TABLE OF CONTENTS

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, Doing Business as AmerenCIPS, and, in Connection Therewith, Certain Other Related Transactions.	))))))))	Case No. EO-2004-0108

INITIAL BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

I. INTRODUCTION

Union Electric Company d/b/a AmerenUE ("AmerenUE", "UE", or "Company") is proposing an affiliate transaction with Central Illinois Public Service Company ("AmerenCIPS" or "CIPS") which requires the Missouri Public Service Commission ("Commission" or "PSC") to conduct a detriment review pursuant to Section 393.190 RSMo 2000 and to apply its Affiliate Transaction Rules (4 CSR 240-20.015 and 4 CSR 240-4.015). The Application requests authority to legally separate Company's Metro East service area in Illinois from the currently integrated AmerenUE system, transferring certain assets from AmerenUE to AmerenCIPS, and allocating certain AmerenCIPS liabilities to AmerenUE. The Application also contains numerous additional requests relating to future ratemaking treatment that are unwarranted and beyond the Commission's authority to grant in this case. Application, subparagraphs (c) - (m), pp. 10-12.

Company has failed to meet its burden of proving that this proposed transaction would not result in a detriment to the rate-paying public pursuant to Section 393.190 RSMo 2000. Company alleges that this proposed Metro East transfer would result in its customers receiving their future capacity and energy from “least cost resources”. Application, Para.14, p. 6. However, the evidence of record now before the Commission falls far short of this claim, and the Application should be rejected.

Company issued no request for proposals (RFP) in an attempt to prove that the proposed transaction is indeed the least cost resource of *all* options available to it. In fact, the evidence shows that many available resources known to Company were not even analyzed in its “least cost” analysis to determine if they were less costly options to meet Company’s resource planning needs into the future. Company has also failed to provide adequate assurances that the proposed transfer would not negatively impact the service quality and reliability provided to its customers. So despite Company’s many claims that the public would be benefited by this transaction, the Office of the Public Counsel (Public Counsel), the statutory representative of the public before the Commission, believes otherwise.

Company has not demonstrated the level of due diligence that should be expected from a utility proposing such a major transaction. No adequate comparative analysis of existing resource options was performed, thus failing to meet its burden to show that the proposed transfer is not detrimental. Instead, Company chose to present only a comparison between only two selected options (the Metro East transfer v. the construction of gas-fired generation). However, even this narrow comparison is so fatally flawed that it should be given no evidentiary weight, especially with regard to the failure to take the enormous cost of future environmental compliance costs into account when analyzing the Metro East transfer option.

Company also fails to meet the even higher burden necessary to show that the proposed transaction, as an affiliate transaction, is in the "best interests of its regulated customers" sufficient to justify a variance from the Commission's Affiliate Transaction Rules, pursuant to 4 CSR 240-20.015(10)(A)(2) and 4 CSR 240-40.015(10)(A)(2). Company admits that this affiliate transaction was not the result of an arms length negotiation. Instead it was concocted entirely within subsidiaries of the holding company, Ameren Corporation, by individuals who serve simultaneously on the boards of each of the participating affiliates.

The record in this case shows that the proposed Metro East Transfer is actually designed to benefit Company's merchant power affiliate and to promote electric retail competition in Illinois, at the expense of AmerenUE's regulated ratepayers. Although it is clear that this transaction would benefit the holding company, it has not been shown to this Commission that it could be accomplished without detriment to Missouri ratepayers.

Several conditions, some proposed by Public Counsel and some proposed by the Commission's Staff (Staff), could mitigate some of the operational and financial detriments associated with the proposed transfer. However, only one condition to the proposed Metro East transfer would allow the Commission be certain whether or not the ratepaying public would be detrimentally impacted. If the Commission does not wish to outright reject the Application despite Public Counsel's objections, Public Counsel recommends, as an alternative, that the Commission require a proper RFP process to be initiated to discover and compare all available resource options.

II. STANDARD OF REVIEW

A. Section 393.190

Before a Missouri public utility such as AmerenUE may sell or otherwise dispose of assets that are necessary or useful in the performance of its duties to the public, it must first obtain approval from this Commission. Section 393.190.1 RSMo 2000 states in pertinent part:

> No gas corporation, [or] electrical corporation, . . . shall hereafter sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public, . . . without having first secured from the commission an order authorizing it so to do.

Note that this statute does not designate where the assets are located, merely that Commission approval is required if it involves part of the system that is necessary or useful in the provision of service to the public by a Missouri electric corporation.

There is no disagreement that the proposed affiliate transfer from AmerenUE to AmerenCIPS would change the way that electricity is generated for and transmitted to AmerenUE or that the rate base and expenses of AmerenUE would be altered. Essentially, the proposal would break up the vertically integrated structure of AmerenUE, reassigning certain electric generation from AmerenUE-Illinois to AmerenUE-Missouri in a way that significantly changes the current resource portfolio for AmerenUE's Missouri customers. Furthermore, approximately $40 million of assets located in Illinois are part of the rate base currently used to calculate rates for Missouri retail customers. (Tr. 1215 - 1217). Although the parties disagree regarding the exact impact on rates and service, there's no disagreement that the electric generation and transmission assets currently serving Missouri customers would change if the proposed transfer were approved, along with the reallocation of enormous expenses and liabilities – ultimately impacting rates and service in some manner (e.g., a roughly 6% increase in the allocation of expenses and liabilities related to electric generation facilities would be transferred from AmerenUE's Illinois ratepayers to its Missouri ratepayers).

The appropriate legal standard to apply in this case is the standard that was first articulated in State ex rel. City of St. Louis v. Public Service Commission, 73 S.W2d 393 (Mo. banc 1934). The Court in City of St. Louis stated:

> To prevent injury to the public, in the clashing of private interest with public good in the operation of public utilities, is one of the most important functions of Public Service Commissions. It is not their province to insist that the public shall be *benefited*, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public *detriment*. In the public interest, in such cases, can reasonably mean no more that "not detrimental to the public."
>
> Id. at 400. (underlining added).

As the Missouri Supreme Court established this "no detriment" test, it emphasized that "the whole purpose of the [Public Service Commission Act] is to protect the public." Id. at 399. Therefore, as the Commission carries out the legislative intent of Section 393.190, it must ensure that there would be no future detriment, either in service or in rates, to Company's future customers as a result of the proposed transaction. This is the traditional manner in which the "public" has been defined for purposes of this statute. The Commission stated it this way in Re: Kansas Power & Light Company and KCA Corporation, a merger case brought under Section 393.190:

> Based upon these findings and determinations, the Commission concludes that Missouri ratepayers will be shielded from any potential ill effects from the proposed merger and will suffer no detriment as a result. Therefore, the Commission concludes that, in the absence of a finding of detriment to the public interest, it may not withhold its approval of the proposed merger and will authorize KPL to acquire and merge with KGE.

1 Mo.P.S.C.3d 150, 159 (1991).

There also appears to be no dispute as to who bears the burden of proof in addressing the "no detriment" standard. Ex. 69 ("AmerenUE's Reply to Staff's List of Conditions"), p. 10. Clearly, it is the applicant utility that must bear the burden of persuasion to show that the change that it wishes to make from the status quo will not result in a public detriment. The Commission's filing requirements for an applicant utility seeking authority to transfer assets require that applicant to initially set forth the purported reasons that there is no public detriment in a Section 393.190 application. See 4 CSR 240-3.110(1)(D).

That burden of persuasion never shifts throughout a case. Anchor Centre Partners v. Mercantile Bank, 803 S.W.2d 23, 30 (Mo. banc 1991). Even though the "no detriment" standard is stated negatively, Missouri courts have stated that petitioners have the responsibility to prove even negative averments *unless* evidence relevant to the issue at hand is peculiarly within the knowledge and control of another party. Kenton v. Massman Const. Co. (Kenton) 164 S.W.2d 349 (Mo. 1942). In utility cases before the Commission, most documents and records relevant to the issues are uniquely within the utility's control, and so it would not be appropriate or fair to shift the burden of persuasion. Kenton at 352; See also Kennedy v. Fournie, 898 S.W.2d 672 (Mo. App. E.D. 1995). (Transfer denied, June 20, 1995).

B. AmerenUE's "Direct and Present Detriment" Argument is Clearly Erroneous and Absurd

There is one aspect of the standard of review in this case that is sharply disputed. Company clings to an antiquated argument that the "no detriment" standard can only be applied as it relates to "a direct and present detriment". See Ex. 69 ("Ameren's Reply to Staff's List of Conditions" filed on April 14, 2004), pp. 9-14. Although the Commission used this language in a few merger cases during the 1990's, this approach is now clearly erroneous, based upon the most recent Missouri Supreme Court pronouncements. AG Processing, Inc. v. Public Service Commission ("AG Processing"), 120 S.W.3d 732, 735-736 (Mo. banc 2003).

In its April 14, 2004 pleading, AmerenUE provides citations that are falsely attributed to City of St. Louis:

> To deny a public utility the right to have that say (to decide whether to dispose of their property) is to deny it an incident important to its ownership of property. State ex rel. City of St. Louis, 73 S.W.2d at 400. The law is clear that in order to deny a private, investor-owned company this important incident of property ownership, there must be "compelling evidence on the record showing that a public detriment is likely to occur" (emphasis added). Id. And, the detriment must be a "direct and present detriment" Id. (emphasis added).
>
> Ex. 69, pp. 9-10

It is extremely misleading for Company to place "Id." after two quotations above **which do not appear in the City of St. Louis case** nor in any other appellate case to which Public Counsel is aware. The "direct and present detriment" language is apparently quoted from past Commission decisions that significantly misstate Missouri law and which pre-date the AG Processing Missouri Supreme Court decision. Company would apparently like to confuse the Commission into believing that this language appears in an appellate court decision, thereby narrowing the Commission's standard of review to the point that it is absolutely meaningless.

The Commission did properly apply the "no detriment" standard in the recent Aquila financing case, Case No. EF-2003-0465, where it correctly interpreted 393.190 and the AG Processing case in this way:

> The Commission concludes a detriment to the public interest includes a risk of harm to ratepayers. In reviewing a recent merger case involving the same parties, the Supreme Court of Missouri ruled that . . . "(w)hile (the Commission) may be unable to speculate about future merger-related rate increases, it can determine whether the acquisition premium was reasonable, and it should have considered (the premium) … when evaluating whether the proposed merger was detrimental to the public." In other words, the Commission could not have known whether the acquisition premium would result in rate increases. But it should have looked at the premium's reasonableness. Likewise, the Commission cannot know whether the encumbrances will result in rate increases. But the Commission should look at the reasonableness of the risk of the increases. This analysis conforms to the concept that . . . "(n)o one can lawfully do that which has a **tendency** to be injurious to the public welfare." (footnotes omitted) (emphasis added by Commission).
>
> Re: Aquila, Inc, Case No. EF-2003-0465, Report and Order (issued on February 24, 2004), pp. 6-7.

Here the Commission recognizes that a rate increase does not have to occur immediately upon the date of the transaction to constitute a detriment. The *risk* itself of higher rates in the future is a detriment to the public.

Moreover, if Company's "direct and present detriment" argument is taken to the extreme, its absurdity becomes clear. If this interpretation of the law were correct, a crafty utility could entirely frustrate Commission review by separating any rate impact or service quality deterioration from the transaction it sought to justify. As long as the service and rate status quo were maintained until a few years down the road, then *any* proposed transaction would have to be approved, no matter how likely to harm the public in later years. For instance, a rate moratorium that ends in two years could be used as an absolute shield against the rejection of any 393.190 proposal made during that time. Such a standard would render Commission review under Section 393.190 a mere rubber stamp.

Company further claims that the Commission is not required to recognize "possible" detriments which rely upon "if-then" statements or which have any probability of not actually occurring. Ex. 69, pp. 10-11, footnote 12. However, the law requires that the Commission deny the proposed transaction even if the detriments found are the result of events that would simply be set into motion or which involve the probability of significant harm which could *likely* occur (not *certain* to occur). The AG Processing case should have settled, once and for all, the notion that the Commission may not look beyond its nose to consider the natural consequence of approving a proposed transaction filed pursuant to Section 393.190 RSMo 2000. The Commission may not put on blinders regarding the ultimate impacts as to the rates and service for Missouri regulated utility customers.

Company also attempts to distinguish the AG Processing case as it relates to the Commission's legal responsibility to consider "all the necessary and essential issues" in a case, as that Supreme Court case has clarified. The operative language from this case is as follows:

> The fact that the acquisition premium recoupment issue could be addressed in a subsequent ratemaking case did not relieve the PSC of the duty of deciding it as a relevant and critical issue when ruling on the proposed merger. **While PSC may be unable to speculate about future merger-related rate increases, it can determine whether the acquisition premium was reasonable, and it should have considered it as part of the cost analysis when evaluating whether the proposed merger would be detrimental to the public.** The PSC's refusal to consider this issue in conjunction with the other issues raised by the PSC staff may have substantially impacted the weight of the evidence evaluated to approve the merger. The PSC erred when determining whether to approve the merger because it failed to consider and decide all the necessary and essential issues, primarily the issue of UtiliCorp's being allowed to recoup the acquisition premium.
>
> Ibid, 120 S.W.3d 732 at 736 (Mo. banc 2003) (emphasis added).

As with the UtiliCorp/St. Joseph Light and Power Company merger that was the subject of the AG Processing case, the proposed Metro East Transfer would set into motion dramatic changes to the rate base and expenses of an electrical corporation in a manner that would significantly harm future ratepayers. Company argues that the Commission should ignore the detriments related to the potential impact on rates because they are "speculative, future and unquantified". AmerenUE's Reply to Staff's List of Conditions, Ex. 69, p. 12. However, as the very language of the AG Processing case quoted above indicates, the "speculative" nature of future rate case decisions does not allow the Commission to ignore such detriments.

III. AMERENUE HAS FAILED TO MEET ITS BURDEN OF PROOF

In its least cost analysis, UE only considered the transfer option versus the build CTG option and failed to even consider or analyze any other supply options. As shown below, the large number of flaws in UE's limited analysis of only two options caused the results of this analysis to be meaningless. UE also failed to demonstrate that it needs the 597 MW of capacity provided by the transfer.

A. Evidence Does Not Support UE's Least Cost Resource Claim

1. Failure to Demonstrate Need For Any 600 MW Resource

UE has failed to demonstrate that the 597 MW of capacity that will be transferred is needed to meet UE's reserve margin. (Ex. 12, pp. 27-29). In fact, UE's response to Public Counsel data request number 563 indicated it had not performed the analysis necessary to calculate the level of reserve margins that UE would have without the proposed transfer. (Ex. 12, p. 27, l. 9-14). Public Counsel witness Kind did the calculations to determine UE's reserve margin and capacity position using the methodology and data that UE provided. (Ex. 12, p. 27, l. 15-21). This analysis is attached as Attachment 2. This analysis demonstrates that UE has ** __________

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_______ * (Ex. 12, p. 28, l. 9-16). Acquiring an additional 597 MWs at this time makes no sense at all.

NP

UE's treatment of the future status of its current EEInc power supplies impacts the least cost analysis in two ways. First, whether EEInc is assumed to continue being a part of UE's power supply portfolio as it has been for the last few decades will impact UE's future resource needs. An assessment of future needs is the starting point in performing a least cost resource analysis. Second, if UE does not assume that EEInc will continue being a part of UE's power supply portfolio, then UE must compare it to all other options to determine whether it would be the least cost option.

2. Failure to Discover and Analyze All Options

As witness Kind explained in his rebuttal testimony UE failed to consider other least cost options via a new request for proposal ("RFP") or to consider and analyze other known resource options. (Ex. 12, pp. 32-38). Instead, UE chose to limit its analysis to the comparison of only two resource options. Failure to review all resource options does not make any sense. (Ex. 12, p. 33, l. 12-23). It doesn't make any sense from a resource planning perspective or from a resource acquisition perspective to only look at two options. (Ex. 12, p. 33, l. 12-15). Indeed, even if UE's comparison of the CTG and Metro East transfer options did not show that the Metro East transfer option had a lower cost than the "build CTG" option (which it clearly does not), this would only prove that the Illinois transfer was the least cost alternative between 2 options that represent a small fraction of the many options that UE (1) already knows of and (2) would discover through the issuance of a new RFP for power supply options. (See Public Counsel's RFP Condition below).

UE's analysis assumes that it is not entitled to any output from the Electric Energy, Inc. ("EEInc") Joppa plant after 2005. (Ex. 12, pp. 29-32). Currently UE receives 400 MW pursuant to its contract with EEInc. UE has argued that its contract with EEInc expires in December of 2005 and that EEInc does not want to do business with UE. (Tr. p. 1547, l. 1-8). However, record evidence demonstrates that UE is an owner of a 40% equity interest in EEInc and that UE is entitled to 40% of the output of the low cost Joppa plant after taking into account the Department of Energy's share. (Tr. p. 1551, l. 13-21; Tr. p. 1576, l. 1-3).[1]

UE witness Nelson in his prepared direct testimony before the Federal Energy Regulatory Commission (FERC) in Docket No. EC04-81-000 on March 25, 2004 testified as follows:

> Q. You also mentioned a commitment by Ameren to seek to ensure that KU is able to receive up to 20 percent of the EEInc output, if it wishes to receive that much. Please explain.
>
> A. Currently, Ameren subsidiaries hold a 60 percent interest in EEInc, which entitles them to, among other things, vote 60 percent of the outstanding shares in shareholder votes and, for all intents and purposes, to elect a majority of the members of the EEInc Board of Directors. The EEInc Bylaws currently provide for the allocation of capacity and energy from the generation facilities owned by EEInc in proportion to the owners' ownership shares. This provision, however, may be changed by a 75 percent vote of the outstanding shares. Upon consummation of the IP Sale, Ameren subsidiaries will hold 80 percent of the voting shares of EEInc.
>
> So as to prevent any ability of Ameren, following closing of the IP Sale, to "freeze out" KU from receiving the 20 percent of the EEInc capacity and output to which it is presently entitled, Ameren commits to: (i) direct its representative members of the EEInc Board of Directors to take no action which would result in decisions to restrict KU's ability to receive up to 20 percent of the capacity and output of the generating facilities owned by EEInc (if KU

[1] EEInc is jointly owned by four parties: Ameren Energy Resources (20%); UE (40%); Illinois Generating (20%); and LG&E Energy Corporation's Kentucky Utilities ("KU") (20%). Ex. 79, p. 12.

> desires to receive such capacity and output); and (ii) direct AER and AmerenUE (the Ameren subsidiaries that are EEInc shareholders) to undertake no action at shareholder votes that would restrict KU's ability to receive up to 20 percent of the capacity and output of the generating facilities owned by EEInc (if KU desires to receive such capacity and output). With these commitments in place, Ameren believes that KU is fully protected from any adverse impact that may result from Ameren's collective ownership in EEInc increasing from 60 to 80 percent.

(Ex. 80, pp. 10-11). Witness Nelson testified that Ameren would direct its subsidiaries to take no action to restrict Kentucky Utilities from receiving its 20% of the capacity from EEInc. By the same token, UE should demand that it receive its entitlement to receive the 40% of the output from Joppa.[2] Simply put, the EEInc by laws entitle UE to 40% of the Joppa output that should be taken into account. UE has touted the Joppa generating stations as one of the most cost effective and cleanest plants in the United States. (Ex. 12, p. 32, l. 4-8). Witness Nelson admitted the Joppa output is cheaper than the blend of the Ameren fleet (Tr. p. 1577, l. 8-16), "is very low cost" (Tr. p. 511, l. 9), and that "the EE, Inc. units would be running all the time they are available" (Tr. p. 511, l. 25, p. 512, l. 1) and that the EEInc units have "very low marginal cost." (Tr. p. 512, l. 1).

Incredibly, witness Nelson testified that Ameren cannot control what EEInc does. (Tr. p. 1577, l. 17-25). Of course, this assertion flies in the face of witness Nelson's FERC testimony that clearly states Ameren can and will "direct" its EEInc board members to take certain actions. (Ex. 80, pp. 10-11). It also ignores that fact that UE as a public utility owner of 40% of EEInc with an entitlement to that low cost power should actively assert its rights. The other red-herring raised by witness Nelson as an excuse for not continuing to receive low-cost power from EEInc is this Commission's affiliate transaction rules. 4 CSR 240-20.015. However, witness Nelson ignores the waiver provision of the rules 4 CSR 240-20.015(10)(A)(2) which states:[3]

> 2. A regulated electrical corporation may engage in an affiliate transaction not in compliance with the standards set out in subsection (2)(A) of this rule, when to its best knowledge and belief, compliance with the standards would not be in the best interests of its regulated customers and it complies with the procedures required by subparagraphs (10)(A)2.A. and (10)(A)2.B. of this rule.

<u>3. Flawed Least Cost Analysis</u>

UE alleges that transferring the electric transmission and distribution properties of UE in the Metro East Service Area in Illinois to CIPS is the least cost alternative available to supply UE's long-term capacity and energy needs. (Ex. 9, p. 1, l. 17-22). UE witness Voytas attempted to support this assertion by providing a twenty-five year analysis of the impact of the transfer as proposed by UE versus building a new combustion turbine generator ("CTGs") type of power plant. (Ex. 9, p. 4, l. 21-22).[4] The analysis compared total revenue requirements for both options for twenty-five (25) years. (Ex. 9, p. 4, l. 22-23). According to Schedule 4 attached to witness Voytas' direct testimony, the transfer of the electric transmission and distribution properties of UE in the Metro East Service Area to CIPS (which would allow UE's customers to utilize

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[2] Ameren subsidiaries currently hold 60% interest in EEInc and are looking to increase that interest to 80%. (Tr. p. 1575, l. 7-12).

[3] Ameren certainly is aware of this rule provision since it has sought a waiver from those rules in this proceeding. Although at the evidentiary hearing, Mr. Nelson expressed an inability to understand this rule. (Tr. 146-148).

the 597 MW of UE capacity that is currently dedicated to serving UE's Illinois load) costs less than building or purchasing CTGs by $2.4 million a year. According to witness Voytas, over the life of the analysis (25 years), the transfer option costs less than the CTG option by $11 million. (Ex. 9, p. 7, l. 5-6, Schedule 4).

UE's least cost analysis does not stand up to scrutiny and should be disregarded by this Commission. Witness Voytas' analysis utilizes a flawed methodology and fails to include certain necessary inputs and under or overstates certain inputs. Moreover, witness Voytas failed to consider and analyze other reasonable alternatives. The record evidence demonstrates that UE's analysis was designed to reach its preordained conclusion that the transfer of the electric transmission and distribution properties of UE in the Metro East Service Area is the least cost option.

At the outset it is important to keep in mind that even UE's alleged $2.4 million yearly benefit is exceedingly small. Dr. Proctor testified that the $2.4 million yearly benefit was "well within the margin of error" and was "thin." (Tr. p. 1299, l. 17-25). UE witness Voytas admitted this fact in his surrebuttal testimony noting that the "present value of the economic benefit of the Metro East transfer as compared to simple cycle CTGs, under the assumption that the JDA is not revised, is relatively small." (Ex. 10, p. 3, l. 10-12).

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[4] UE is also proposing to transfer certain transmission facilities and natural gas facilities and agreements to CIPS, but UE failed to include any economic least cost analysis related to the gas transfers. (Ex. 14, p. 19, l. 21; Ex. 18, p. 3, l. 16-19).

B. Metro East Flaws in the Transfer Revenue Requirements Analysis

1. Future Environmental Costs Were Ignored

UE failed to take into account **any** expected increases in future environmental compliance costs in its transfer analysis. Specifically, UE failed to take into account nitrogen oxide emission ("NOx"), carbon dioxide ("CO_2") emission, sulfur dioxide ("SO_2") emission, mercury emission or particulate emission compliance costs in its analysis. (Tr. p. 554, l. 12-25; p. 555, l. 1). UE claimed it failed to model these costs in its analysis because "[t]here is no way to determine what future regulations will be in place and what requirements for technology installations will be required at AmerenUE power plants over the next twenty years." (Ex. 10, p. 45, l. 9-11). UE's claims conflict with information it filed in its 10-K Report before the Securities and Exchange Commission ("SEC") and are contrary to its own internal planning documents that specifically analyze the impacts new environmental regulations will have on UE's operations.

Public Counsel witness Ryan Kind testified that costs of compliance for emissions that are currently regulated, such as SO_2 could increase, and costs of compliance for emissions that are not currently regulated, such as mercury and CO_2 could be substantial. (Ex. 12, p. 39, l, 9-14). UE's failure to take into account the increased environmental compliance costs that will be associated with the 597 MW of transferred capacity casts serious doubt on the validity of UE's analysis.[5] In fact, UE witness Moore, an environmental cost expert, indicated it would not be appropriate to

[5] Interestingly, another UE witness, Mr. Kevin Redhage, who testified as to probable nuclear decommissioning costs, explained at length how unknown costs can be appropriately calculated within an acceptable range, or "zone of reasonableness." (Tr. 326-327).

ignore possible environmental compliance cost increases in this proceeding. (Tr. p. 728, l. 18-22). However, witness Moore acknowledges that UE witness Voytas did not include increased environmental compliance costs in his least cost analysis. (Ex. 21, p. 2, l. 1-4).

The evidence of record demonstrates that UE has already quantified the range of costs associated with new environmental compliance rules. Exhibit 58 contains selected portions of Ameren's Form 10-K. The Environmental Matters section clearly delineates a range of $160 to $180 million UE will have to expend to comply with pending environmental rules and hundreds of millions of dollars UE may have to expend to comply with future environmental rules. Specifically, the 10-K notes:

> The EPA issued a rule in October 1998 requiring 22 eastern states and the District of Columbia to reduce emissions of NOx in order to reduce ozone in the eastern United States. Among other things, the EPA's rule establishes an ozone season, which runs from May through September, and a NOx emission budget for each state, including Illinois. The EPA rule requires states to implement controls sufficient to meet their NOx budget by May 31, 2004. In February 2002, the EPA proposed similar rules for Missouri. These rules are expected to be issued as final rules in the spring of 2004. The compliance date for the Missouri rules is expected to be May 1, 2007.
>
> As a result of these requirements, we have installed a variety of NOx control technologies on our power plant boilers over the past several years. The following table presents our future estimated capital expenditures to comply with the final NOx regulations in Missouri and Illinois between 2004 and 2008:

<TABLE>
<CAPTION>

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<S>	<C>
Ameren…………………………….	$210 million to $250 million
UE………………………………….	$160 million to $180 million
CIPS……………………………….	-
Genco……………………………..	$ 50 million to $ 70 million

CILCORP………………………… -
CILCO…………………………… -
==

(Ex. 58, p. 151 of 184)

UE's own 10K demonstrates that it will have to spend well over a hundred million dollars between 2004 and 2008 to reduce emissions of NOx in order to reduce ozone in the eastern United States. Moreover, the Form 10-K advises investors that UE is facing new regulations with respect to SO_2, NOx and mercury emissions from coal-fired power plants. Specifically, the 10-K notes:

> On December 31, 2002, the EPA published in the Federal Register revisions to the NSR programs under the Clean Air Act, governing pollution control requirements for new fossil-fueled generating plants and major modifications to existing plants. On October 27, 2004, the EPA published a set of associated rules governing the routine maintenance, repair and replacement of equipment at power plants. Various northeastern states, the state of Illinois and others have filed a petition with the United States District Court for the District of Columbia challenging the legality of the revisions to these NSR programs. Other states, various industries and environmental groups have filed to intervene in this challenge. At this time, we are unable to predict the impact if this challenge is successful on our future financial position, results of operations or liquidity.
>
> In mid-December 2003, the EPA issued proposed regulations with respect to SO2 and NOx emissions (the "Interstate Air Quality Rule") and mercury emissions from coal-fired power plants. These new rules, if adopted, will require significant additional reductions in these emissions from our power plants in phases, beginning in 2010. The rules are currently under a public review and comment period and may change before being issued as final late in 2004 or early 2005. The following table presents preliminary estimated capital costs based on current technology on the Ameren system to comply with the SO2 and NOx rules, as proposed:
>
> <TABLE>
> <CAPTION>

	2010	2015
<S>	<C>	<C>
Ameren…	$400 million to $600 million	$500 million to $800 million
UE………	$250 million to $350 million	$300 million to $500 million
CIPS……	-	-
Genco….	$140 million to $220 million	$150 million to $200 million
CILCORP(a)	$ 10 million to $ 30 million	$ 50 million to $100 million
CILCO…..	$ 10 million to $ 30 million	$ 50 million to $100 million

</TABLE>

(a) CILCORP consolidates CILCO and therefore includes CILCO balances.

The proposed mercury regulations contain a number of options and the final control requirements are highly uncertain. Ameren anticipates additional capital costs to comply with the mercury rules could be up to $100 million by 2010, with UE incurring approximately two-thirds of the costs and Genco incurring most of the remaining costs. Depending upon the final mercury rules, similar additional costs would be incurred between 2010 and 2018.

(Ex. 58. pp. 151-152 of 184).

The above capital cost estimates for UE to comply with the Interstate Air Quality (IAQ) rule shows that UE would need to spend from 550 to 850 million dollars by 2015 to comply with this rule. The above capital cost estimate for UE to comply with future mercury rules by 2015 is 2/3 of $200 million or $133 million. Adding the range of future NOx compliance costs (160 to 180 million dollars) to the range of IAQ rule capital costs and the range of mercury rules capital costs sums to a capital cost range of $843 million to $1,163 million by the year 2015 that were excluded from UE's estimate of costs that would be incurred during the twenty-five years of its least cost analysis (the time period from 2004 through 2029).

The future environmental compliance capital costs associated with the additional 6% of UE's generating capacity that would be available to UE's Missouri customers would be 6% of the UE system future environmental compliance capital costs which would range from **$51 million** ($863 million x .06) to **$70 million** ($1,163 million x .06). Putting this range of 51 to 70 million dollars of future capital costs in perspective, the total net rate base associated with the 6% portion of UE's generation that would be transferred to UE's customers is $195 million in 2004 (this declines to $136 million in 2010 and $86 million in 2015 if the future environmental compliance capital costs are ignored). Therefore, these future environmental capital cost investments would cause an increase in UE's 2015 rate base of somewhere from 58% ($50,580,000/$86,415,372 = .58) to 81% ($69,780,000/$86,415,372 = .81). If UE is assumed to earn a return on its rate base of 10%, then, once the environmental capital costs are incurred and the Metro East transfer portion of UE's rate base is increased from between 51 to 70 million dollars, the annual costs of the generation formerly used to supply UE's Illinois customers would increase from between **$5.1 million to $7 million per year** due to the increased rate base upon which UE would be earning a return. This range of annual cost increases does not include the increased annual operating and maintenance costs associated with future environmental regulations.

Obviously, UE is facing substantial environmental compliance costs in the future and yet witness Voytas wholly failed to include any estimate in his Metro East transfer least cost analysis. UE refers to the generation that it proposes to transfer from its Illinois customers to its Missouri customers as "low cost… baseload generation" (Ex. 69, p. 2) and "cheap…baseload generation." (Ex. 69, p. 5) The only way this coaldominated fleet of UE plants can be viewed as “low cost” or “cheap” generation relative to building new CTG is to stick your head in the sand and ignore all the extremely costly pending and proposed environmental regulations that are expected to dramatically change the costs of continuing to operate this generation over the next 5 to 15 years.

Ameren’s Form 10-K pronouncements are consistent with its internal planning documents that specifically delineate environmental compliance costs. Highly confidential Exhibit 44 sets out Ameren’s corporate strategy to ** _______

____

_________ * (Tr. p. 736, l. 7-15). Highly confidential Exhibit 44 provides a high and low-end analysis of the hundreds of millions of dollars of compliance costs Ameren expects to incur.[6]

Witness Moore on redirect attempted to discredit Ameren’s own internal planning documents. (Tr. p. 804 through p. 807, l. 17). The Commission should disregard this self-serving testimony. First of all, such testimony is in direct conflict with Ameren’s Form 10-K that clearly delineates the costs related to environmental compliance. Second, witness Moore admitted that Exhibit 44 is the most recent Ameren planning document regarding environmental costs. (Tr. p. 736, l. 16-24). Finally, it would simply be imprudent for Ameren not to be aware of the possible costs it expects to incur for environmental compliance that impact its utility operation.

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[6] To not burden this brief with a large amount of highly confidential material, the actual costs can be found starting on page 3 of 133 of Exhibit 44 ending on page 5 of 133 and at Transcript pages 739 through 746.

2. Unsupportable SO_2 Adjustment

According to UE witness Voytas, UE used the most current year-end rate base and revenue requirements (Ex. 9, p. 5, l. 1-2; Tr. p. 552, l. 1-2), for the year ending December 31, 2002. Those revenue requirements were normalized to more accurately reflect future expectations since UE experienced several extraordinary costs in 2002. (Ex. 9, p. 5, l. 2-5).[7] In his prefiled testimony and initial workpapers, witness Voytas only explicitly identified two normalization adjustments: 1) the production O&M expenses included in the cost of Callaway Refuel 12; and 2) the administrative and general expenses related to the Voluntary Retirement Program ("VRP") and the Venice Plant shutdown. (Ex. 9, p. 5, l. 19-23; p. 6, l. 1-7; Tr. p. 558, l. 23-25; p. 559, l. 1-3; Ex. 40). However, witness Voytas did make one other adjustment to SO_2 revenues that only appears in his workpapers that support his initial workpapers Exhibit 41. (Tr. p. 563, l. 7-9; p. 565, l. 23-25, p. 566, l. 1-3).

Exhibit 41, witness Voytas' supplemental workpapers, contained the stealth SO_2 revenue adjustment made by UE to its analysis on page 5. (For the Commission's ready reference, page 5 of Exhibit 41 is attached as Attachment 1). ** ___________

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___________ * UE believed 2001 reflected a more typical year than 2002 so witness Voytas made an adjustment to his analysis. Specifically, witness Voytas added $7,647,620 in revenues to the 2002 SO_2 sales revenues of $10,202,380. (Tr. p. 566, l.

[7] Witness Voytas testified "normalization" is done to "make it look more like expectations, like budgets, like it either has in the past or expected to look in the future." (Tr. p. 553, l. 2-4).

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5-10). Witness Voytas derived the $7,647,620 by subtracting $10,202,380 2002 revenue number form the $17,850,000 revenue number for 2001. (Tr. p. 566, l. 11-14).

Then witness Voytas allocated the $7,647,620 between AmerenUE-Illinois, AmerenUE-wholesale and AmerenUE-Missouri. (Tr. p. 568, l. 8-24). For AmerenUE-Illinois, witness Voytas allocated $707,717. (Tr. p. 568, l. 21-24). Witness Voytas on cross-examination testified as follows:

> Q. Would you agree with me that the $707,717 is built into your analysis every year for the 25 years of the SO2 revenue?
>
> A. That's correct.
>
> Q. And this is in addition to the 10,202,380 of SO2 revenue built in every year for the 25 years in your analysis; is that correct?
>
> A. That's correct. The total is 17,850,000.
>
> R. That's my next question. Would you agree with me that built into your AmerenUE total company, you have built into your analysis over $17 million in revenues for SO2 sales for a 25 year period?
>
> A. Yes, I have.

(Tr. p. 568, l. 25; p. 569, l. –12). Witness Voytas unequivocally testified that he had built in over $17 million in revenues from SO_2 sales for a 25 year period in his Metro East Service Area Transfer Revenue Requirements Analysis. Witness Voytas testified that the stealth SO_2 adjustment is found on Schedule 2 to his direct testimony in the line denoted "Other Production Expenses." (Tr. p. 570, l. 4-25; p. 517, l. 1-7).[9]

The evidence of record demonstrates that this Commission should not accept UE's use of over $17 million of SO_2 allowance sales revenues for a twenty-five year

[8] This number is **substantially lower** than the 2002 revenues from SO_2 allowances found in highly confidential Exhibit 47 and stated in the testimony of UE witness Moore. (Tr. p. 760, l. 12-15).
[9] Witness Voytas admitted there was no way of knowing an SO_2 revenue adjustment had been made to Schedule 2, Exhibit 9 from looking at the schedule. (Tr. p. 571, l. 8-12).

period in its transfer revenue requirements analysis. First, UE's adjustment overstates the actual level of 2001 SO_2 sales revenues because he used an inaccurate 2002 sales figure as the starting point for his adjustment. Second, the adjusted SO_2 sales revenue figures as used by UE in its analysis are not sustainable for a twenty-five year period, thus rendering the results of UE's analysis useless.

If UE had used the alleged 2002 SO_2 revenues of $10,202,380 found on Exhibit 41, page 5, the revenue requirement for the transfer case would be increased. Witness Voytas admitted that using the unadjusted 2002 SO_2 sales revenue figures would result in increasing the Metro East transfer revenue requirement. (Tr. p. 575, l. 17-25; p. 576, l. 1-11). In fact, in response to UE data request 25G, Public Counsel Chief Economist Ryan Kind calculated the transfer revenue requirement using the unadjusted 2002 SO_2 revenue. (Tr. p. 578, l. 17-21). This analysis was entered into the record as Exhibit 86. Mr. Kind replicated UE's study changing the SO_2 revenue adjustment to use the unadjusted 2002 SO_2 revenues. This analysis demonstrates that if this flaw alone is corrected, the advantage of the transfer versus building CTGs is reduced to a yearly benefit of only $1.7 million and a present value benefit over the life of the analysis of only $4.1 million (Ex. 86, p. 8). As Public Counsel witness Kind testified, the SO_2 adjustment accounts for ** ____ * of the alleged benefits for the transfer option. (Tr. p. 671, l. 5-25).

UE witness Voytas testified that he had built into his transfer revenue requirement analysis over $17 million in revenues from SO_2 allowance sales for a twenty-five (25) year period relative to the CTG option. (Tr. p. 569, l. 8-12). However, UE witness Moore testified ** ____

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* at current prices. (Tr. p. 783, l. 2-6).[10] This assumption would require UE to completely exhaust its SO_2 bank which would be contrary to the requirements set out in EO-98-401 that UE may sell only up to one-half of all Phase I allowances without seeking specific Commission approval. (Ex. 50, p. 2). Witness Voytas' assumption that UE can achieve $17.8 million per year for 25 years selling SO_2 allowances is untenable and should be rejected.

Witness Voytas testified **under oath** on March 26, 2004, in no uncertain terms that he built the over $17 million in revenues from SO_2 sales into his analysis for a twenty-five year period. (Tr. p. 568, l. 25; p. 569, l. 1-12). However, on April 8, 2004, thirteen days after his initial testimony, witness Voytas testified under oath to something wholly different. Apparently recognizing the untenable nature of his proposed SO_2 adjustment, witness Voytas, **completely contradicting** his March 26, 2004 testimony, asserted that the adjustment for SO_2 revenues was only done for one test year. (Tr. p. 1684, l. 17-25). Witness Voytas' testimony is not credible and is merely a transparent attempt to salvage an ill-conceived analysis.

It should be noted that Mr. Voytas' SO_2 adjustment exacerbated another major flaw in his analysis of the Metro East transfer option, the failure to include environmental compliance costs that UE expects to incur over the 25 year study period**.** Witness Kind's rebuttal testimony addressed the issue of whether UE's past and future aggressive SO2 allowance sales practices would accelerate the need for UE to make

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[10] The current price at the time of hearing was higher than the $170 per ton assumed by witness Voytas. Thus, using witness Voytas' number UE's SO_2 bank would be exhausted sooner than Mr. Moore claimed, at current prices. (Tr. p. 777, l. 19-25; p. 778).

large capital investments in order to comply with pending and expected environmental regulations. (Ex. 12, p. 39, l. 3 – p. 41, l. 4) ** ______________________________

______________________________ *

3. Failure To Consider SO_2 Revenue Income Tax Impacts

In its analysis, UE increased SO_2 allowance sales revenues by $7,647,620 (Tr. p. 568, l. 8-24) and allocated $707,717 of those revenues to the UE-Missouri portion of Illinois (Tr. p. 568, l. 21-24), but those revenues are pretax levels. ** ______________

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Despite the flaws that UE has admitted exist in its analysis with respect to the non-sustainable level of adjusted SO_2 sales and the failure to reflect the income tax impacts associated with its adjustment, UE has continued to provide "updated" comparisons of the CTG option versus the Metro East transfer option which fail to correct for these admitted errors in its analysis. The Commission should not base its decision on any of these "updated" comparisons as they contain the same major SO_2 adjustment flaws that existed in the original cost analysis included in Mr. Voytas' direct testimony.

C. Flaws in the CTG Revenue Requirements Analysis

1. Inadequate Support For Cost Estimates Of New Gas-Fired Capacity

In the "build CTGs" portion of his least-cost analysis, witness Voytas used a $471/kW figure for the cost of new gas-fired generation. (Tr. p. 1665, l. 19-22). Witness Voytas indicated that this $471/kW figure was the weighted cost of Ameren Energy Generation's ("AEG") Pinckneyville and Kinmundy plants, but witness Voytas failed to explain why he believes these plants are a good proxy for the cost of new gas-fired capacity. (Ex. 12, p. 38, l. 17-20). UE's use of the $471/kW figure is too high, thus improperly inflating the revenue requirements of the build CTGs option.

Public Counsel witness Kind testified that in UE's Application in Case No. EA-2000-37, UE estimated the cost of constructing new gas-fired capacity at $390/kW and in its recent FERC filings in Case No. EC03-53, NRG offered to sell its three-year old gas peaker plant in Audrain County to AmerenUE for $312/kW. (Ex. 12, p. 38, l. 24-27;

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p. 39, l. 1-2). Witness Voytas admitted that the use of a lower cost/kW would result in lowering the costs of the purchase CTG portion of his analysis appearing on Schedule 4 of his direct testimony. (Tr. p. 1669, l. 16-21).

In fact, witness Voytas on October 2, 2003, filed rebuttal testimony in FERC Docket No. EC03-53-000 stating as follows:

> Q. What value does Dr. Rudkevich use in his FCR Model for the cost of installing a new combustion turbine in the year 2002?
>
> A. The value Dr. Rudkevich uses is $400/kW.
>
> Q. Do you believe this is a valid assumption?
>
> A. No, I do not. This value is much lower than what Ameren would use in its modeling. A more realistic value would be closer to $450/kW based on CTGs that Ameren either built recently or is planning to build in the near future.

(Ex. 85, p. 37 of 41). Two weeks after witness Voytas filed his direct testimony in this proceeding asserting the cost to build CTGs was $471/kW, he filed FERC testimony asserting a more realistic value would be closer to $450/kW. Merely reducing the cost to build CTGs from $471/kW to $450/kW virtually eliminates any benefit the transfer of UE's Metro East operations has versus building CTGs. Public Counsel witness Kind replicated UE's workpapers only changing the $471/kW input and reducing it to $450/kW. As Exhibit 83, page 8 demonstrates that making only this change reduces the annuity per year difference to a mere .6 million and causes the present value ("PV") of the 25 year revenue requirements for the transfer option to exceed the PV of the 25 year revenue requirements for the CTG option by $6.1 million.

Reducing the cost per kW input of the "build CTG" option by a mere $21/kW results in the "build CTG" option being the least cost option for UE over a twenty-five

(25) year period. Simply put, even if the other flaws in witness Voytas' least cost study are ignored, using a more realistic price for the "CTG build" option results in that option being the least cost option for UE to pursue.

2. Using a 17% Reserve Margin Inflated Cost of CTG Option

The study performed by Witness Voytas assumes that UE must maintain a 17% reserve margin. (Exhibit 41, p. 7). Witness Kind testified that using this high reserve margin inflated the cost of the CTG option. (Tr. p.1819, l.4) Separately, Mr. Kind has demonstrated that at a more reasonable reserve margin level, there is no need for anything close to the 600 MWs of capacity that would be obtained from both of the options that were analyzed in witness Voytas' least cost analysis. (See Attachment 2).

Witness Voytas ** ____

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______ * Witness Voytas also admitted that reducing the number of megawatts of new CTG capacity would lower the cost of the CTG option. (Tr. 1647, l. 13-25). ** ______

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____ * (Tr. 1819, l. 4 –7)

3. CT cost should have been phased in as needed to meet capacity shortfalls.

Both witnesses Kind and Proctor pointed out in their rebuttal testimony that witness Voytas' calculation of the revenue requirements of the CTG option improperly

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assumed that all 597 MW of capacity were needed in the first year of the 25 year cost study. (Exhibit 12, p. 28, l. 12-16, Exhibit 14, p. 11, l. 16-20). Incurring all of these costs in the first year instead of incurring them over time (as the capacity was actually required to meet capacity shortfalls) inappropriately inflated the cost of the CTG option. Exhibit 12, Attachment 2 (this attachment is also Attachment 2 to this Brief). This document clearly shows that under all likely scenarios, UE has no need for anything close to 597 MWs for at least the first two years of the 25 year period used to evaluate the costs of the CTG option. It should be noted that the analysis in Attachment 2 is premised upon the assumption that the transfer of the Pinckneyville and Kinmundy plants to UE could occur without the approval of the instant application. Witness Nelson testified that those generating units could be transferred without the Metro East transfer being approved by the Missouri Commission. (Tr. 364, l. 10-19)

D. Company Analyzed Options Inconsistently

The record shows that witness Voytas used inconsistent methodologies to evaluate the costs of the CTG and transfer options. Witness Voytas testified that he did not escalate the fixed Operation and Maintenance (O & M) over the 25 year study period used the analysis of the Metro East transfer option. (Tr. 1621, l. 21-23). Witness Voytas testified that he did not know whether he had applied a 2 percent escalation rate to the Operating and Maintenance costs in his analysis of the CTG option. (Tr. 1622, l. 24 through Tr. l. 15). Later in the hearing, witness Kind testified that his review indicated that Mr. Voytas' CTG analysis had in fact applied a two percent escalation factor to the level of O & M costs over the 25 year study period. (Tr. 1819, l. 17-25).

It was inappropriate for the Voytas least cost analysis to assume that O & M costs would remain constant for the Metro East Transfer option but would increase at a rate of two percent per year for the CTG option. This difference in the methodologies used by witness Voytas to analyze the two options improperly biased the results of this analysis in favor of the Metro East transfer option. (Tr. 1819, l. 8-25)

<u>E. Summary of Corrections to Company's Least Cost Analysis</u>

The two tables that follow summarize the corrections to the flaws identified in Company's least cost analysis that which are addressed in sections 3.B, 3.C., and 3.D. above. Table 1 shows corrections to flaws in Company's analysis that were modeled by Ryan Kind. (Ex. 83, 86, 87, and 88). Table 2 shows the directional impact on the revenue requirements of correcting additional flaws identified in each option of Company's analysis

Table 1 –Summary of Certain Corrections to Voytas Least Cost Analysis

Description of Correction	25 Year Present Value of Revenue Requirement (millions)		Annualized Amount From 25 Year Analysis (millions)	
	Metro East Transfer Option	CTG Option	Metro East Transfer Option	CTG Option
Reverse unsustainable $7.6 million SO2 allowance sales adjustment (Ex. 86)	$425.3	$429.4	$43.8	$45.5
High $471 CTG cost/kW reduced to $450/kW (Ex. 83)	$418.4	$412.3	$43.1	$43.7
Combined impact of the two above corrections (Ex. 87, Ex. 88 p. 2)	**$425.3**	**$412.3**	**$43.8**	**$43.7**

The bottom row of Table 1 shows that when just two of the many flaws in witness Voytas's limited analysis are corrected, it is already clear that the CTG option is the least cost option as measured by (1) the present value of twenty-five year revenue requirements and (2) and the levelized annual costs.

Table 2 – Additional Corrections Needed to Voytas Least Cost Analysis (Directional Impacts That Corrections Would Have on 25 Year and Annual Revenue Requirements Are Shown)

Description of Flaw in Voytas Analysis	Metro East Transfer Option Directional Impact	CTG Option Directional Impact
Transfer option excluded costs of pending and proposed environmental regulations over the 25 year study period. (Tr. pp. 554, 555)	Increase ($5.7 to $7 million annual increase, see below)	
High 17% reserve margin used in the CTG option analysis instead of a more reasonable 15% margin. (Tr. 1649, l. 12-14, Tr. 1651)		Decrease
New CTGs should have been "phased in" in the CTG analysis because not all are needed in early years. (Exhibit 12, p. 28, l. 12-16,Exhibit 14, p. 11, l. 16-20)		Decrease
O & M costs should have been accelerated by 2% per year in the transfer analysis since these costs were accelerated in CTG option. (Tr. 1819, l. 17-25)	Increase	

All of the flaws summarized in the above tables would tend to make the CTG option less expensive relative to the transfer option. As Table 1 shows, when Company's cost study is modified to correct for the obvious errors related to the unsustainable SO_2 adjustment and the inflated CTG cost/kW, then the CTG option is clearly less expensive in terms of the present value of twenty-five year revenue requirements and in the terms of the annual levelized revenue requirement. If Company's cost study was also adjusted to remedy the significant flaws summarized in Table 2, the CTG option would become even more favorable relative to the Metro East transfer option. In particular, as discussed in a later section of this brief, Company's exclusion of the pending and expected future environmental compliance costs has underestimated the annual costs of the Metro East transfer in future years by millions of dollars.

The inclusion of future environmental costs would have an enormous impact on the transfer option revenue requirement because, even though only an additional six percent (6%) of the Company's total future environmental costs would be allocated to UE's Missouri customers under the transfer option, UE's most recent estimate of these future costs is in the billion dollar range. (Ex. 58, pp. 151-152 of 184). Company's failure to include these costs in the Voytas least cost analysis, when such costs are the subject of UE internal planning documents (Ex. 44, pp. 3-5 of 144) and public Securities and Exchange Commission (SEC) filings (Ex. 58), makes this a necessary and essential issue that must be addressed in this case.

It is worth emphasizing again that Company's so called "least cost" analysis, even after it is corrected for the blatant flaws discussed in this section, still ignores all but one alternative (the CTG option) of many alternatives available to the Metro East transfer option. The evaluation of other resource options, including several *known* resource options such as the EEInc Joppa plant and the NRG Audrain plant, were ignored by Company in its limited analysis. Only a new Request for Proposal (RFP) process, properly conducted and analyzed, could provide the substantial evidence necessary to determine the least cost resource for AmerenUE's customers.

IV. TRANSMISSION SERVICE/RELIABILITY DETRIMENT

As explained below, the Metro East transfer proposal was worked out individuals simultaneously representing the various Ameren subsidiaries involved, and is designed to break apart a portion of the vertically integrated utility system now serving AmerenUE's customers. A portion of AmerenUE's generation portfolio would no longer be directly connected to its Missouri customers via transmission assets that are owned and operated by AmerenUE. AmerenUE's current Illinois transmission facilities that link the Venice and Pinckneyville generation facilities to its transmission network in Missouri would be transferred to its affiliate AmerenCIPS. (Ex. 12, p. 42, l. 5-8). The transfer of these transmission facilities could have adverse reliability impacts (as well as rate impacts) upon Missouri customers. The danger is exacerbated due to the major changes that are currently taking place through FERC transmission policies and by the ever-developing organization of entities that manage the grid in the Midwest (e.g., Midwest ISO). (Ex. 12, p. 42, l. 8-12).

Company has provided no assurances that there will be no changes in transmission service as a result of the proposed transfer which would reduce the current level of transmission service and reliability in Missouri. Both Public Counsel and Staff have proposed "hold harmless" conditions that would require any approval of the Metro East transfer to be conditioned upon Company's agreement to hold Missouri ratepayers harmless from any adverse rate or reliability impacts that result from changes in ownership proposed for the transmission assets connecting Venice, Pinckneyville, EEInc/Joppa and Keokuk generating facilities. (Ex. 12, p. 42, l. 13-17; Ex. 14, p. 19, l. 1-18).

V. WAIVER OF THE COMMISSION'S AFFILIATE TRANSACTION RULES WOULD NOT BE IN THE BEST INTEREST OF AMERENUE'S CUSTOMERS.

The Metro East transfer is subject to the Commission's Affiliate Transaction Rules, which require that any affiliate transaction involving Company not provide a financial advantage to an affiliate that is not regulated by the Commission. 4 CSR 240-20.015(2)(A) and 4 CSR 240-40.015(2)(A). The Missouri Supreme Court has affirmed that the Commission's affiliate transaction rules are designed to prohibit utilities from providing an advantage to their affiliates and to the detriment of ratepaying customers. Atmos Energy Corp. v. Public Service Commission, 103 S.W.3d 753, 763-764 (Mo. banc 2003).

Both AmerenCIPS and Ameren Corporation are entities affiliated with AmerenUE, placing them within the definition of "affiliated entity" pursuant to the rules. 4 CSR 240-20.015(1)(A) and 4 CSR 240-40.015(1)(A). AmerenUE would be providing a financial advantage to AmerenCIPS (which is not regulated by the Commission) if it transferred assets to AmerenCIPS for compensation that is not the greater of fair market value or the fully distributed costs of those assets. (Ex. 20, p. 7). The earnings of AmerenCIPS will increase as a result of the proposed transfer. (Tr. 1035, l. 4-7). But there is no evidence that supports the contention that AmerenUE is receiving reasonable and prudent consideration for the transmission and distribution assets being transferred to AmerenCIPS. (Ex. 20, p. 8).

Furthermore, AmerenUE would be providing a financial advantage to Ameren Corporation by asking that AmerenUE be required to pick up significant liabilities that would otherwise not be AmerenUE's responsibility absent the transfer. (For a dramatic example of this, see the discussion of environmental compliance costs discussed earlier in this brief.) Company acknowledges that liabilities yet unknown could possibly impact AmerenUE as a result of the proposed transfer. (Ex. 69, pp. 19-20; Tr. 1043). Mr. Nelson stated that "whoever benefited from the generation should be responsible for paying the liability." (Tr. 1077, l. 23-24). However, the proposed Metro East transfer would not live up to this principle, as it would assign pre-existing environmental liabilities to AmerenUE-Missouri for generation that has been serving AmerenUE-Illinois. Staff and Public Counsel have both concluded that the terms of the Metro East transfer are designed to provide a financial benefit, not to AmerenUE, but rather to the overall corporate holdings of its unregulated holding company. (Ex. 20, p. 9; Ex. 12, pp. 4-7). The proposed transaction is clearly a transaction for which the rule was designed to cover.

The Metro East transfer proposal should be subjected to scrutiny under the rule as it is an affiliate transaction that was clearly not hammered out in the context of an "arm's length transaction".[11] It was actually the board of directors for the holding corporation, Ameren Corporation, that ** ____

____

______________________ * (Ex. 12HC, p. 17, l. 10-17). Moreover, the current Ameren Strategic Plan[12] shows that ** ____

________________________________ * (Ex. 12HC, p. 19, l. 16-19, Attachment 1). Further strategic planning provisions that are relevant to the proposed affiliate transaction are excerpted and attached to Ryan Kind's Rebuttal Testimony. (Ex. 12HC, pp. 19-23, Attachment 1). The entity that actually drew up the documents and hammered out the details of the proposal is yet another affiliated entity, Ameren Services (AMS), who simultaneously acted as an agent for **both** parties to the agreement (AmerenUE and AmerenCIPS). (Ex. 20, p. 8, l. 22-24).

Company witness Craig Nelson asserted a unique argument at the evidentiary hearing to suggest that an arm's length transaction (of sorts) is actually taking place. Mr. Nelson creatively contends that an arm's length transaction is occurring between the two regulatory commissions, the Missouri Public Service Commission and the Illinois Commerce Commission (ICC). (Tr. 456, 1039-1040). This notion is clearly absurd in that the two regulatory commissions are not negotiating between themselves. This argument is also inconsistent with the Commission's rejection of an AmerenUE

[11] Black's Law Dictionary defines this term as follows: **Arm's length transaction.** Said of a transaction negotiated by unrelated parties, each acting in his or her own self interest; the basis for a fair market value determination . . . For example, if a corporation sells property to its sole shareholder for $10,000, in testing whether $10,000 is an "arm's length" price it must be ascertained for how much the corporation could have sold the property to a disinterested third party in a bargained transaction. Ibid., West Publishing, Fifth Edition, p. 100.

[12] Significantly, there is no separate strategic planning document for AmerenUE. The strategic plans for all of the subsidiaries within the Ameren family are subsumed into one single planning document. (Tr. 478).

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argument made in Case No. EO-96-14, where AmerenUE argued that the Commission was a "party" to a Stipulation and Agreement which it had reviewed and approved.[13]

A truly "arm's length transaction" would involve two unentangled, unrelated parties assessing the transaction to determine if it was truly in their best interest. Due diligence would be performed to determine the appropriate value of the transferred assets as well as determine the appropriate compensation for the considerable liabilities being transferred. An absolute minimum requirement for such due diligence would be the issuance of a proper RFP to allow the consideration of all available options so that those options could be compared side-by-side with the proposed Metro East transfer. (See Public Counsel's RFP Condition below).

The Application requests that this Commission grant a waiver or a variance from the requirements of the affiliate rules "for good cause shown". Ibid., para. 18, p. 7. UE witness Nelson argues that the Commission should grant a waiver because, in his opinion, the proposed transaction is not detrimental to the public. (Ex. 6, p. 16). At the evidentiary hearing Mr. Nelson had to acknowledge that he did not clearly understand the waiver provisions of the affiliate transaction rule and could not make sense of the waiver provision. (Tr. 146-148).

Neither "good cause shown" nor "not detrimental" is the proper standard for a waiver from the Commission's affiliate transaction rules. A utility shall only be granted a waiver under these rules when, to the utility's best knowledge and belief, compliance

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[13] On December 23, 1999, the Commission rejected AmerenUE's argument that the Commission's July 21, 1995 Report and Order accepting a Stipulation and Agreement was a "contract" between the Commission and AmerenUE. This decision was affirmed by the Cole County Circuit Court on May 17, 2002 in Circuit Court Case No. 00CV323273.

with the standards would not be in the best interests of its regulated customers. 4 CSR 240-20.015(10)(A)(2) and 4 CSR 240-40.015(10)(A)(2). Nowhere in its Application, or anywhere else in the record, is there an explanation of how Company believes that the "best interests" standard can be met to justify a waiver. Company spends much energy arguing that the rule should not apply and fails to provide any serious effort to attempt to meet this burden (a much heavier burden than the "not detrimental" standard of Section 393.190, by the way).

The Commission should reject the request for a waiver from its affiliate transaction rules for electric and natural gas transactions. As an alternative, the Commission could require AmerenUE to issue an RFP to examine the proposed transfer in a the context of what else is available in the marketplace to meet AmerenUE's resource needs, as described later in this brief. This is appropriate because there are currently no structural elements in place to ensure that the proposed transfer was negotiated fairly (i.e., an arm's length transaction). The Public Counsel RFP condition would allow the Commission to evaluate whether the proposed transfer is actually in the best interests of AmerenUE's customers.

VI. PUBLIC COUNSEL RECOMMENDATIONS REGARDING PROPOSED CONDITIONS

If the evidentiary record justifies it, the Commission has the inherent power and authority to authorize a proposed transaction subject to sufficient conditions, provided that the conditions would eliminate any detriment to the public. This inherent power flows from the ability and responsibility to reject a proposed transaction that would result in a detriment to the public. If the Commission finds that a proposed transaction would be detrimental, but that it would not be detrimental if it was conditioned in certain ways, then it flows logically that the Commission has the authority to approve a transaction subject to those conditions. Clearly, the applicant utility has the option of accepting all conditions that are ordered and follow through with the proposed transaction or has the option of not completing the transaction.

The Commission has requested and received a list of conditions from its Staff, filed on April 6, 2004 (Staff's List of Conditions"). Ex. 68. The Staff initially points out in that document that the lack of detail in Company's filings in this case (including, no analysis of the impact to AmerenUE's Missouri natural gas operations or of the Missouri retail transmission cost) has left it unable to calculate the total detriment to Missouri's ratepayers. Id., pp. 1-2. Staff recommends approval of the proposed transaction *only* on the condition that *all* of the Staff conditions are adopted by the Commission. Id. at 2. Public Counsel responded to Staff's List of Conditions, pointing out these Staff conditions are not sufficient to mitigate the all of the detriments identified in this case. Ex. 70, p. 2. Although still insufficient to totally protect Missouri consumers from detriment, Public Counsel suggests additional conditions that would be necessary and essential to mitigate some detriments of the proposed transfer. Ex. 70, pp. 2-4.

The only condition that Public Counsel is comfortable actually recommending to the Commission is a condition precedent to approval that would require Company to issue an RFP for proposals to meet future load so that all viable alternatives to the Metro East transfer could be discovered, followed by a proper side-by-side comparison of all available resource options, as described below. (Ex. 70, p. 2). Despite Public Counsel's belief that the transaction as proposed cannot be justified as preventing a detriment to customers on the present record, Public Counsel does offer other potential conditions and supports many of Staff's proposed conditions as at least mitigating potential detriments related to the proposed Metro East transfer.

A. Public Counsel's Proposed Conditions

1. RFP Condition

As an alternative to simply rejecting the Application, Public Counsel recommends that the Commission issue a condition precedent to any approval of the proposed Metro East transfer, requiring Company to issue an RFP for proposals to meet its future load. Under this proposed condition all viable alternatives to the transfer could be discovered, followed by a proper side-by-side comparison of all available resource options. (Ex. 70, p. 2.) All parties to this case would be allowed sufficient time to provide input into the structuring of the RFP process and to analyze all responses to this RFP. Id. If, based upon Company's analysis of the RFP responses and after comments from Public Counsel, Staff and any other party to this case, the Commission ultimately determines that the proposed transfer is the least cost option available, then the Company would be allowed to proceed with the transfer (subject to any other appropriate conditions issued by the Commission). Id.

It would be highly imprudent for a utility to build or otherwise acquire a large amount of capacity in today's overbuilt market without issuing an RFP to see what offers are made for purchase power or the sale of existing plants. (Ex. 12, p. 33.) When

AmerenUE issued an RFP several years ago (before the capacity glut in the Midwest was fully developed), it received a large number of attractive responses. Id.

In order to justify Company's limited comparison of the Metro East transfer to only one other option (build CTG option), Mr. Voytas contends that the Company has performed Asset Mix Optimization studies which have shown that the building of combustion turbine generation are the least cost generation alternative to supply AmerenUE's capacity and energy needs "until around 2010" (Ex. 9, p. 4, l. 16-19). However, other options that may be available in the marketplace at any given point in time are not included in those Asset Mix Optimization studies. (Ex. 12, pp. 33-34). Simply relying upon the output of an Asset Mix Optimization study is not consistent with the resource planning process employed by Company over the last few years. (Ex. 12, pp. 34-35).

The fact that the Metro East transfer would be an affiliate transaction does not relieve Company from the obligation to use an RFP process. This type of process has been approved by the Commission in a past case involving an AmerenUE affiliate transaction. In Case No. EA-2000-37, AmerenUE sought and received permission from the Commission to allow AmerenCIPS to transfer its generation assets to an Exempt Wholesale Generator (EWG) owned by Ameren Corporation. The Report and Order issued in that case was admitted into this record as Ex. 36. One of the conditions that the Commission required for approval of that transaction was that AmerenUE would agree to a process for issuing RFPs for new generation resources under certain circumstances when Ameren affiliates are involved in the resource acquisition process. Id., Attachment 1, pp. 14-15.

Many of the same affiliate concerns that were present in that EWG case are also present in this case. The conditional approval which called for an open and fair resource acquisition process was intended to help prevent AmerenUE ratepayers from being harmed by a resource acquisition process that served the interest of the parent company instead of serving the interest of AmerenUE's regulated ratepayers. (Ex. 12, p. 34, l. 17-22).

<u>2. Alternative Conditions to Mitigate Detriments Associated With a Failure to Analyze All Resource Options.</u>

It is clear from the record In this case that there are numerous known existing resource options that were not even considered in Company's narrow "least cost" study. For a list of many of these known resource options, review the rebuttal testimony of Mr. Kind. (Ex. 12HC, pp. 35-38). Numerous detriments were demonstrated by the Staff and by Public Counsel relating to these overlooked yet known resource options. The magnitude of these detriments relate to the high risk of increased future rates due to the acquisition of additional capacity for AmerenUE's Missouri customers through the Metro East transfer without a proper analysis to determine the least cost resource available. If the Commission chooses to approve the proposed Metro East transfer, despite the numerous detriments identified by Staff and Public Counsel, then Public Counsel recommends that the Commission only issue its approval subject to two additional conditions that would at least partially mitigate these detriments:

(a.) Public Counsel suggests that any approval be conditioned upon a Company agreement to continue receiving the capacity and related energy from the generating facilities owned by EEInc and to which Company is **entitled** to receive pursuant to the EEInc Bylaws. (Ex. 70, pp. 2-4). This condition would require Company to agree to commit itself to avoid being “frozen out” from receiving the 40% of capacity and output to which it is presently entitled by directing its representative members who serve on the EEInc Board of Directors to take no action that could reasonably result in decisions to restrict Company’s entitlement to receive this capacity and output. Id. If the Commission conditions its approval of the proposed Metro East transfer in this way, then the last paragraph in section 9 of Staff’s List of Conditions (Ex. 69, p. 14) would not be needed to address detriments pertaining to Company’s exclusion of the EEI Joppa plant from its least cost analysis

This condition would clearly be reasonable given the fact that Ameren has also expressed a willingness to provide almost identical assurances to Kentucky Utilities Company (KU) in the context of its merger application to the FERC in Docket No. EC04-81. In the March 2004 prepared direct testimony of Mr. Craig Nelson offered by Ameren to the FERC in that proceeding, it is stated that if the Ameren/Illinois Power acquisition is approved, Ameren commits to selling some of the output to the Joppa plant owned by EEInc. and offers to insure that KU is able to continue to receive output from the Joppa plant (Ex. 80, p. 4). There is absolutely nothing preventing Ameren from providing the same assurances that it provided to KU and thus ensure that AmerenUE will continue to receive its 40% entitlement to the low cost capacity and power from the EEInc Joppa plant.

(b.) Any approval in this case should also be conditioned upon an agreement by Company that it make its best efforts to sell, under long-term contracts of one year or more, any capacity in excess of the Mid-America Interconnected Network (MAIN) recommended reserve requirement, currently 14.12%. (Ex. 70, p. 4). In years when its excess capacity exceeds the recommended MAIN reserve requirement by 40MW or more, such sales shall be conducted through an RFP coordinated with the Staff and Public Counsel. Id. Company would be required by this condition to further agree to provide information relating to such sales to the Staff and to Public Counsel, along with updates on this subject through any resource planning briefings. Id.

B. Public Counsel's Support of Staff's Proposed Conditions

Assuming the Commission approves the Application over Public Counsel's strong objections any approval of the proposed Metro East transfer should also be conditioned upon each of the conditions detailed on pages 3 through 14 of the August 6, 2003 Staff List of Conditions (Ex. 69). These proposed conditions would mitigate many (but not all) of the detriments identified by Staff and Public Counsel in this case.

1. **No Ratemaking Determinations.** As the Staff indicates in its List of Conditions, AmerenUE's Application appears to seek relief that could be interpreted as constituting ratemaking determinations, specifically subparagraphs ©-(m) of the Applications requested relief, Public Counsel believes that any Commission order providing approval of the Application should clearly state that all ratemaking determinations related to this

application are preserved for future Commission ratemaking proceedings. (Ex. 70, pp. 4-5; Ex. 69, p. 3).

2. **Joint Dispatch Agreement.** If the application is approved without changes to the JDA, the cost and revenue allocations resulting from the JDA will clearly be more harmful to Missouri ratepayers than through the current allocations. (Ex. 14). Transferring load to AEG/AEM will cause a decrease in the margins from off-system sales that are allocated to Missouri ratepayers even though there will be no change in the manner that generation resources funded by Missouri customers are dispatched. In addition, after the transfer, the AmerenUE Illinois load would still be served by low cost energy provided by AmerenUE's base load generation resources. Therefore, Missouri customers would be foregoing a greater amount of margins from off system sales as an increasing amount of energy is transferred to AEG/AEM. Public Counsel fully supports Staff's two JDA Conditions explained on pp. 3-5 of Ex. 69.

3. **Liabilities and Costs.** It is very important to ensure that Missouri customers do not experience upward pressure on rates after the transfer due to the assignment of additional liabilities to Missouri customers because Company has failed to quantify this impact in its flawed least cost analysis (which was erroneously purported to compare the proposed transfer to building new CTGs). Public Counsel believes a proper least cost analysis demonstrates that the transfer is not the least cost option and any further cost increases due to the proposed assignment of

liabilities will only impose further detriments on AmerenUE's Missouri customers if the transfer is approved. Public Counsel supports all of Staff's Liabilities and Costs Conditions explained on pp. 5-8 of Ex. 69.

4. **SO_2 Allowances.** As the evidence in this case shows, a significant portion of the purported cost advantage of the transfer relative to building new CTGs arises from AmerenUE's normalization of annual SO_2 revenues to a level that the Company admits is **not sustainable** over the 25 year period included in the Company's least cost study. Not only did the Company make normalization adjustments increasing the projected SO_2 sales levels in its study to unsustainable levels, the Company is actually making sales at a non-sustainable level and has plans to continue doing so for the next few years. Without the Staff's proposed conditions, AmerenUE's Missouri customers will be at risk for 98% (instead of the current 92% exposure) of large increases in future SO_2 compliance costs. In addition, Missouri customers would be exposing themselves to cost recovery of 98% of AmerenUE's generation resources (including future SO_2 compliance costs) based upon a flawed least cost study. It would be more economical to continue relying on 92% of AmerenUE's existing generation resources plus the less costly generation resources that AmerenUE will add to its generation portfolio if the transfer is not approved.

   Public Counsel supports the Staff SO_2 Allowance condition, calling for an investigation case to examine whether Company has sold allowance without Commission authority and without safeguards against affiliate abuse. (Ex. 69, pp. 8-9).

5. **<u>Natural Gas Issues.</u>** This is another area of costs that the Company did not incorporate in its flawed least cost study. Given that a proper least cost study would show that other options are more economical that the proposed transfer, it is important that AmerenUE's Missouri customers be held harmless from any further upward pressure on natural gas rates due to the issues that the Staff has identified in this area. (Ex. 69, pp. 9-10).

6. **<u>Affiliate Transaction Rules.</u>** Public Counsel believes that the Commission should only grant a variance from its electric and gas affiliate transaction rules if all of the conditions recommended by both Staff and Public Counsel are directed by the Commission. Such a variance requires a determination from this Commission that "compliance with the standards would not be in the best interest of regulated customers", as described in section V of this brief. Public Counsel believes that the Commission cannot properly make such a determination unless it conditions any approval of the proposed transfer on all of the conditions that have been recommended by both the Staff and OPC.

7. **<u>Nuclear Decommissioning Fund.</u>** This is yet another area of costs that the Company did not incorporate into its flawed least cost study. Given that a proper least cost study would show that other options are more economical that the proposed transfer, it is important that AmerenUE's

Missouri customers be protected from any further upward pressure on rates due to this issue that the Staff has identified. (Ex. 69, pp. 10-11).

8. **Transmission.** As stated in the Rebuttal testimony of Public Counsel witness Ryan Kind, any approval of the proposed transfer should be conditioned on AmerenUE's agreement to hold its Missouri ratepayers harmless from any adverse rate or reliability impacts resulting from a portion of AmerenUE's generation portfolio no longer being directly connected to Missouri via transmission assets that are owned and operated by AmerenUE. Public Counsel believes that the Staff's proposed conditions in this area would satisfy the concerns in this area. (Ex. 69, pp. 12-14).

9. **Access to Books, Records, Employees and Officers.** Public Counsel experienced substantial difficulties gaining access to information from Ameren and its affiliates that is relevant to this case. The Staff's proposed condition is necessary to ensure that AmerenUE and its holding company, Ameren Corporation, do not raise additional barriers to the effective regulation of Missouri's largest regulated energy monopoly. (Ex. 69, p. 14).

VII. CONCLUSION

It is understandable that the proposed Metro East Transfer may have some superficial appeal. The state of Illinois has a different regulatory scheme for electric utilities, having restructured its electric utility regulatory scheme in 1997. It is also understandable that Ameren Corporation has a lot to gain from this affiliate transaction. But neither the accommodation of electric restructuring in a neighboring state nor the desire to promote the goals of UE's parent holding company, Ameren Corporation should supercede the interests of its captive customers here in Missouri.

The Metro East transfer would clearly be detrimental to AmerenUE's Missouri customers. Even the extremely flawed "least cost" analysis of Company, comparing the transfer to building CTGs shows a detriment when it is corrected for flaws that are documented in this record. The detriment to future rates is clear even before corrections are made to Company's analysis to account for environmental compliance costs related to the transfer. The transmission service and reliability detriment create significant risks for Missouri. These are necessary and essential issues the Commission cannot ignore. Moreover, Company has absolutely failed to meet the higher standard dictated by the Commission's Affiliate Transaction Rule, to show that this affiliate transaction is in the best interest of its Missouri customers and thus no waiver from the rule should be granted.

If the Commission orders anything other than the complete rejection of the Application, it should require Company to issue a proper RFP to compare the Metro East Transfer to all other viable alternatives to meet Company's future load, allowing all parties to participate in the process as Public Counsel has proposed. Only then could the Commission ensure that the full range of resource options are discovered and analyzed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to the following this 18th day of May 2004:

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