

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of an Investigation of Union)
Electric Company d/b/a AmerenUE)

Case No. EO-2006-0430

STAFF REPORT

Comes now the Staff of the Missouri Public Service Commission (Staff) in response to the May 11, 2006 Order of the Missouri Public Service Commission (Commission) and files the attached Staff Report. On May 11, 2006, the Commission, based on requests from interested persons, issued an Order directing the Staff to conduct a formal investigation of Union Electric Company d/b/a AmerenUE, issued a standard Protective Order establishing "highly confidential" and "proprietary" classifications of information, and authorized the Staff to file a complaint against AmerenUE if the results of its audit warranted it doing so. Copies of the "highly confidential" and "nonproprietary" versions of the Staff Report follow, with the "highly confidential" or "HC" and "nonproprietary" or "NP" versions marked as Appendix A. The Staff Report states that the Staff is not yet able to determine whether the electric rates of AmerenUE are "just and reasonable" or excessive and provides details in the Staff Report.

Wherefore the Staff submits its Report in compliance with and in response to the Commission's May 11, 2006 Order.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record this 12th day of June 2006.

/s/ Steven Dottheim

Staff Report In Response To And In Compliance With The Commission's May 11, 2006 Order In Case No. EO-2006-0430

The Commission in the initial paragraph of its May 11, 2006 Order in Case No. EO-2006-0430 stated:

Based on requests from interested persons and the need to discuss and protect proprietary and confidential information, the Commission hereby directs the Staff of the Commission to conduct a formal investigation of Union Electric Company d/b/a AmerenUE, specifically to include, but not limited to, the Joint Dispatch Agreement, the EEI, Inc. issues, and sulfur dioxide emission allowances. The Staff shall file a report with the Commission no later than June 11, 2006. The Commission hereby directs the Staff to hereby conduct the investigation expeditiously and authorizes it to take any appropriate action including filing a complaint against AmerenUE if, based on the investigation, it determines such action is appropriate.

The Commission directed in the second item of its "Ordered" section that: "2. The Staff of the Commission shall file an investigation report on June 11, 2006." This report is being filed by the Staff in response to and in compliance with the Commission's directive in this case.

This report is comprised of five sections. Those sections are: Status Of Staff Conclusion Whether AmerenUE's Existing Missouri Retail Electric Rates Are Just And Reasonable; Joint Dispatch Agreement; EEInc; Sulfur Dioxide (SO₂) Emission Allowances; and Next Steps.

Status Of Staff Conclusion Whether AmerenUE's Existing Missouri Retail Electric Rates Are Just And Reasonable

The Staff's current conclusion regarding the retail electric rates currently charged by AmerenUE in Missouri is that the Staff is not yet able to determine whether those rates are "just and reasonable" or excessive, i.e., the Staff is not yet able to determine whether AmerenUE is recovering in rates its prudently incurred costs or in excess thereof, is earning a reasonable return on its appropriate rate base or in excess thereof and what is required for AmerenUE to have a reasonable opportunity to recover in rates its prudently incurred costs and earn a reasonable return on its appropriate rate base in the future based on efficient and economical management. The Staff is uncertain whether AmerenUE's rates are "just and reasonable" or excessive because of two items in particular: (1) the Amended Joint Dispatch Agreement (hereinafter referred to as the Joint Dispatch Agreement or JDA) and (2) Electric Energy, Incorporated (EEInc). The Staff's position

is mainly influenced by the quantification of the amount of monies not realized by AmerenUE through its continued participation in the JDA.

The Staff continues to use a twofold approach to develop its cost of service evaluation of the electric rates currently charged by AmerenUE in Missouri. The Staff is developing a cost of service based on both (a) AmerenUE's December 29, 2005 cost of service revenue requirement submittal, provided by AmerenUE pursuant to the Stipulation And Agreement in Case No. EC-2002-1, and (b) public information respecting AmerenUE's 2005 calendar year actual results. The Staff's approach is designed to provide a higher level of confidence regarding the Staff's ultimate conclusion concerning AmerenUE's Missouri electric rates than would be the case if the Staff developed AmerenUE's cost of service revenue requirement based on just one of these sources of information. At this time, the Staff has only been able to quantify a range for the monies not realized by AmerenUE as a result of its continued participation in the JDA and has not finalized certain other quantifications. Thus, at one end of the range, pending final quantification of certain significant cost of service revenue requirement items (e.g., rate of return, EEInc, fuel and transportation costs, Taum Sauk, Callaway, pensions, etc.), both of these cost of service revenue requirement approaches support a conclusion that AmerenUE's current Missouri electric rates are excessive if the highest estimate of the monies not realized by AmerenUE through its continued participation in the JDA is adopted, approximately **_____** and the Commission were to find AmerenUE's continuation in the JDA to be inappropriate. At the other end of the range, pending final quantification of significant cost of service revenue requirement items (e.g., rate of return, EEInc, fuel and transportation costs, Taum Sauk, Callaway, pensions, etc.), both cost of service revenue requirement approaches support a conclusion that AmerenUE's current Missouri electric rates are adequate if the lowest estimate of the monies not realized by AmerenUE through its continued participation in the JDA is utilized, approximately **_____** and the Commission were to find AmerenUE's continuation in the JDA to be inappropriate.

When the Staff quantifies all other significant cost of service revenue requirement items, there will be a plus or minus range around the cost of service revenue requirement supported by current rates that will be evaluated by the Staff to determine if the result is significant enough to justify the Staff proposing a change in overall rate levels. The Staff wants to be clear that it has taken the approach in the past and intends to continue to take the approach that it will not propose a rate reduction if its analysis shows that a utility is only earning marginally in excess of its cost of service revenue requirement. It is the Staff's experience that if the analysis shows that a utility is only earning marginally in excess of its cost of service revenue requirement, then there is too much uncertainty that something may occur in the near term that will shift the utility's rates from an excess earnings/revenues situation to the utility's rates being either just and reasonable or the utility's rates even being deficient, thereby a rate reduction not having been warranted. (In such a situation, a marginal rate reduction may be short-lived and send the wrong pricing signals to customers.) So as to be clear the Staff also notes that its analysis to date does not show a cost of service revenue requirement deficiency for AmerenUE,

pending final quantification of significant cost of service revenue requirement items (e.g., rate of return, EEInc, fuel and transportation costs, Taum Sauk, Callaway, pensions, etc.). As one would expect, the Staff and AmerenUE have different positions on a number of significant items. Some of these issue areas are not new and have been fairly well defined in prior Commission proceedings. Some areas are new. The Staff is hopeful that AmerenUE's general rate case filing, which AmerenUE has stated will occur by July 10, 2006, will provide comprehensive explanations of AmerenUE's revenue requirement, thereby assisting the Staff in its continued audit of AmerenUE.

Joint Dispatch Agreement

The initial Joint Dispatch Agreement, entered into as part of the Union Electric Company – CIPSCO, Inc. merger, was an internal Ameren arrangement between Union Electric Company and Central Illinois Public Service Company which were under the control of Ameren Corporation's senior management. The Amended Joint Dispatch Agreement is among Union Electric Company, Central Illinois Public Service Company (AmerenCIPS), and Ameren Energy Generating Company (AEG), Ameren's non-regulated electric generation operation in Illinois to which the generating facilities of AmerenCIPS were divested as an exempt wholesale generator. All of these entities are also under the control of Ameren Corporation's senior management. Under this arrangement any AmerenUE and AEG generation, in excess of the generation needed to meet the qualified respective native loads of each is transferred to the other entity at the transferring entity's incremental cost. (Also, the non-AmerenUE load served under the JDA at AmerenUE's incremental cost is no longer limited to just the AmerenCIPS native load.) These transactions result in the transferring entity not obtaining the monies that are otherwise available by selling the energy into the market at market prices and/or not generating power and thereby retaining sulfur dioxide emission allowances for which there is also a market and value and whose retention would provide greater flexibility to meet future emission requirements. The utilization or availability of sulfur dioxide emission allowances is becoming a greater issue and is discussed in the sulfur dioxide emission allowances section of this report.

Since Case No. EC-2002-1, the Staff has taken and continues to take the position that the JDA results in a subsidy by AmerenUE of AEG, which benefits Ameren Corporation at the expense of AmerenUE's retail customers. The Staff in its testimony in its excess earnings/revenues complaint case against AmerenUE, Case No. EC-2002-0001, quantified this subsidy to be \$100 million. As indicated above, the Staff's current quantification of the subsidy ranges from ** _____ **, on the low side, to ** _____ **, on the high side.

Pursuant to the JDA, beginning December 31, 2004, AmerenUE has had the right to terminate the JDA with the provision of at least one year's written notice. Thus, AmerenUE has had the unilateral ability to terminate the negative effects of this agreement on (1) AmerenUE's financial results and (2) AmerenUE's unadjusted cost to provide service to its electric customers. Regardless, AmerenUE decided not to give notice to terminate the JDA when it first had the opportunity, and it has continued not to

do so. It is the Staff's intention, as part of its continuing audit, to address with the individuals involved the rationale for AmerenUE's continued participation in the JDA under the current terms of that agreement, other than the change that AmerenUE committed to make as a result of the AmerenUE Metro East Transfer Case, Case No. EO-2004-0108.

AmerenUE has raised attorney-client privilege and attorney work product immunity objections respecting certain documents identified by AmerenUE in a privilege/immunity log provided to the Staff in response to Staff discovery concerning the JDA. The Staff anticipates it is likely that there will be other AmerenUE attorney-client privilege and attorney work product immunity objections to Staff discovery and AmerenUE attorney-client privilege and attorney work product immunity objections to the discovery of other parties in the course of the audits in the AmerenUE rate increase case, which AmerenUE has stated it will file by July 10, 2006. The Staff intends to follow the Commission's rule on discovery, 4 CSR 240-2.090 to attempt to resolve pending and future discovery disputes. The Staff has advised AmerenUE that in addition it intends to suggest that the Commission utilize a Regulatory Law Judge as a special master to hear and rule on unresolved attorney-client privilege and attorney work product immunity objections respecting Staff discovery.

EEInc

Union Electric Company was an original sponsor-owner and Union Electric Company d/b/a AmerenUE owns forty percent (40%) of the issued and outstanding shares of capital stock of EEInc. EEInc owns an approximately 1100 MW coal-fired base load plant located in Joppa, Illinois. The other original owners of EEInc stock were Central Illinois Public Service Company, twenty percent (20%); Illinois Power Company, twenty percent (20%); Kentucky Utilities Company, ten percent (10%); and Middle South Utilities, Inc. ten percent (10%) (Kentucky Utilities, Inc. acquired the Middle South Utilities, Inc. portion in the 1950's). Presently, in essence as a result of acquisitions, Ameren Energy Resources, a wholly-owned, non-utility subsidiary of Ameren, directly holds Central Illinois Public Service Company's former twenty percent (20%) of the shares of EEInc and Illinois Power Company's former twenty percent (20%) of the shares of EEInc. Thus, Ameren subsidiaries, AmerenUE and Ameren Energy Resources, presently own eighty percent (80%) of the issued and outstanding shares of capital stock of EEInc. The Staff also notes that originally Union Electric Company built a transmission line to the Joppa facility in order to be able to deliver the energy from Joppa to Union Electric Company's customers. The respective rights to capacity and energy and the associated assignment of costs of the Joppa facility were delineated in a purchase power agreement that expired on December 31, 2005. The energy and capacity formerly contracted for sale to AmerenUE under the now expired purchase power agreement is now being sold by EEInc to an affiliated entity, Ameren Energy Marketing Company, since January 1, 2006. AmerenUE's cost to provide service to its retail customers as reflected in its December 29, 2005 cost of service revenue requirement submittal has increased, as the generation from the coal-fired capacity owned by EEInc used to serve AmerenUE load must now be replaced at a higher cost. In addition, because of the resulting decrease in

base-load generation from the expiration of the EEInc contract, AmerenUE's off-system sales margins have also decreased.

The Staff has not completed its analysis of EEInc, but at this stage the Staff believes there are two not unrelated questions that require further review. One question is whether the Joppa facility should be treated in any manner as part of the AmerenUE system based on prior representations of Union Electric Company, thereby, possibly involving Section 393.190.1 RSMo. The other question is regarding the prudence of AmerenUE's conduct respecting efforts, if any, to continue to have the output from the Joppa facility available to directly provide service to AmerenUE's retail load at cost.

Sulfur Dioxide (SO₂) Emission Allowances

AmerenUE has authority to sell its sulfur dioxide emission allowances by virtue of the authority granted by the Commission to AmerenUE in Case No. EO-98-401, In the Matter of the Application of Union Electric Company for Authorization to Manage Sulfur Dioxide Emission Allowance Inventory. An initial concern regarding AmerenUE's activities in this matter was raised by the Office of the Public Counsel in Case No. EC-2002-1, and was also raised by parties in Case No. EO-2004-0108.

The Staff understands that AmerenUE has not been selling significant quantities of its sulfur dioxide emission allowances and the Staff notes that the value of sulfur dioxide emission allowances used to generate energy transferred to AEG under the JDA are included in the cost of energy sold to AEG under the JDA. Irrespective of its current practices, there still remains the question regarding past sales of sulfur dioxide emission allowances of whether AmerenUE's sulfur dioxide emission allowances were sold to meet Ameren Corporation earnings targets or for other purposes without adequate consideration for the consequences to AmerenUE's costs to comply with environmental requirements in the future. In addition, the current form of the JDA only explicitly allows the generating party to charge for the cost of emission allowances, and does not allow charges for capital improvements associated with environmental compliance requirements that would reduce the quantity of emission allowances needed for generation. The cost of service revenue requirement effect and analysis at this time does not reflect any environmental costs caused by the prior sales of sulfur dioxide emission allowances. The Staff expects this matter to become an issue after 2008 or upon a request by AmerenUE to implement an environmental cost recovery mechanism under Senate Bill No. 179, Laws 2005, codified as Section 386.266.

Next Staff Actions

As the Commission is aware, in AmerenUE's May 17, 2006 Limited Motion For Reconsideration Or Clarification Of Discovery Deadlines And Motion For Expedited Treatment, AmerenUE stated that it will file a general rate case on or before July 10, 2006. The Staff has no reason to not believe that AmerenUE will file a general rate case on or before July 10, 2006. The Staff intends to continue with its audit of AmerenUE and

continue to proceed with the discovery matters addressed hereinabove, as appropriate, prior to AmerenUE filing its general rate case. The Staff assumes that upon AmerenUE filing its general rate case, the Commission will issue an Order setting an intervention period and scheduling an early prehearing conference for the purpose of the parties proposing a procedural schedule to the Commission. The Commission may want to consider consolidating the instant case and the general rate case filed by AmerenUE. Should the Commission desire to close the instant case after AmerenUE files its general rate case, for ease of administration and as a convenience to the parties in the instant case, the Commission may want to grant all of the parties in the instant case intervenor status in the AmerenUE general rate case. The Staff notes that (1) the Commission in its May 11, 2006 Order authorized the Staff to take any appropriate action including filing a complaint against AmerenUE, and (2) the Commission usually in one of its early orders in a general rate case authorizes the Staff to file a complaint seeking a reduction in revenues if the Staff's audit reflects that the utility's earnings are excessive. The Commission issued such an Order on February 3, 2006 in Kansas City Power & Light Company's general rate case, ER-2006-0314, but, presumably due to an oversight, has issued no such authorization to the Staff in The Empire District Electric Company general rate case, ER-2006-0315. The Commission may want to be absolutely clear in its Order adopting a procedural schedule, or even in an earlier Order in AmerenUE's general rate case, expected to be filed on or before July 10, 2006, that the Staff is authorized to file an excess earnings/revenues complaint case against AmerenUE if the Staff determines that such action is appropriate.