerenUE's alternative conditions. These alternative conditions, proposed by an Applicant which has acknowledged that it has never really considered the impact on ratepayers and would rely upon the Commission to provide such protections, would allow AmerenUE to: (1) maintain the incremental pricing for intercompany transfers of energy and (2) shift pre-closing liabilities to Missouri ratepayers, if AmerenUE shows, in a future rate proceeding that benefits associated with this transaction outweighs these acknowledged detriments.

The majority's acceptance of the alternative conditions significantly lessens Missouri ratepayer protections. First, the majority relies upon the flawed assumption that savings from a merger or other transaction may somehow be tracked. Such tracking is somewhat akin to the angel's ability, in the movie *It's A Wonderful Life*, to demonstrate how the world would have been different absent a particular event; such an assumption is based upon the mistaken belief that the post-transaction company can realistically ascertain how the world would have been had the company not proceeded with a particular transaction. Once understood, the costs for this fictitious company are then compared to actual costs and savings calculated. Such discussions border on the absolute limits of speculation.

In fact, approximately 15 years ago the Commission invited a merging entity to track merger savings in an effort to allow that Company to share in any recognized savings. The Commission recognized the tall task in front of the utility. Ultimately, the Commission noted:

> Staff has persuasively argued that KPL has a strong incentive to view savings as merger-related even if they are not and to classify them in the CSTS (cost savings tracking system) so as to increase the pool of savings subject to the sharing plan. Staff demonstrated several flaws in the CSTS which could allow nonmerger savings to seep into the pool of savings to be shared. . . The Commission is not convinced that KPL's tracking plan will exclude all nonmerger savings from the pool of merger savings to be shared.[28]

As recognized by Commissioner Mueller in his separate opinion:

> I do not believe that it is possible to make the merger savings tracking plan (MSTP) foolproof. It will be in the interest of KPL to classify as many savings as possible as being the result of the merger even though they might have occurred without the merger. Even the most competent auditor will not be able to find and exclude all such instances of mischaracterization. Therefore, I believe that savings which would have occurred without the merger will be included in the MSTP to be shared with the stockholders.

Second, the conditions offered by AmerenUE and adopted by the majority guarantees continues needless litigation in the future over: (1) the detriment suffered by the Missouri ratepayers in the form of increased exposure to environmental liabilities as well as the costs associated with subsidizing AEG through the JDA and (2) the speculative benefits which have occurred as a result of the transaction. The

[28] In re Kansas Power & Light Company for authority to merge with Kansas Gas & Electric, Case No. EM-91-213, 1 MoPSC 3d 150, 156-157, issued September 24, 1991.

encouragement of such ongoing litigation in the face of such obvious detriments is worrisome.

Finally, the majority's adoption of the Company's alternative conditions is inherently inequitable. In essence, the majority allows AmerenUE to take advantage of future benefits, either not known or not quantified at this point in time, and use them to justify the imposition of detriments on Missouri ratepayers, specifically detriments associated with the increased allocation of liabilities as well as those from the JDA. In essence, the majority has presented the Company a "no lose situation" by allowing it to later justify the detrimental aspects of this transfer.

Noticeably, the majority was not willing to provide the Missouri ratepayers a similar "no lose situation". During a recent on-the-record presentation, I specifically asked the Company whether it would be willing to shield ratepayers from the appearance of unknown detriments just as it is willing to gain from the appearance of unknown benefits.

> Q. [I]f your modeling is wrong on what you're assessing your benefits to be going forward, and ultimately we find in rate cases coming up that looking at the whole transfer, that the benefits weren't really as great as what you anticipated, and the detriments exceed - - not just the ones from the liabilities, but the detriments actually exceed the benefits, is Ameren willing to accept the condition that they will pick up all of those detriments as they're measured and as they're incurred going forward to be determined in the future whenever we get to those rate cases?
>
> A. I think the short answer to your question is we're not prepared to make that kind of commitment.[29]

In conclusion, I find it particularly worrisome that the majority has adopted "customer protection" conditions offered by a Company that has admitted that it never

[29] Tr. 1928-1929.

focused on the need to protect the ratepayer, and that, instead, has insisted that any customer protection role should be necessarily shouldered by this Commission.

VI. DENIAL OF DUE PROCESS

The original Report and Order set forth conditions designed to prevent certain detriments which otherwise caused the transfer to not pass the "not detrimental to the public interest" standard.[30] At the same time as it created an undercurrent of threats regarding the transfer of the Pinckneyville and Kinmundy units as well as the performance of the Noranda contract, AmerenUE also proposed alternative conditions which it claims would "allow the Company to complete the transfer of the Metro East load as well as the transfer of the Pinckneyville and Kinmundy CTGs to AmerenUE" as well as, presumably, the performance of the Noranda energy contract.[31]

AmerenUE's request for rehearing was a retreat from its litigated position. As such it proposed alternative conditions that were not litigated or discussed in the original hearing. As Staff noted in its Response to the Motion for Rehearing, "[p]utting aside these questions of tactics and strategy, the Commission must address the legal questions regarding the procedure it should / must follow if it wants to consider new proposals from AmerenUE."[32] Relying upon several recent court decisions, the Staff states that "if the Commission has any interest in pursuing adoption of these conditions that AmerenUE raised in its Application for Rehearing and Alternative Motion, the Commission needs an

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[30] State ex rel. City of St. Louis v. Public Service Commission, 73 S.W.2d 393 (Mo. 1934) (citing to Electrical Public Utilities Co. v. West, 140 Atl. 840 (Md. 1928).

[31] AmerenUE's Application for Rehearing and Alternative Motion for Clarification of the Commission's Order of October 6, 2004, at page 7.

[32] Staff Response to AmerenUE's Application for Rehearing and Alternative Motion and Public Counsel's Application for Rehearing, at pages 8-9.

evidentiary basis for doing so constituting competent and substantial evidence upon the whole record. . . [T]he Commission needs to establish a procedural schedule which would include adequate time for prefiled testimony, discovery, a hearing and briefs."[33]

In addition to Staff's pleading, the Commission's rules also establish sufficient basis for the Commission to have engaged in additional due process. Commission Rule 4 CSR 240-3.110 provides the filing requirements for an Electric Utility seeking to sell, assign, lease or transfer assets. In addition to other requirements, that rule requires the applicant to include a statement regarding "the reasons the proposed sale of the assets is not detrimental to the public interest."

By allowing AmerenUE to engage in substantive changes to its litigated position in the context of its Motion for Rehearing, the Commission has essentially ignored the requirements of its own rules. The previously cited Commission filing rule as well as the Commission's rules of practice and procedure clearly contemplate a thorough application identifying the reasons the proposed sale of assets is not detrimental to the public interest. The disclosures contained in the application should then be subjected to discovery, as contemplated by 4 CSR 240-2.090, presentation of evidence with attendant cross examination, as contemplated by 4 CSR 240-2.110 and 2.130, and briefs or oral arguments, as contemplated in 4 CSR 240-2.140.

Instead of undertaking the procedure contemplated by its Rules of Practice and Procedure, the Commission merely requested certain filings, none of which were actually received into the evidentiary record, and held an on-the-record conference, at which none of the parties were allowed to engage in cross-examination of the Company's witness regarding the revised Application. By allowing AmerenUE to make wholesale changes

[33] Id. at page 9.

to its Application without also providing sufficient procedural safeguards for the other parties to challenge the appropriateness of the new changes, the Commission has significantly undermined the due process rights of all parties. Moreover, given the lack of evidentiary foundation for AmerenUE's revised Application, the Commission's Report and Order on Rehearing suffers from fatal flaws.

VII. CONCLUSION

This dissenting opinion provides detailed discussion of deficiencies in the Report and Order on Rehearing. Briefly, I believe that the majority's decision: (1) fails to provide for adequate due process for parties; (2) fails to rely upon competent and substantial evidence in the evidentiary record; (3) runs afoul of the Commission's affiliate transaction rules; and (4) encourages an environment where utilities are free to dictate policy to the Commission.

While general discussion of such shortcomings may be fine for academic discussions, the practical matter is that the majority's decision potentially has a negative effect on AmerenUE ratepayers. The information contained in the latest Staff pleading indicates that, given the current structure of the JDA, "that the Metro East transfer is not economic."[34] Staff's analyses indicate that, absent any conditions, the proposed Metro East transfer may result in an annual detriment of over $31 million to AmerenUE shareholders. Even with the limited conditions offered by AmerenUE and agreed to by the Commission, I believe that this transaction viewed alone will most likely have a negative effect on all Missouri ratepayers (residential, commercial and even those industrial ratepayers represented in the two intervenor groups). Sadly, the only winners in the majority's decision are the Ameren shareholders.

[34] Staff Response to AmerenUE Filings, dated February 7, 2004, at page 11.

Respectfully submitted,

Steve Gaw
Commissioner

Dated at Jefferson City, Missouri,
on this 23rd day of February, 2005.