Exhibit No.:
Issue(s): SO2 Allowance Transactions
MISO Withdrawal
Coal Inventory
Witness/Type of Exhibit: Kind/Direct
Sponsoring Party: Public Counsel
Case No.: EM-96-149

DIRECT TESTIMONY

OF

RYAN KIND

Submitted on Behalf of
the Office of the Public Counsel

UNION ELECTRIC

NP

Case No. EM-96-149

May 7, 2002

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of the application of Union Electric Company for an order authorizing: (1) certain merger transactions involving Union Electric Company; (2) the transfer of certain assets, real estate, leased property, easements and contractual agreements to Central Illinois Public Service Company; and (3) in connection therewith, certain other related transactions.	)	Case No. EM-96-149

AFFIDAVIT OF RYAN KIND

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Ryan Kind, of lawful age and being first duly sworn, deposes and states:

1. My name is Ryan Kind. I am a Chief Utility Economist for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my affidavit consisting of pages 1 through 45 with Schedules RK-1 through RK-3.

3. I hereby swear and affirm that my statements contained in the attached affidavit are true and correct to the best of my knowledge and belief.

Ryan Kind

Subscribed and sworn to me this 7th day of May 2002.

KATHLEEN HARRISON
Notary Public - State of Missouri
County of Cole
My Commission Expires Jan. 31, 2006

Kathleen Harrison
Notary Public

My commission expires January 31, 2006.

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DIRECT TESTIMONY

OF

RYAN KIND

UNION ELECTRIC COMPANY D/B/A AMERENUE

CASE NO. EM-96-149

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. Ryan Kind, Chief Energy Economist, Office of the Public Counsel, P.O. Box 7800, Jefferson City, Missouri 65102.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND.

A. I have a B.S.B.A. in Economics and a M.A. in Economics from the University of Missouri-Columbia (UMC). While I was a graduate student at UMC, I was employed as a Teaching Assistant with the Department of Economics, and taught classes in Introductory Economics, and Money and Banking, in which I served as a Lab Instructor for Discussion Sections.

My previous work experience includes several years of employment with the Missouri Division of Transportation as a Financial Analyst. My responsibilities at the Division of Transportation included preparing transportation rate proposals and testimony for rate cases involving various segments of the trucking industry. I have been employed as an economist at the Office of the Public Counsel (Public Counsel or OPC) since April 1991.

Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE THIS COMMISSION?

A. Yes, prior to this case I submitted written testimony in numerous gas rate cases, several electric rate design cases and rate cases, as well as other miscellaneous gas, water, electric, and telephone cases.

Q. HAVE YOU PROVIDED COMMENTS OR TESTIMONY TO OTHER REGULATORY OR LEGISLATIVE BODIES ON THE SUBJECT OF ELECTRIC UTILITY REGULATION AND RESTRUCTURING?

A. Yes, I have provided comments and testimony to the Federal Energy Regulatory Commission (FERC), the Missouri House of Representatives Utility Regulation Committee, the Missouri Senate's Commerce & Environment Committee and the Missouri Legislature's Joint Interim Committee on Telecommunications and Energy.

Q. HAVE YOU BEEN A MEMBER OF, OR PARTICIPANT IN, ANY WORK GROUPS, COMMITTEES, OR OTHER GROUPS THAT HAVE ADRESSED ELECTRIC UTILITY REGULATION AND RESTRUCTURING ISSUES?

A. Yes. I was a member of the Missouri Public Service Commission's (the Commission's) Stranded Cost Working Group and participated extensively in the Commission's Market Structure Work Group. I am currently a member of the Missouri Department of Natural Resources Weatherization Policy Advisory Committee, the Operating Committee of the North American Electric Reliability Council (NERC), and the National Association of State Consumer Advocates (NASUCA) Electric Committee. I have served as the public consumer group representative to the Midwest ISO's (MISO's) Advisory Committee and currently serve as the alternate consumer group representative to that committee. During the early 1990s, I served as a Staff Liaison to the Energy and Transportation Task Force of the President's Council on Sustainable Development.

I. SUMMARY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony will provide Public Counsel's recommendations in the following areas:

- Inclusion of revenues from actual and potential SO2 allowance transactions taking place during the sharing period in the calculation of sharing credits and sharing levels.

- Exclusion of MISO withdrawal fees (also referred to as "exit fees") from the calculation of sharing credits and sharing levels.

- Consideration of the impact that coal inventory levels at less than the levels agreed to in the 2nd EARP (the New Experimental Alternative Regulation Plan approved by the Commission in EM-96-149) had on earnings due to decreased opportunity sales (short term off-system sales into wholesale power markets) and increased short term power purchases.

II. DETERMINATION OF EARNINGS TO BE SHARED WITH RATEPAYERS

Q. HOW DOES THE STIPULATION AND AGREEMENT APPROVED BY THE COMMISSION IN CASE NO. EM-96-149 ADRESS ADJUSTMENTS THAT MAY BE MADE TO THE EARNINGS REPORT THAT AMERENUE (UE OR THE COMPANY) FILES WITH THE COMMISSION?

A. Counsel advises me that it provides the Commission with discretion to determine the appropriate level of earnings used in the calculation of sharing credits based on recommendations of Staff, Public Counsel, or other parties. I am advised that one basis that may be used by the Commission to determine that earnings should be adjusted is a

finding that the Company has manipulated its earnings in the earnings report that it files with the Commission.

Q. HOW MIGHT EARNINGS BE MANIPULATED IN A MANNER THAT UNDERSTATES THE LEVEL OF EARNINGS THAT SHOULD BE USED TO DETERMINE CREDITS THAT WOULD BE SHARED WITH RATEPAYERS?

A. Generally speaking, earnings could be understated if the revenues on the Company's earnings report are understated or the expenses on the report are overstated. Expenses could be overstated if they do not accurately reflect the level of expenses incurred by the regulated utility during the sharing period or if the utility chose to alter its operations so that its expenses during the sharing period would be higher than the expenses would be if no regulatory incentives existed to understate earnings. Revenues could be understated if they do not accurately reflect the level of revenues received by the regulated utility during the sharing period or if the utility chose to alter its operations so that its revenues during the sharing period would be lower than the revenues would be if no regulatory incentives existed to understate earnings. An example of this type of activity would be if the Company structured a transaction so that it would receive revenues after the sharing period even though the deal was struck during the sharing period.

Q. DOES THE HOLDING COMPANY AND MANAGEMENT STRUCTURE OF UE PROVIDE UE WITH GREATER INCENTIVES TO MANIPULATE EARNINGS THAN WOULD EXIST IF UE WAS A "STAND ALONE" REGULATED UTILITY?

A. Yes, I believe so.

Q. PLEASE EXPLAIN.

A. The holding company structure of UE and its parent company, Ameren, is fairly complex and includes an extensive mixture of regulated and non-regulated business lines. While Ameren operates a regulated vertically integrated utility in Missouri, it operates a regulated distribution utility in Illinois along with an unregulated generation company and an unregulated power marketing company. Many of Ameren's affiliates (e.g. Ameren Services, Ameren Energy, and Ameren Energy Fuels & Services) perform activities on behalf of both the regulated and unregulated portions of Ameren's operations.

It must be assumed that from the perspective of Ameren's officers and directors at the holding company level, their fiduciary responsibility to shareholders is to seek to obtain the highest possible returns at the holding company level, subject to risk considerations. One consideration in obtaining high returns at the Ameren holding company level would obviously be the ability to avoid "regulatory take back" (e.g. through sharing credits) or the adjustment of earnings levels (e.g. through rebasing of rates in a general rate proceeding). Therefore, if Ameren has the opportunity to enter into a profitable transaction, such as a long term power sale, one would expect the holding company to prefer having the transaction take place at one of its unregulated subsidiaries rather than at one of its regulated utility subsidiaries.

Q. WOULDN'T THE SENIOR OFFICERS OF UE BE MOTIVATED TO ACHIEVE THE HIGHEST POSSIBLE LEVEL OF PERFORMANCE AT UE SO THAT THEY COULD TAKE CREDIT FOR THIS ACCOMPLISHMENT, EVEN THOUGH SOME OF ITS HIGH PERFORMANCE MIGHT COME AT THE EXPENSE OF ONE OF ITS AFFILIATES OR ITS PARENT?

A. No. The achievement of outstanding operating results by UE that came at the expense of its affiliates or the overall financial performance of Ameren would not be expected to occur unless the senior management of Ameren was ineffective at pursuing its fiduciary

responsibilities to the holding company shareholders. An effective management at the holding company level would be certain to communicate the overriding importance of the holding company's financial performance to UE's senior management and hold them accountable for not achieving good financial operating results at the UE level that come at the expense of the holding company's performance.

Q. HAVE YOU SEEN EVIDENCE OF AMEREN'S SENIOR MANAGEMENT COMMUNICATING WITH UE'S SENIOR MANAGEMENT ABOUT THE OVERIDING IMPORTANCE OF THE HOLDING COMPANY'S FINANCIAL PERFORMANCE AND HOLDING THEM ACCOUNTABLE FOR NOT ACHIEVING GOOD FINACIAL OPERATING RESULTS AT THE UE LEVEL THAT COME AT THE EXPENSE OF THE HOLDING COMPANY'S PERFORMANCE?

A. No, given the shared management structure of the holding company and UE, there would be no need for such communications and accountability to take place. This is because Charles Mueller serves as the Chairman and Chief Executive Officer of Ameren, UE, and Ameren Services and because Gary Rainwater is the President and Chief Operating Officer of Ameren, UE, and Ameren Services.

III. REVENUES FROM SO2 TRANSACTIONS

Q. PLEASE SUMMARIZE THIS ISSUE.

A. The Commission issued an order on December 15, 1998 in Case No. EO-98-401 that authorized UE to manage its sulfur dioxide (SO2) emission allowance inventory in accordance with the terms of the Stipulation and Agreement in that case. Since that time, UE has engaged in a number of transactions with its SO2 allowances. The earnings report filed by UE for the sharing period beginning July 1, 2000 and ending June 30, 2001 only reflected $899,416 in revenues associated with SO2 allowance transactions.

Public Counsel believes that some of the allowance transactions that occurred during the sharing period were structured and timed in a manner that would avoid having them appear in the earnings report. Consequently, OPC recommends several adjustments to negate UE's attempts to manipulate the earnings associated with its allowance transactions.

Q. PLEASE SUMMARIZE THE ADJUSTMENT THAT OPC IS RECOMMENDING IN THIS CASE.

A. The earnings report filed by UE should be adjusted to reflect an additional $28,122,151 in revenues associated with SO2 emission allowance transactions. This includes the following five adjustments:

- **_____**

- **_____**

- **_____**

- $12,800 for revenues associated with a gain from SO2 options that was moved by UE to a "below the line" revenue item.

- $413,851 for a negative expense associated with gains from SO2 options that was moved by UE to a "below the line" negative expense item.

Q. PLEASE PROVIDE SOME BACKGROUND INFORMATION ABOUT THE FEDERAL ENVIRONMENTAL LAWS THAT CAUSED UE TO RECEIVE SO2 EMISSION ALLOWANCES.

A. On November 15, 1990, President Bush authorized major revisions to the Clean Air Act (CAA) that included a requirement for substantial reductions in power plant emissions (both SO2 and NOx) intended to control acid rain. Title 4 of the CAA amendments of 1990 created a new market-based system for reducing SO2 emissions below 1980 levels. In this system, owners of power plants like UE received their allocation of the emission allowances through an allocation process based primarily on historic fuel consumption from 1985 through 1987. Power plant owners use this allocation of allowances for their own compliance and any excess allowances can be either sold in the market or banked for future use or sale. Those power plant owners that do not have sufficient allowances can buy allowances in the market to achieve compliance. Different amounts of allowances were allocated to power plant owners during Phase I (1995-1999) and Phase II. Each allowance permits a generating unit to emit one ton of SO2 during or after a specified year. Unused allowances can be banked for future use or sale.

The market-based system for regulating SO2 emissions, where allowances could be traded, was intended to minimize the cost of reducing SO2 emissions to the desired level. The system of tradable allowances encourages utilities to over-comply with emissions reductions targets when they can do so at a cost that is less than the market value of allowances while at the same time, allowing utilities to under-comply with the reduction targets when they can buy allowances at a cost that is less than their own cost of compliance. The most common strategies for lowering SO2 emissions are converting to low sulfur coal or scrubbing power plant emissions. UE has reduced its emissions by converting many of its power plants to permit the burning of low sulfur coal from sources in the West like the Powder River Basin.

Q. PLEASE EXPLAIN THE RELATIONSHIP BETWEEN THE SO2 EMISSION ALLOWANCES THAT UE RECEIVES EVERY YEAR AND THE SERVICE THAT THE COMPANY PROVIDES TO MISSOURI RATEPAYERS AS A REGULATED ELECTRIC UTILITY.

A. I already mentioned that the quantity of allowances that UE receives every year is based largely on the amount of fuel that was consumed at its generating plants during the 1985 through 1987 time period. The generating plants to which the allowances were allocated were built to serve the native load of UE. The electric rates paid by UE's customers have been set at a level high enough to provide UE with a reasonable opportunity to recover from its customers the costs associated with the financing and operation of these power plants. UE has not needed to pay for any costs that are not recoverable in rates in order to receive its annual allocation of emission allowances for the plants that it uses to serve its regulated utility service customers.

Q. WHAT WERE SOME OF THE MAIN PROVISIONS OF THE STIPULATION & AGREEMENT APPROVED BY THE COMMISSION IN CASE NO. EO-98-401?

A. The Stipulation & Agreement in Case No. EO-98-401, which gave UE limited flexibility to manage its SO2 allowances, included the following four key provisions:

> 1. AmerenUE will have the authority to manage its allowance inventory, with the restrictions discussed below. The Staff and the Office of Public Counsel reserve the right to reexamine and modify their positions respecting the Commission granting AmerenUE the authority to manage its sulfur dioxide emission allowance inventory, when the New Experimental Alternative Regulation Plan resulting from the Union Electric Company- CIPSCO, Inc. merger Case No. EM-96-149 expires on June 30, 2001. **Any profits or losses that are realized from the sales or any other transactions associated with allowances, will be booked to utility operating income according to generally accepted accounting principles. The regulatory treatment of these profits and losses as well as the prudence of any allowance transaction is subject to review and adjustment as part of any audit and/or examination in a future sharing calculation or future rate case.** (emphasis added)

2. **The Company is authorized to manage the entire allowance inventory, but may sell only up to one-half of all Phase I allowances without seeking specific Commission approval.** This includes sales to AmerenCIPS and other utilities. AmerenUE may request authorization to sell additional allowances, above this level, through a filing with the Commission. (emphasis added)

3. Sales in combination with other transactions, such as power contracts, are also authorized as a portion of the level discussed above. However, the Company must book a profit from the sale of the allowances at least equal to the current market value as established by the monthly price index published by Cantor Fitzgerald Environmental Brokerage Service. Should either the Staff, the Office of the Public Counsel or the Company wish to use a different index for this purpose in the future, notice will be given to the other parties and all parties will negotiate in good faith to agree on a substitute. The Commission will be asked to resolve the matter if no agreement is reached in a reasonable time period.

4. The Company will be required to provide detailed reporting of all the transactions involving allowances once each year. The reporting date will be August 31 for the previous twelve months ending on June 30. The database to support allowance transactions and inventory balances will be maintained and available to the Staff upon request during the year.

Q. CAN YOU QUANTIFY THE EFFECT OF THE SECOND ITEM FROM THE STIPULATION AND AGREEMENT SHOWN ABOVE WHICH STATES THAT "THE COMPANY IS AUTHORIZED TO MANAGE THE ENTIRE ALLOWANCE INVENTORY, BUT MAY SELL ONLY UP TO ONE-HALF OF ALL PHASE I ALLOWANCES WITHOUT SEEKING SPECIFIC COMMISSION APPROVAL?"

A. Yes. Its my understanding that UE received ** _____ ** Phase I SO2 emission allowances and that the Commission order allowed it to sell one-half, or ** _____ ** of these allowances without seeking additional Commission approval.

Q. DO THE ALLOWANCES THAT UE RECIEVES EVERY YEAR FROM THE ENVIRONMENTAL PROTECTION AGENCY (EPA) HAVE ANY VALUE AT THE TIME UE RECIEVES THEM?

A. The answer to this question is both yes and no, depending on what is meant by the word "value." If the word "value" is interpreted to mean "market value", then these allowances have value at the time they are received by UE because the Company could find a willing buyer to purchase the allowances at the time UE receives its allocation. On the other hand, it is my understanding that from a strict accounting point of view, allowances are reflected on the Company's balance sheet as having a zero value since the Company did not make any direct payments to receive the allowances. However, if a Company purchases allowances in the market and saves them for future use, instead of just receiving an annual allowance allocation from the EPA, then these allowances would be reflected on a Company's balance sheet at the market price.

Q. WHAT WAS THE MARKET VALUE OF UE'S EMISSION ALLOWANCE INVENTORY DURING THE SHARING PERIOD?

A. Ameren estimated the market value of UE's emission allowance inventory during the sharing period to be approximately **_____**

Q. DOES THE STIPULATION AND AGREEMENT APPROVED BY THE COMMISSION IN EM-96-149 CONTAIN ANY PROVISIONS THAT REFER SPECIFICALLY TO SO2 EMISSION ALLOWANCES?

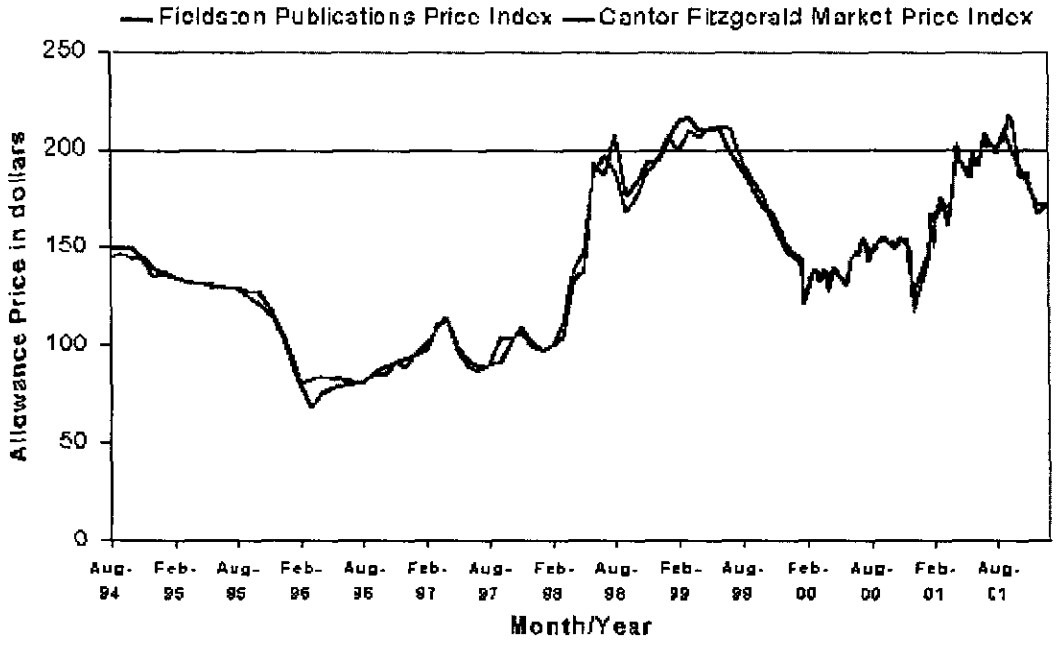
A. Yes. Section 7 of this Stipulation and Agreement contains terms that the parties agreed to regarding the New Experimental Alternative Regulation Plan (2nd EARP). Attachment C to the Stipulation and Agreement Contains additional details about implementation of the 2nd EARP. Item 2.a. on page 1 of Attachment C states that:

> the earnings report will reflect the following:...Any sale of emission allowances shall be reflected above-the line in the ROE calculation.

Q. PLEASE EXPLAIN WHY YOU BELIEVE THAT THE AMOUNTS OF REVENUES FROM SO2 TRANSACTIONS REFLECTED IN UE'S EARNINGS REPORT SHOULD BE GIVEN CLOSE SCRUTINY.

A. As I described earlier, the Commission has given UE the authority to sell nearly 400,000 emission allowances without any approval beyond that already granted to UE in Case No. EO-98-401. Emission allowances have been trading in the range of $70 to $217 over the last few years. (See graph below.) If UE were to sell 60,000 allowances per year and received an average price of $180 per allowance for these sales, it would generate revenues of $10.8 million per year. The earnings associated with these sales would be equal to the amount of revenues less some small payments that may be necessary for brokers fees.

FIGURE 1 - HISTORICAL SO2 EMISSION ALLOWANCE MARKET PRICE DATA



If UE has significant amounts of excess allowances and is not using the authority granted by this Commission to sell some of these allowances into the market, then further inquiry is prudent to determine if there is some good reason for not selling a portion of its excess inventory. This is especially true if the expected future appreciation in the value of allowances falls short of the discount rate used to value future revenue streams.

Unfortunately, both the EARP and the rate case that was expected at the conclusion of the EARP may have given UE the incentive to avoid making sales where a substantial amount of the earnings from these sales would have to be returned to ratepayers in credits. Other factors, such as Ameren's hopes of getting its generation assets removed from Missouri ratemaking jurisdiction along with the emission credits associated with those generation assets may have also impacted Ameren's decisions regarding the type and amount of transactions that would take place involving UE's emission allowances.

Q. HAVE YOU REVIEWED DOCUMENTS AS PART OF YOUR AUDIT OF UE FOR THIS SHARING CASE AND FOR THE COMPLIANT CASE THAT LEAD YOU TO BELIEVE THAT AMEREN CONSIDERED THE POSSIBLE REGULATORY TREATMENT OF UE'S ALLOWANCES IN THIS SHARING CASE OR THE CURRENT UE COMPLAINT CASE (CASE NO. EC-2002-1) IN ITS DECISIONS ABOUT THE MAGNITUDE, TYPE, OR TIMING OF SO2 TRANSACTIONS THAT IT WOULD MAKE DURING THE SHARING PERIOD?

A. **____**

Q. HAVE YOU REVIEWED DOCUMENTS AS PART OF YOUR AUDIT OF UE FOR THIS SHARING CASE AND FOR THE COMPLIANT CASE THAT LEAD YOU TO BELIEVE THAT AMEREN CONSIDERED THE POSSIBILITY OF GETTING UE'S GENERATION ASSETS REMOVED FROM MISSOURI RATEMAKING JURISDICATION ALONG WITH THE EMISSION CREDITS ASSOCIATED WITH UE'S GENERATION ASSETS IN ITS DECISIONS ABOUT THE

MAGNITUDE, TYPE, OR TIMING OF SO2 TRANSACTIONS THAT IT WOULD MAKE DURING THE SHARING PERIOD?

A. **____**

Q. HAVE YOU REVIEWED DOCUMENTS AS PART OF YOUR AUDIT OF UE FOR THIS SHARING CASE AND FOR THE COMPLIANT CASE THAT LEAD YOU TO BELIEVE THAT AMEREN CONSIDERED THE POTENTIAL FOR USING UE'S **_____ BANK OF EXCESS ALLOWANCES TO COVER ONGOING OR FUTURE DEFICITS IN THE AMOUNT OF ALLOWANCES NEEDED AT AMEREN'S NON-REGULATED POWER PLANTS IN ITS DECISIONS ABOUT THE MAGNITUDE, TYPE, OR TIMING OF SO2 TRANSACTIONS THAT IT WOULD MAKE?**

A. **_____

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_____****

Q. PLEASE IDENTIFY AND EXPLAIN THE AMEREN DOCUMENTS THAT YOU HAVE REVIEWED WHICH SHOW THAT AMEREN CONSIDERED THE POSSIBLE RATEMAKING TREATMENT OF UE'S ALLOWANCES IN ITS DECISIONS ABOUT THE MAGNITUDE, TYPE, OR TIMING OF SO2 TRANSACTIONS THAT IT WOULD MAKE.

A. The first document that I will discuss is a copy of the minutes from the **_____

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_____

[redacted]

**

Q. DOES THE ABOVE QUOTE FROM THE ** [redacted]

[redacted]

A. **

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Q. PLEASE IDENTIFY AND EXPLAIN THE NEXT AMEREN DOCUMENT THAT YOU REVIEWED WHICH SHOWS THAT **

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Q. PLEASE IDENTIFY AND EXPLAIN THE NEXT AMEREN DOCUMENT THAT YOU REVIEWED WHICH SHOWS THAT AMEREN _____

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Q. ALL OF THE DOCUMENTS REFERENCED ABOVE REFER TO THE ** _____

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_____ ** **HOW MANY OF UE'S SO2 ALLOWANCES WERE SOLD DURING THE FINAL SHARING PERIOD OF THE SECOND EARP?**

A. ** _____

_____ **

Q. HOW MANY SALES HAVE TAKEN PLACE SINCE THE END OF THE SHARING PERIOD?

A. I am unable to give a full accounting of the sales that took place beyond the end of the EARP because UE has thus far refused (despite the lack of a formal objection) to provide all of the information requested in OPC DR No. 560. What I can say, based on the sketchy information that I have received, is that between October 1, 2001 and sometime in late February of 2002, UE had received ** _____ _____ _____ _____ _____ **

Q. THE ** _____ _____ _____ _____ ** HAVE YOU REVIEWED ANY ** _____ ** DOCUMENTS AS PART OF YOUR AUDIT OF UE FOR THIS SHARING CASE THAT LEAD YOU TO BELIEVE THAT AMEREN IS INTERESTED IN UTILIZING UE'S EXTENSIVE BANK OF SO2 ALLOWANCES TO HELP IT COMPLY WITH ENVIRONMENTAL REGULATIONS AT NEW NON-REGULATED COAL PLANTS THAT WERE UNDER CONSIDERATION BY AMEREN?

A. ** _____ _____ _____ _____ _____ _____

**

Q. **DO YOU BELIEVE IT WAS APPROPRIATE FOR AMEREN TO CONSIDER ITS ** ______ ** IN ITS DETERMINATION OF HOW TO MANAGE UE'S SO_2 ALLOWANCE INVENTORY?**

A. ** ______

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_____ **

Q. PLEASE REPEAT THE RECOMMENDATIONS THAT YOU HAVE MADE REGARDING ADJUSTMENTS THAT PUBLIC COUNSEL BELIEVES SHOULD BE MADE TO UE'S OPERATING RESULTS SO THAT THE ACTUAL AND POTENTIAL EARNINGS ASSOCIATED WITH THE MAJOR SO2 ALLOWANCE TRANSACTIONS TAKING PLACE DURING THE 3RD YEAR OF THE SECOND EARP ARE SHARED WITH RATEPAYERS.

A. Public Counsel recommends adjusting the earnings report filed by UE to reflect an additional $28,122,151 in revenues associated with SO2 emission allowance transactions. As I stated earlier, this includes the following five adjustments:

1) ** _____

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2) ** _____

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3) ** _____

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_____ **

4) $12,800 for revenues associated with a gain from SO2 options that was moved by UE to a "below the line" revenue item. OPC recommends reversing this UE adjustment.

5) $413,851 for a negative expense associated with gains from SO2 options that was moved by UE to a "below the line" negative expense item. OPC recommends reversing this UE adjustment.

Q. PLEASE EXPLAIN PUBLIC COUNSEL'S RATIONALE FOR THE FIRST ADJUSTMENT RELATED TO THE ** _____ ******

Public Counsel recommends ** _____

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Q. HAVE YOU REVIEWED ANY ADDITIONAL AMEREN DOCUMENTS THAT SUPPORT PUBLIC COUNSEL'S RECOMMENDATION OF TREATING THIS ** **

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**Q. PLEASE EXPLAIN PUBLIC COUNSEL'S RATIONALE FOR THE SECOND ADJUSTMENT RELATED TO THE ** **

A. **

[redacted]

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Q. HAS UE ENGAGED IN ANY ** _____ ** SINCE THE EARP HAS ENDED AND IT HAS RETURNED TO TRADITIONAL REGULATION?

A. ** _____

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**Q. PLEASE EXPLAIN PUBLIC COUNSEL'S RATIONALE FOR THE THIRD ADJUSTMENT RELATED TO ** _____

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A. Public Counsel recommends that ** _____

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Q. HAS UE _____
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A. ** _____
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Q. PLEASE EXPLAIN PUBLIC COUNSEL'S RATIONALE FOR THE FOURTH ADJUSTMENT RELATED TO $12,800 FOR REVENUES ASSOCIATED WITH A GAIN FROM SO2 OPTIONS THAT WAS MOVED BY UE TO A "BELOW THE LINE" REVENUE ITEM.

A. At the time this testimony was filed, UE has still failed to provide a timely response to OPC DR Nos. 547 and 548 which requested UE to provide support for this adjustment. In light of the above discussion about ** _____
_____

_____** Public Counsel recommends that this credit-reducing adjustment be disallowed unless and until UE can fully support it.

Q. PLEASE EXPLAIN PUBLIC COUNSEL'S RATIONALE FOR THE FIFTH ADJUSTMENT RELATED TO $413,851 FOR A NEGATIVE EXPENSE ASSOCIATED WITH GAINS FROM SO2 OPTIONS THAT WAS MOVED BY UE TO A "BELOW THE LINE" NEGATIVE EXPENSE ITEM.

A. At the time this testimony was filed, UE has not yet responded to OPC DR Nos. 571 through 574 which requested UE to provide support for this adjustment. Public Counsel acknowledges that UE's response to these DRs are not due until May 9, 2002. However, in light of the above discussion about the **_____ _____**

Public Counsel recommends that this credit-reducing adjustment be disallowed unless and until UE can fully support it.

IV. MIDWEST ISO WITHDRAWAL EXIT FEES

Q. PLEASE EXPLAIN HOW UE TREATED THE MIDWEST INDEPENDENT SYSTEM OPERATOR (MISO) EXIT FEES THAT IT INCURRED DURING THE TEST YEAR.

A. According to UE's response to OPC DR No. 1003, the Company allocated **_____** of this exit fee to its Missouri electric operations.

Q. PLEASE SUMMARIZE WHY OPC BELIEVES THAT IT WOULD NOT BE APPROPRIATE TO INCLUDE UE'S PORTION OF THE AMEREN MISO EXIT FEE AS AN EXPENSE IN THE CALCULATION OF THE SHARING CREDIT.

A. There are two principal reasons why Public Counsel believes that the MISO exit fees do not represent reasonable or prudent expenditures on behalf of the regulated operations of UE. First, UE failed to get the necessary Missouri PSC approvals for the action that the Company took (withdrawing from the MISO) that caused it to incur the MISO exit fees. Secondly, the decision that UE's parent company, Ameren, made to withdraw from the MISO was not done to further the ability of UE to provide safe and adequate utility service at just and reasonable rates. Instead, the decision to withdraw was based on considerations related to the non-regulated operations of Ameren (the holding company that owns UE) and the future unregulated opportunities of Ameren.

Q. WHEN DID AMEREN FIRST STATE PUBLICLY THAT IT INTENDED TO WITHDRAW FROM THE MISO?

A. Ameren issued a press release on November 9, 2000 where it "announced its intention to withdraw from the Midwest Independent System Operator (MISO) and to become a member of the Alliance Regional Transmission Organization (Alliance RTO), pending the necessary regulatory approvals."

Q. PLEASE SUMMARIZE THE KEY PARTS OF THE CHRONOLOGY OF AMEREN'S ATTEMPT TO WITHDRAW FROM THE MISO AND JOIN THE ALLIANCE RTO (ARTO).

A. The following chronology summarizes some of the key dates:

- February 21, 1997 – This Commission approved the merger of UE and CIPSCO Incorporated in Case No. EM-96-149 on the condition that UE "participate in a regional ISO [the predecessor of RTOs] that eliminates pancaked transmission rates and that is consistent with the ISO guidelines set out in FERC Order 888." (Order at page 16)

- May 13, 1999 – This Commission approved UE's application to participate in the MISO under conditions set forth in the Stipulation and Agreement in Case No. EO-98-413. One of the terms that UE agreed to in that stipulation was that "in the event that AmerenUE seeks to withdraw from its participation in the Midwest ISO pursuant to Article Five or Article Seven of the Midwest ISO Agreement, the Company shall file a Notice of Withdrawal with the Commission, and with any other applicable regulatory agency, and such Withdrawal shall become effective when the Commission, and such other agencies, approve or accept such Notice or have otherwise allowed it to become effective."

- November 9, 2000 – Ameren provided formal written notification to the MISO of the Company's intent to withdraw from the MISO.

- January 11, 2001 – Ameren signed an agreement to join the Alliance RTO.

- January 16, 2001 – Ameren filed an application with the Federal Energy Regulatory Commission (FERC) to withdraw from the MISO where it sought permission to withdraw immediately.

- May 8, 2001 – FERC approved a settlement agreement that provided FERC approval for Ameren to withdraw from the MISO and join the ARTO. Ameren still lacked the necessary Missouri PSC approval for the proposed withdrawal.

- May 15, 2001 – Ameren made an $18 million "exit fee" payment to the MISO ($12.5 million for UE and $5.5 million for CIPS).

- June 8, 2001 – UE filed at the Missouri PSC an "Application of Union Electric Company for an Order Authorizing it to Withdraw From the Midwest ISO to Participate in the Alliance RTO." This application initiated Case No. EO-2001-684.

- December 20, 2001 – FERC granted RTO status to the MISO.

- February 28, 2002 – UE filed its Motion for Continued Abeyance in Case No. EO-2001-684 requesting that the Commission continue to hold the proceeding in abeyance until May 1, 2002.

Q. THE CHRONOLOGY ABOVE INDICATES THAT UE HAS ALREADY PAID $12.5 MILLION TO WITHDRAW FROM THE MISO EVEN THOUGH THE MISSOURI COMMISSION HAS NEVER AUTHORIZED UE'S WITHDRAWAL FROM THE MISO. IS THAT CORRECT?

A. Yes. The relief that UE sought in Case No. EO-2001-684 that would have permitted its withdrawal, has never been granted.

Q. IS UE SEEKING TO REDUCE THE AMOUNT THAT IT WILL SHARE WITH RATEPAYERS IN THE THIRD YEAR OF THE 2ND EARP BY ALLOCATING **_____ IN MISO WITHDRAWAL FEES TO ITS MISSOURI ELECTRIC OPERATIONS?**

A. Yes.

Q. DO YOU BELIEVE IT IS APPROPRIATE TO INCLUDE **_____ IN MISO WITHDRAWAL FEES IN THE EARNINGS REPORT THAT WILL BE USED TO CALCULATE SHARING CREDITS FOR UE'S CUSTOMERS?**

A. Certainly not. Ameren should never have signed any agreements (on behalf of UE) to withdraw from the MISO without the required authorization from this Commission. Of course, Ameren (on behalf of UE) went beyond just signing agreements to exit the MISO, it actually paid the MISO a substantial "exit fee" for a withdrawal that never received the necessary approvals from this Commission. It is now seeking to obtain ratepayer funds to

pay for much of the unauthorized withdrawal fee payment by including this expense in the calculation of earnings that must be shared with ratepayers.

Q. DOES AMEREN APPEAR TO UNDERSTAND THAT IT HAS NEVER RECEIVED THE NECESSARY APPROVAL FROM THE MISSOURI COMMISSION TO WITHDRAW FROM THE MISO?

A. Yes. In the Ameren 2001 report to shareholders that was released just a few weeks ago, Ameren states on page 23 that "the Company's withdrawal from the Midwest ISO remains subject to MoPSC approval."

Q. PLEASE EXPLAIN THE COMMITMENT THAT UE MADE IN CASE NO. EO-98-413 TO SEEK MISSOURI PSC APPROVAL PRIOR TO WITHDRAWING FROM THE MISO.

A. As the above chronology indicates, this Commission issued an order in Case No. EM-96-149 on February 21, 1997 that approved the merger of UE and CIPSCO Incorporated on the condition that UE "participate in a regional ISO [the predecessor of RTOs] that eliminates pancaked transmission rates and that is consistent with the ISO guidelines set out in FERC Order 888." As part of its compliance with this condition, UE filed, on March 30, 1998, an Application with the Commission in Case No. EO-98-413 for an order authorizing the Company to participate in the MISO. The parties in Case No. EO-98-413 entered into a Stipulation and Agreement that resolved all of the issues in the case. One of the provisions of that Stipulation and Agreement, which was signed by UE and later approved by the Commission, was that:

> In the event that AmerenUE seeks to withdraw from its participation in the Midwest ISO pursuant to Article Five or Article Seven of the Midwest ISO Agreement, the Company shall file a Notice of Withdrawal with the Commission, and with any other applicable regulatory agency, and such Withdrawal shall become effective when the Commission, and such other agencies, approve or accept such Notice or have otherwise

allowed it to become effective. (Stipulation & Agreement, page 3, paragraph number 11)

Q. HAS UE SOUGHT AUTHORIZATION FROM THIS COMMISSION TO WITHDRAW FROM THE MISO?

A. Yes.

Q. DID UE SEEK TO OBTAIN THIS AUTHORIZATION PRIOR TO WITHDRAWING FROM THE MISO AND PAYING THE EXIT FEES ASSOCIATED WITH THAT WITHDRAWAL?

A. No. As the chronology that I listed earlier indicates, Ameren, acting as an agent for UE, notified the MISO of UE's withdrawal on November 9, 2000. Ameren made an $18 million dollar exit fee payment to the MISO on May 15, 2001. On June 8, 2001, several weeks after making this payment to the MISO, UE filed an application with this Commission where it sought approval to withdraw from the MISO.

Q. HAS THE COMMISSION ISSUED A REPORT AND ORDER IN CASE NO. EO-2001-684 WHERE UE SOUGHT COMMISSION AUTHORIZATION TO PERMIT ITS WITHDRAWAL FROM THE MISO?

A. No. The Commission held hearings in this case last October and the case has been fully briefed, but the Commission has not issued an order either denying or approving UE's application to withdraw from the MISO. UE has filed pleadings requesting the Commission to essentially place this case on hold and no Commission decision has been made as of the date this testimony was filed.

Q. PLEASE SUMMARIZE THE PROBLEM WITH UE SEEKING TO HAVE THE MISO EXIT FEES CONSIDERED IN THE CALCULATION OF ITS SHARING CREDITS EVEN THOUGH IT HAS

NEVER RECEIVED THE NECESSARY APPROVAL FROM THIS COMMISSION TO WITHDRAW FROM PARTICIPATION IN THE MISO.

A. There is no basis for including an expense item for MISO exit fees in the calculation of sharing credits. Including this fee in the calculation of sharing credits would reward the utility for taking actions which lacked the necessary prior authorization by this Commission. If UE's payment of MISO exit fees is included in the earnings credit calculation for the third sharing period of the second EARP, then UE will have, in essence, been rewarded for violating the provisions of a Commission order.

Q. PLEASE PROVIDE AN UPDATE ON THE CURRENT STATUS OF THE MISO AND ITS SUITABILITY AS AN ISO/RTO THAT WOULD SATISFY THE TERMS OF THE COMMISSION'S DIRECTIVE IN CASE NO. EM-96-149 FOR UE TO "PARTICIPATE IN A REGIONAL ISO."

A. As I stated earlier, Ameren was initially ordered to "participate in a regional ISO [the predecessor of RTOs] that eliminates pancaked transmission rates and that is consistent with the ISO guidelines set out in FERC Order 888." On September 16, 1998, the FERC issued an order conditionally approving the establishment of the MISO. In that order, the FERC concluded that the MISO would eliminate pancaked transmission rates (Docket Nos. ER98-1438-000 and EC98-24-000, page 33). The FERC also concluded in its order that the MISO was consistent with FERC's ISO principles set forth in Order 888, either as proposed by the MISO or as modified by the FERC (pages 19 – 60).

As the findings and conclusions in the FERC order described above indicate, the MISO was clearly on a path to satisfy this Commission's directives for UE to "participate in a regional ISO [the predecessor of RTOs] that eliminates pancaked transmission rates and that is consistent with the ISO guidelines set out in FERC Order 888." I have personally

been an active participant in the development of the MISO as a member of its Stakeholder Advisory Committee and firmly believe that up until the point that Ameren announced its withdrawal from the MISO, the MISO was on a path to satisfy the Commission's conditions for ISO participation by UE that were set forth in its order in Case No. EM-96-149.

The FERC subsequently issued an order December 19, 2001 that granted RTO status to the MISO. The proposed Alliance RTO was denied RTO status on that same date, and on April 24, 2002, the FERC issued an order reiterating the directives in its previous order for the Alliance participants to join either the MISO or another RTO.

Q. PLEASE TURN TO THE OTHER ISSUE THAT YOU RAISED ABOUT WHETHER UE'S EXPENDITURE OF FUNDS FOR MISO EXIT FEES WAS A PRUDENT OR REASONABLE EXPENDITURE FOR A REGULATED ELECTRIC UTILITY TO MAKE.

A. The other issue I raised was that Ameren's decision to withdraw from the MISO was not done to further the ability of UE to provide safe and adequate utility service at just and reasonable rates. Instead, the decision to withdraw appears to have been based on considerations related to the non-regulated operations of Ameren and the future non-regulated opportunities of Ameren. In the testimony that follows, I will reference Attachments to my testimony in the MISO withdrawal case, Case No. EO-2001-684. Additional copies of these attachments are not included as attachments to this testimony, but can be found in my direct testimony which has been admitted into the record in Case No. EO-2001-684.

Q. WHAT WERE THESE OTHER CONSIDERATIONS RELATED TO THE NON-REGULATED OPERATIONS OF AMEREN AND THE FUTURE NON-REGULATED OPPORTUNITIES OF

AMEREN THAT PLAYED A ROLE IN AMEREN'S DECISION TO LEAVE THE MISO AND JOIN THE ARTO?

A. The other factors included:

1) The impact that Ameren's choice of an RTO would have on the future earnings prospects of Ameren's unregulated power marketing business and its unregulated generation assets.

2) The flexibility to divest its transmission assets at a later date to a transco at market value.

3) The ability to maintain as much control as possible over transmission assets.

4) The governance of an RTO and the degree to which transmission owners can continue to exert influence over RTO policies (including transmission expansion plans) during and after the formation of the RTO.

Q. PLEASE EXPLAIN WHY YOU BELIEVE THE FIRST FACTOR LISTED ABOVE HAD AN IMPACT ON AMEREN'S DECISION TO LEAVE THE MISO AND JOIN THE ARTO.

A. There are several reasons why I believe that Ameren considered the impact that its choice of an RTO would have on the **future earnings prospects of its unregulated power marketing business and its unregulated generation assets**. First, it's simply common sense that Ameren would consider this factor as part of its fiduciary duty to attempt provide future earnings growth for its shareholders. When UE merged with CIPS several years ago to form Ameren, UE acknowledged in its testimony that the increased number of transmission interconnects was expected to benefit the Company's power marketing operations. (See page 9 of Ameren CEO Charles Mueller's direct testimony in Case No. EM-96-149).

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Q. PLEASE EXPLAIN WHY YOU BELIEVE THE SECOND FACTOR LISTED ABOVE HAD AN IMPACT ON AMEREN'S DECISION TO LEAVE THE MISO AND JOIN THE ARTO.

A. There are several reasons why I believe that Ameren considered the impact that its choice of an RTO would have on the Company's **flexibility to divest its transmission assets at a later date to a transco at market value**. First of all, the restructuring legislation that Ameren has promoted in last two legislative sessions has provided for divesting of transmission assets with no oversight from the Commission. If this provision was important enough for Ameren to have included consistently in the legislation that it supported, then it is safe to assume that Ameren desires the flexibility to divest its

transmission assets without having any conditions imposed upon it that would interfere with gaining the maximum financial benefits for shareholders. These types of provisions do not just appear in proposed legislation by accident.

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Q. PLEASE EXPLAIN WHY YOU BELIEVE THE THIRD FACTOR LISTED ABOVE HAD AN IMPACT ON AMEREN'S DECISION TO LEAVE THE MISO AND JOIN THE ARTO.

A. There are several reasons why I believe that Ameren considered the impact that its choice of an RTO would have on **the ability to maintain as much control as possible over transmission assets.** First, it's just common sense that utilities would like to continue

performing the functions that they currently perform unless this somehow threatens their future earnings.

Second, one would expect that a vertically integrated utility would want to maintain control of "bottleneck facilities" when this control may allow them to enhance the future financial outcomes from their affiliated unregulated businesses (e.g. power marketing and non-regulated generation) that rely on access to these "bottleneck facilities" to engage in competitive unregulated business opportunities.

Third, on page 4 of Attachment RK-2 to my Direct Testimony in Case No. EO-2001-684, Ameren's senior management informs its Board of Directors that its investigation of alternatives to the MISO was prompted in part by Ameren's objective to "minimize the loss of control over assets."

Q. PLEASE EXPLAIN WHY YOU BELIEVE THE FOURTH FACTOR LISTED ABOVE HAD AN IMPACT ON AMEREN'S DECISION TO LEAVE THE MISO AND JOIN THE ARTO.

A. There are several reasons why I believe that Ameren considered the impact that its choice of an RTO would have on **the degree to which the RTOs governance would allow transmission owners can continue to exert influence over RTO policies** (including transmission expansion plans) during and after the formation of the RTO. First, my experience as an active participant during the formal and information ISO/RTO formation processes at the MISO from 1996 through the end of the year 2000 allowed me to interact with a large number of transmission owners and gain insights into their perspectives on ISOs/RTOs. During 1999 and 2000, when I served on the MISO Advisory Committee, I attended meetings almost every month at the MISO in Indianapolis, Indiana. Over these two years, I saw the MISO transformed from an organization that was largely run and staffed by transmission owner personnel to one

where the MISO board and management cooperated with the entire spectrum of stakeholders to set up an entity that could enhance reliability and facilitate the development of competitive wholesale markets across a broad area in the Midwest. It became clear to me from these experiences that a large number of transmission owners were highly uncomfortable with the concept of losing control over their transmission assets to an organization that was independent from the control of any one stakeholder group, including transmission owners.

During the spring and summer of 2000, some curious things began to happen as this process moved along. Certain transmission owners became visibly upset with the MISO management and with some of the stakeholder groups. Some transmission owners began to circulate rumors that the MISO was being mismanaged and was setting an enormous and costly infrastructure to perform its operations. The MISO stakeholder advisory committee responded to some of these allegations and even set up a Financial Audit Committee composed of stakeholders, including myself, to investigate the allegations of mismanagement. The MISO's management cooperated with this committee and no mismanagement or exorbitant expenditures were discovered as part of this process. In many cases, the MISO management was simply following through on purchasing and implementing systems that had been specified and selected by the transmission owners themselves during the time that transmission owner personnel served as a substitute for having a MISO staff.

It became increasing apparent to me that these efforts to discredit the MISO and sow discontent among the stakeholders were largely due to the success that the MISO was starting to achieve in implementing the objectives that the FERC outlined in Orders 888 and 2000 for transmission organizations that were independent from any single stakeholder group so they would be in a position to operate the transmission grid in a

manner that provided true open access and leveled the playing field between marketers and generators that were affiliated with transmission owners and those that were not.

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V. COAL INVENTORY ADJUSTMENT

Q. PLEASE SUMMARIZE THE COAL INVENTORY ISSUE.

A. The Stipulation and Agreement in Case No. EM-96-149 states in Attachment C, Reconciliation Procedure, item 2.f., that the earnings report will utilize a coal inventory equal to the 75 day supply. ** _____
_____ ** Public Counsel is recommending an adjustment to the coal inventory carrying costs that UE reflected on its earnings report so that the actual cost incurred is used in the calculation of sharing credits.

Q. PLEASE PROVIDE A MORE COMPLETE EXPLANATION OF THE RATIONALE FOR THE ADJUSTMENT TO COAL INVENTORY CARRYING COSTS THAT PUBLIC COUNSEL IS RECOMMENDING.

A. Since UE kept a coal inventory below the level agreed to in Case No. EM-96-149, it is likely that earnings were adversely affected as UE reacted to reduced coal inventory levels by (1) foregoing some opportunity sales that would have been made if the full 75

day inventory had been maintained and/or purchasing power in order to conserve coal even though the costs of purchased power exceeded UE's marginal generation costs.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. YES.

Schedules RK-1
through RK-3
have been deemed
PROPRIETARY
in their entirety.