Exhibit No.:	
Issue(s):	Fuel Adjustment Clause
Witness:	Lynn M. Barnes
Sponsoring Party:	Union Electric Company
Type of Exhibit:	Addl Direct Testimony
Case No.:	ER-2010-0036
Date Testimony Prepared:	February 22, 2010

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2010-0036

ADDITIONAL DIRECT TESTIMONY REGARDING AMERENUE'S FUEL ADJUSTMENT CLAUSE

OF

LYNN M. BARNES

ON

BEHALF OF

UNION ELECTRIC COMPANY
d/b/a AmerenUE

**** DENOTES HIGHLY CONFIDENTIAL INFORMATION ****

St. Louis, Missouri
February 22, 2010

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REGARDING AMERENUE'S FUEL ADJUSTMENT CLAUSE

OF

LYNN M. BARNES

CASE NO. ER-2010-0036

I. <u>INTRODUCTION</u>

Q. Please state your name and business address.

A: My name is Lynn M. Barnes. My business address is One Ameren Plaza, 1901 Chouteau Avenue, St. Louis, Missouri 63103.

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

A. I am employed by Union Electric Company d/b/a AmerenUE (AmerenUE or the Company) as Vice President, Business Planning and Controller.

Q. Are you the same Lynn M. Barnes who filed direct testimony in this case on July 24, 2009?

A. Yes, I am.

Q. What is the purpose of your additional direct testimony?

A. The purpose of my testimony is to respond to the Commission's February 17, 2010 **Order Directing The Parties to Submit Testimony Concerning the Appropriateness of AmerenUE's Current Fuel Adjustment Clause** (the Order), which indicates that parties "may file additional direct testimony" regarding the appropriateness of AmerenUE's current fuel adjustment clause (FAC).

Q. Have you already provided testimony regarding the appropriateness of the FAC?

A. Yes, my July 24, 2009 direct testimony and the extensive minimum filing requirements included therewith explain why continuation of AmerenUE's FAC is appropriate, including why it is reasonably designed (and indeed critical) to provide AmerenUE with a sufficient opportunity to earn a fair return on equity (ROE).[1] That testimony and its schedules also explain why AmerenUE has sufficient financial incentive to be prudent and take reasonable efforts to minimize its fuel and purchased power costs, consistent with supplying reliable service to its customers.

Q. Please briefly summarize that testimony.

A. The testimony I filed in July 2009 explained that the conditions that were present when the Commission approved AmerenUE's FAC last March still existed when this rate case was filed.

Q. Do those conditions still exist today?

A. Yes, they do. In its January 27, 2009 Report and Order which approved AmerenUE's FAC, the Commission asked the following question: "Does AmerenUE have a reasonable opportunity to earn a fair return on equity without a fuel adjustment clause?" The Commission's answer to that question was "no." The reasons that the answer was "no" still exist today; that is, fuel costs are continuing to rise over time, and the Company's net fuel costs (fuel and purchased power costs less off-system sales revenues) have risen substantially

[1] The Commission's FAC rules impose extensive minimum filing requirements for utilities seeking to establish or continue an FAC. The Company fully complied with those requirements, which included information that addressed both the issue of why the FAC is reasonably designed to provide a sufficient opportunity to earn a reasonable ROE and why the FAC contains appropriate incentives. No party took any issue with any of those minimum filing requirements.

since the FAC took effect on March 1, 2009. Moreover, the facts and circumstances that led the Commission to find that the three factors traditionally examined by the Commission in evaluating fuel adjustment clause requests supported the approval of a fuel adjustment clause for AmerenUE also have not changed in any material way.

Q. What were those factors?

A. As provided for in the Commission's Report and Order in the Company's last rate case:

> [t]he Commission concluded a cost or revenue change should be tracked and recovered through a fuel adjustment clause if that cost or revenue change is:
>
> 1. substantial enough to have a material impact upon revenue requirements and the financial performance of the business between rate cases;
> 2. beyond the control of management, where utility management has little influence over experienced revenue or cost levels; and
> 3. volatile in amount, causing significant swings in income and cash flows if not tracked.[2]

Q. Briefly, how do the Company's circumstances relate to those three factors?

A. With respect to the first factor, the Company's fuel and purchased power costs are still the Company's largest operating and maintenance (O&M) expense, representing approximately 47% of its total O&M costs. In addition, the Company's net fuel costs have risen substantially from the normalized level established in the Company's last rate case ($322.5 million per year at that time) to approximately $538 to 550 million—an

[2] Report and Order, Case No. ER-2008-0318, p. 61.

approximately 67 - 70% increase.[3] This demonstrates that the first factor continues to support continuation of the FAC. Nothing has changed with respect to the second factor, that is, the lack of control the Company has over the national and international fuel and power markets which dictate what its net fuel costs will be. Finally, nothing has changed regarding the continuing volatility of the Company's net fuel costs, as is clearly shown by the substantial change in the Company's net fuel costs in just the last year. And as I noted, AmerenUE's FAC is still appropriate and is absolutely necessary for the Company to have a reasonable opportunity—indeed any realistic opportunity at all—to earn its authorized ROE.

Q. Please summarize this additional FAC testimony.

A. The bottom line is this: we need regulatory consistency with regard to recovery of our fuel costs, and must have an FAC to have any chance to earn our allowed ROE. We have acted prudently in regard to managing our net fuel costs, and have sufficient incentives to continue to do so. As a consequence, the Company's FAC should be continued in its present form.

II. APPROPRIATENESS OF AMERENUE'S FAC

Q. Can you please provide additional specific reasons why the current FAC is still appropriate for AmerenUE?

A. Certainly. There are several reasons why AmerenUE's FAC is still appropriate. Those reasons are: 1) there is no reasonable opportunity for the Company to earn its authorized ROE without AmerenUE's FAC; 2) it is premature to modify or eliminate the FAC as it has been in place less than a year, and one recovery period cycle will not even

[3] These figures are based upon the Staff's December 18, 2009 filing and the Company's July 24, 2009 filing. The final net fuel cost figure will be determined as part of the true-up, but net fuel costs will undoubtedly be substantially higher than the $322.5 million of net fuel costs established in the Company's last rate case.

be complete until October 2010; 3) the MPSC Staff as well as other intervenors had approximately five months (prior to filing direct testimony) to review and take issue with AmerenUE's FAC and raised no substantive concerns whatsoever; 4) AmerenUE's FAC is critical to maintaining the Company's credit quality; and 5) inconsistent regulatory policy erodes investor confidence in the utility and casts a shadow on the state regulatory process.

Q. Please elaborate on each of those points.

A. First, AmerenUE's FAC is absolutely necessary for AmerenUE to have any reasonable opportunity to earn its authorized ROE. As noted in our testimony on interim rates and specifically in Gary Weiss' rebuttal testimony on interim rates, even with the FAC in place, we have not been able to earn close to our authorized ROE during the period the FAC has been in effect, and indeed have consistently fallen far short of our authorized ROE for most of the prior two and one-half years. The situation would have been much worse over the past year without an FAC. As Schedule LMB-F4 shows, AmerenUE's electric retail net operating income for the year ended December 31, 2009 would have been approximately $18 million lower (before true-up) if the FAC had not been implemented in March 2009. Additionally, as Schedule LMB-F5 indicates, AmerenUE's return on equity during that same period was just 7.27%, with an FAC in place.[4] Without the FAC, the earned ROE would have dropped to 6.69%, which would have been over 400 basis points below our authorized return of 10.76%.

Looking forward to 2010, without the FAC currently in place, the Company would stand to lose an additional amount of approximately **$__________** due to higher net fuel costs between January 1, 2010 and the anticipated effective date of new rates to be set in this

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[4] These return on equity figures are adjusted to account for the Company's absorption of the impact of the Taum Sauk Plant being out of service due to the December, 2005 upper reservoir collapse.

case in mid to late June, 2010. This additional loss is the result of the substantial rise in net fuel costs since the Company's rates were last set approximately one year ago (including an increase in coal, coal transportation and nuclear fuel costs in 2010, together with lower off-system sales prices). I would note that even with continuing AmerenUE's FAC after this case, even with a true-up of certain costs and revenues through January 31, 2010 in this case, and even if AmerenUE witness Professor Roger Morin's 10.8% recommended return on equity for AmerenUE is adopted, **____ ____ _______.** Without an FAC this serious problem would be exacerbated even more.[5]

Second, regardless of the financial impact of the FAC we have seen thus far, it would be premature to adjust or eliminate the FAC at this point in time as it has been in effect less than one year. Indeed, we have not completed even one cycle of refunding costs to customers from the results of the initial accumulation period, which means there has not yet been a true-up of this first cycle nor has there been an opportunity for a prudence review to occur.

Third, the Commission's Staff has recommended that the FAC be continued, with minor "housekeeping" modifications, to which the Company has already agreed. In addition, every party in this case had approximately five months (leading up to the due date for their FAC testimony – December 18, 2009) to examine and conduct discovery regarding the

[5] I would note that the Company's earnings in 2009, **_______________________________________ _______________________________________,** demonstrate that some of the arguments made in the past relating to the concern that an FAC might allow the Company to over-earn are proving to be incorrect. I would also note that if net fuel costs come down over time (for example, power prices at some point may increase and thus lower net fuel costs, or fuel prices might decline at some point), the FAC will ensure that customers receive the benefit of those decreases, as opposed to the Company retaining that benefit and earning a higher ROE. The FAC is a two-way street, as demonstrated by the Company's first adjustment, which passed a temporary reduction in net fuel costs on to customers.

propriety of continuing the Company's FAC in substantially its current form, and no party took any issue with the need for continuing the FAC in its current form.

Fifth, AmerenUE's FAC remains critical to maintaining the Company's credit quality and keeping the Company's risk profile (with regard to this issue) essentially on par with the more than 90% of integrated electric utilities across the country that operate with an FAC (including the two other electric utilities in Missouri who are eligible to have FACs). As the Commission found in the Company's last rate case, "the opinions of credit rating agencies do matter."[6] Just as the credit rating agencies found AmerenUE's FAC to be supportive of its credit quality, the credit rating agencies would undoubtedly find that discontinuation of AmerenUE's FAC to be unsupportive of credit quality. Similarly, as discussed by AmerenUE witness Julie Cannell in her rebuttal testimony, equity investors too factor in the existence of an FAC, or lack thereof, in evaluating the regulatory jurisdiction in which a utility operates, which in turn has an effect on the utility's cost of equity. As the Commission itself stated, "AmerenUE needs a fuel adjustment clause to be able to compete for capital with other utilities that already have a fuel adjustment clause."[7] Its ability to do so will be materially compromised without continuation of its fuel adjustment clause, given that the use of fuel adjustment clauses to address recovery of fuel and purchased power costs reflects mainstream regulatory treatment across the country, as the Commission found based on the substantial evidence on this point presented in the Company's last rate case.

Finally, both debt and equity investors also value consistency in regulation. If this Commission cancels or materially modifies the FAC it approved for AmerenUE just last March, and that it has approved in substantially the same form for the other two electric

[6] Report and Order, Case No. ER-2008-0318, p. 69.
[7] *Id.*

utilities in the state that are eligible to have an FAC, this inconsistency will further erode investor confidence in the regulatory environment in this state and in the utilities that operate in this state.

III. SUFFICIENT FINANCIAL INCENTIVE TO BE PRUDENT

Q. Does the FAC as currently implemented provide AmerenUE with sufficient financial incentive to be prudent in and take reasonable efforts to minimize its net fuel costs?[8]

A. Yes. The Company has not changed its practices or risk management policies regarding hedging fuel and purchased power costs since the Commission approved its FAC. In addition, power plant performance as measured by equivalent availability was actually improved in 2009 over 2008, before the FAC was approved. The Callaway Plant set an all-time record for generation in 2009, and unplanned trips at our power plants were down in 2009 versus 2008. Moreover, as discussed in the rebuttal testimony of AmerenUE witness Mark Birk, the Company is increasing its power plant maintenance expense in 2010, and expects a continued high level of power plant maintenance expenditures over the next several years. That maintenance, of course, contributes to more efficient plants that are able to generate more off-system sales over time at a lower cost. This directly (and positively) impacts net fuel cost levels for customers. These facts demonstrate that the Company continues to prudently buy fuel and power, and continues to take prudent steps to maximize its off-system sales, as it has always done, and that the Company does have a sufficient incentive to continue to do so.

[8] The Commission's Order referred to minimizing "fuel and purchased power costs." As discussed earlier, because the Company's FAC tracks fuel and purchased power costs and off-system sales revenues, the relevant measure is "net fuel costs."

In addition, unlike most utilities with FACs, the Company will bear five percent of all net fuel cost increases.[9] And as noted earlier, the losses we would incur by not continuing AmerenUE's FAC in substantially its current form, because of regulatory lag and the inability to time rate cases to fully capture rising net fuel costs, provides a powerful enough incentive for the Company to act prudently and continue to perform as the Commission expects us to so that the Commission will continue to approve its use.[10] Specifically, the Company continues to prudently negotiate and hedge long-term fuel contracts where appropriate; to prudently sell as much power into the off-system sales markets as it can; and to prudently maintain its power plants to maximize those sales. Also as noted earlier, we are not yet through the first full cycle under the current FAC, and no prudence review has yet occurred. Although we are confident the prudence review will demonstrate that the Company has continued to act prudently regarding the management of our net fuel costs, the existence of that prudence review process, and the potential for the disallowance of imprudently incurred costs provides another important incentive for the Company to prudently manage its net fuel costs. In sum, there is simply nothing to indicate a lack of prudence on the Company's part, and nothing to indicate that the Company lacks sufficient financial incentives to continue to prudently manage its net fuel costs.

[9] In addition to containing a sharing percentage, the Commission's reliance on historic costs to make FAC adjustments is out of the mainstream and also creates substantial cash flow lags, which create additional incentives for the Company to prudently manage its net fuel costs. That lag is considerable. For example, historic net fuel costs incurred between February and June will not even begin to be reflected in rates until October, and will not be fully recovered until the following September, which means that it takes as much as 19 months after some of the costs were incurred to fully recover them.

[10] As the Commission noted, " 'a fuel adjustment clause is a privilege, not a right, which can be taken away if the company does not act prudently.'" Report and Order, Case No. ER-2008-0318, p. 74. (*quoting* Report and Order, Case No. ER-2008-0093, pp. 45-46). The Commission went on to note that "[i]f AmerenUE does not efficiently control its net fuel costs, the Commission could reconsider the fuel adjustment clause." *Id.*

IV. SUMMARY AND CONCLUSIONS

Q. Please summarize your conclusions.

A. The Commission's Order asked two questions: does the 95% pass through mechanism: 1) afford AmerenUE a sufficient opportunity to earn its authorized ROE, and/or 2) provide AmerenUE with a sufficient incentive to be prudent with respect to managing its net fuel costs? The answer to the first question is that the 95% pass through mechanism actually reduces the Company's opportunity to earn its authorized ROE, but that the fuel adjustment clause itself not only improves the Company's opportunity to earn its authorized ROE, but in fact is absolutely necessary if the Company is to have any reasonable opportunity to earn its authorized ROE. The answer to the second question, as addressed above, is an unqualified "yes." Moreover, the considerations outlined by the Commission in the Company's last rate case when the FAC was initially approved relating to the magnitude of fuel and purchase power costs, the Company's inability to control them, and the fact that these costs are volatile and can cause large swings in income and cash flows if not tracked still exist today.

The FAC also provides consistent regulatory treatment among the electric utilities across the state, which is consistent with the regulatory treatment provided by other commissions to utilities across the country. This consistency is of critical importance to the debt and equity investors upon whom the Company must rely for capital, and benefits customers when fuel costs decline.

Finally, all of the parties in this case have had many months to examine the issues raised in the Order, to conduct discovery, and to raise concerns if there were any.[11] No such concerns were raised, and indeed the Staff recommends continuing the FAC essentially in its current form.

In sum, we need regulatory consistency with regard to recovery of our fuel costs, and must have an FAC to have any chance to earn our allowed ROE. We have acted prudently in regard to managing our net fuel costs, and have sufficient incentives to continue to do so. As a consequence, the Company's FAC should be continued in its present form.

Q. Does this conclude your additional direct testimony regarding AmerenUE's fuel adjustment clause?

A. Yes, it does.

[11] As part of their Jointly Proposed Procedural Schedule, the parties to this case all agreed that "all testimony relating to changes to AmerenUE's fuel adjustment clause, including the structure, terms, and continuation of the fuel adjustment clause" had to be included in their December 18, 2009 direct testimonies. The Commission adopted the parties' proposed schedule.

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-2010-0036

AFFIDAVIT OF LYNN M. BARNES

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

Lynn M. Barnes, being first duly sworn on her oath, states:

1. My name is Lynn M. Barnes. I work in the City of St. Louis, Missouri, and I am employed by Union Electric Company d/b/a AmerenUE as Vice President, Business Planning and Controller.

2. Attached hereto and made a part hereof for all purposes is my FAC Direct Testimony on behalf of Union Electric Company d/b/a AmerenUE consisting of 11 pages, Schedules LMB-~~E~~F4 through LMB-~~E~~F5, all of which have been prepared in written form for introduction into evidence in the above-referenced docket.

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

Lynn M Barnes
Lynn M. Barnes

Subscribed and sworn to before me this 22nd day of February, 2010.

Mary Hoyt
Notary Public

My commission expires: 4-1-2010

Mary Hoyt - Notary Public
Notary Seal, State of
Missouri - Jefferson County
Commission #06397820
My Commission Expires 4/1/2010

AmerenUE
Impact of FAC
12 Months Ended December 31, 2009 and 12 Months Ended June 30, 2010

12 Months Ended December 31, 2009

	Missouri Retail
Electric Net operating Income with FAC	$ 370,370
Year 2009 FAC Adjustments (FERC Account 174)	(28,989)
Composite Tax Rate	38.4%
Income Tax	11,132
Impact on Net Operating Income	$ (17,857)
Electric Net Operating Income Without FAC	$ 352,513

January - June 2010

FAC Adjustment	$ (118,503)
Composite Tax Rate	38.4%
Income Tax	45,505
Impact on Net Operating Income January - June 2010	$ (72,998)

SCHEDULE LMB-F5

HIGHLY CONFIDENTIAL IN ITS ENTIRETY