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Service Commission

Exhibit No.:	
Issue(s):	Ratemaking Policy
Witness:	David A. Svanda
Sponsoring Party:	Union Electric Company
Type of Exhibit:	Direct Testimony
Case No.:	ER-2007-0002
Date Testimony Prepared:	July 6, 2006

MISSOURI PUBLIC SERVICE COMMISSION

Case No. ER-2007-0002

DIRECT TESTIMONY

OF

DAVID A. SVANDA

ON

BEHALF OF

UNION ELECTRIC COMPANY
d/b/a AmerenUE

St. Louis, Missouri
July, 2006

AmerenUE Exhibit No. 4
Case No(s). ER-2007-0002
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DIRECT TESTIMONY

OF

DAVID A. SVANDA

CASE NO. ER-2007-0002

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is David A. Svanda. My business address is 6464 Lounsbury Rd., Williamston, Michigan 48895.

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

A. I am the Principal in my own consulting firm, Svanda Consulting.

Q. Please describe your educational background, employment, and regulatory experience.

A. I received a Bachelor of Arts degree in Political Science/Urban Affairs in June 1972 from Western Illinois University, Macomb, Illinois. I then received a Master of Public Administration Degree from the Maxwell Graduate School at Syracuse University, Syracuse New York, in June 1973. I began my professional career in municipal government work, including nearly eleven years (from 1980 to 1991) as City Manager of Marquette, Michigan. I began a career with state government in Michigan as Director of the Northern Michigan office of then-Michigan Governor John Engler, serving in that capacity for three years before becoming a candidate for the United States House of Representatives in 1994. I then served for one year as Director of Administrative Services for Governor Engler and for the following nearly eight years (from December 1995 to August 2003) as a Commissioner on the Michigan Public Service Commission. After leaving the Michigan Public Service Commission, I started my own firm, Svanda Consulting.

During my tenure as a Michigan Public Service Commissioner, I also served as Chairman of the Board and President of the National Association of Regulatory Utility Commissioners (NARUC) and as chair of NARUC's Committee on Finance and Technology and NARUC's Mentoring and New Member Services Committee. I am also the past president of the 15-state Mid-American Regulatory Conference (MARC). My other regulatory experience includes membership on the Federal Communication Commission's Local and State Government Advisory Committee, membership on the Keystone Energy Board, the Emerging Issues Policy Forum Board, and service as a trustee of the NARUC Education and Research Foundation. I have also served as an advisor to the Michigan State University Institute of Public Utilities and the National Regulatory Research Institute. In addition, I have served on various other national, state, regional, and local boards.

Q. Please describe the business of Svanda Consulting.

A. Svanda Consulting is a multi-client firm focused on energy, telecommunications and water at the state, regional and national levels.

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to: (1) discuss key regulatory and public policy considerations and principles that should guide the Commission's ratemaking decisions in this case; (2) address AmerenUE's superior performance and its comparatively low customer rates; (3) discuss the challenges faced by AmerenUE and the electric industry as a whole and the critical importance, in light of those challenges, of maintaining a financially healthy utility which can operate in a balanced and constructive regulatory environment; and (4) put into perspective the magnitude of AmerenUE's requested rate relief.

Q. **Please summarize your principal conclusions.**

A. My principal conclusions are as follows:

1. The Missouri Public Service Commission (Commission) and the Missouri legislature have provided a generally constructive regulatory environment for utilities in Missouri in recent years. Missouri has avoided regulatory structural problems that have created significant difficulties in states such as California. Missouri has also adopted policies that have allowed AmerenUE to remain financially strong, while providing customers with reasonable rates, and it has successfully used incentives to create favorable outcomes for AmerenUE and its customers. Although the regulatory environment in Missouri was criticized by credit rating agencies only a few years ago, the Commission has taken steps to move its policies into the mainstream, particularly in the areas of depreciation cost recovery, return on equity and, most recently, the adoption of proposed rules enabling electric utilities to utilize a fuel adjustment clause as permitted by statute.

2. In this environment, AmerenUE has achieved superior performance resulting in a "win-win" situation for the Company and its customers. This superior performance includes high service quality, reliable service, impressively low rates compared to other electric utilities, and satisfied customers. In addition, AmerenUE has remained financially healthy enough to make significant

investments in its infrastructure, maintain a solid credit rating, and pay reasonable returns to its investors.

3. The electric utility industry is facing a number of new challenges. Rate increases of the type sought by AmerenUE in this case are being necessitated across the country by rising fuel and purchased power costs, increases in other operating costs, substantial infrastructure investment needs, and increased costs of environmental compliance. The industry is facing additional uncertainties due to the increase in global competition for resources, the enactment of the Energy Policy Act of 2005 (which, among other things, repealed PUHCA), and the risk that additional, more restrictive environmental regulations will be enacted.

4. In this challenging environment, the regulator's key duty is to appropriately balance the interests of all stakeholders. Ratemaking is not simply an exercise in applying mechanical formulas and "crunching numbers" to calculate the lowest possible level of rates for the short-term. Rather, regulators must set policies that will operate in the long-term interest of consumers, utilities and ultimately the state in which they are employed. Maintaining a financially healthy electric utility benefits customers over the long term by maintaining credit ratings, lowering financing costs, and providing access to the capital necessary to finance current and future infrastructure and environmental investment timely and efficiently. Ratemaking is *not* a zero sum game where maintaining financially healthy utilities can only come at the expense of ratepayers over the long run.

5. The rate relief AmerenUE has requested is balanced, and it will result in rates that, when adjusted for inflation, are no higher than they were in 2002.

Even with the proposed rate increase, AmerenUE's rates will have increased by less than the rates in the rest of the state, the Midwest, rates in other non-restructured states, and the nation as a whole. AmerenUE's rates will still be among the lowest in the country, and they will insure that AmerenUE maintains the financial strength to continue to invest in infrastructure and continue to provide customers with superior service at reasonable rates over the long-term.

III. PERSPECTIVE OF MISSOURI REGULATORY POLICY

Q. From your perspective, please comment on the state of public utility policy in Missouri generally.

A. First let me say that I have not previously been directly involved in Missouri regulatory proceedings. However, I bring the perspective gained from many years of service as a Michigan commissioner and as a former MARC and NARUC President. This experience has given me the opportunity to observe regulation across many states involving a wide variety of utilities.

Based upon that experience, I would note that Missouri's legislative and regulatory policies have been successful in avoiding the structural problems that have plagued states such as California. Moreover, it is apparent to me that in the last few years the Commission began a progression of positive steps that have improved the State's regulatory environment and made it more consistent with the mainstream of regulatory policy on a national basis. These improvements include regulatory orders that made Missouri depreciation policy more consistent with those of other states and that set utilities' allowed returns on equity at levels more consistent with those of other utilities across the country. In addition, enabled by new legislation, the Commission is currently taking steps to develop regulatory rules that will allow Missouri electric utilities to utilize fuel adjustment clauses and other regulatory mechanisms that have also been employed successfully in most other states. Not surprisingly, credit rating agencies have taken note of the "potentially improving regulatory situation in Missouri" as a positive factor for the outlook of Missouri utilities' credit ratings and financial health.[1] These constructive regulatory policies have also contributed to the fact that, as the Commission has recognized, Missouri enjoys some of the lowest electricity rates in the country.[2]

Nevertheless, despite avoiding the difficulties experienced in some other states, the regulatory environment in Missouri has been viewed unfavorably in the recent past. Only a couple years ago, for example, rating agencies and financial analysts described the Missouri regulatory environment as "challenging," "poor," and "marked by relatively low allowed ROEs, low depreciation allowances, and the lack of a permanent fuel adjustment clause."[3] Despite the Commission's positive recent steps, the regulatory environment continues to challenge the financial stability of some Missouri utilities. For example, Standard and Poor's noted in its recent downgrade of Empire District Electric Company that "restrictive" Missouri regulations regarding fuel and purchased-power costs still causes "less-than-adequate recovery of O&M expenses and other costs."[4]

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[1] Moody's Credit Opinion, Dec. 16, 2005.

[2] PSC News, *Missouri Electric Rates for Residential and Business Customers Among the Lowest in the Country*, June 28, 2006; see also PSC News, *Missouri Electric Rates for Homes, Businesses Among Lowest in Nation*, Dec. 19, 2005.

[3] Standard & Poor's, *Empire District Rating Placed on CreditWatch Negative*, RatingsDirect, September 28, 2004; Standard & Poor's, Standard & Poor's *Research Summary: Empire District Electric Co*, Jan 20, 2004; A.G. Edwards, *Equity Research: Electric Utilities*, July 3, 2002; Ratings *on Empire District Electric Co. Lowered to 'BBB'*, RatingsDirect, July 2, 2002.

[4] Standard & Poor's, *Research Update: Empire District Electric Downgraded To 'BBB-' On Expected Tight Financials*, May 17, 2006.

I would also note that the combination of Missouri regulatory policies and AmerenUE's corporate philosophy have provided support for various customer-focused programs and protections. Examples of which I am aware include Missouri's recent attention to improving its cold weather rule, support of programs such as AmerenUE's Dollar More Program, and weatherization, community development, and economic development programs. Missouri legislative and regulatory policies currently under development, most notably, the recently enacted fuel adjustment clause legislation and the proposed fuel adjustment clause rules designed to implement the legislation, also contain a number of customer-focused features.

Q. What is your perspective on AmerenUE's performance within the regulatory environment in Missouri?

A. Despite what at times were challenges presented by the regulatory environment, which not surprisingly included disputed items in past regulatory proceedings such as AmerenUE's 2002 rate case, AmerenUE and the Commission have been able to work constructively over the last decade, building the foundation for AmerenUE's superior performance which I address further below. For example, AmerenUE was able to operate under an Experimental Alternative Regulatory Plan from 1996 to 2001, and the currently expiring rate moratorium that has steadily reduced rates since 2002 while allowing the Company to maintain its financial strength. AmerenUE has also wisely stuck to its core regulatory utility business and has remained focused on the region in which it operates. It has avoided the pitfalls some other utilities have experienced when they shifted their focus to unregulated businesses and far-flung utility operations.

Q. You noted above AmerenUE's superior performance within this regulatory environment. Please elaborate.

A. AmerenUE is among the most efficient and lowest-cost electric utilities in the United States, provides excellent customer service, and offers reliable service at impressively low rates. Not surprisingly, AmerenUE also enjoys high customer satisfaction.

Q. Please explain your statement that AmerenUE is among the most efficient and lowest cost utilities in the country.

A. AmerenUE has exceptionally low production costs. For example, as Mr. Baxter discusses in his testimony, AmerenUE has some of the lowest production costs in the industry. AmerenUE's low production costs have also been recognized by credit rating agencies, including Moody's Investor Service.[5]

Q. Please explain your statement that AmerenUE offers excellent customer service, provides reliable service, and enjoys high customer satisfaction.

A. As discussed in the direct testimony of AmerenUE witness Richard J. Mark, AmerenUE's service quality rating is among the highest in both the Midwest and nationally. As he explains, J.D. Power and Associates has given AmerenUE service quality scores well above the Midwest and National average. AmerenUE was also one of only four electric or gas utilities in the nation recognized by J.D. Power for the high customer service of its call centers.

AmerenUE fares similarly well in terms of service reliability offered to its customers. Mr. Mark's direct testimony shows that AmerenUE service reliability rating, again, exceeds both Midwestern and national averages with fewer and shorter service interruptions than the rest of the industry. Finally, as Mr. Mark's direct testimony shows, AmerenUE also enjoys an excellent customer satisfaction rating, again achieving satisfaction scores that are well above average and among the highest of all surveyed utilities in the Midwest and nation wide.

Q. Has AmerenUE been able to achieve high quality, high reliability, and high customer satisfaction while also maintaining low rates?

A. Yes, it has. AmerenUE was able to perform at or near the top of these benchmarks while offering its service at impressively low rates. As Mr. Baxter shows in his Schedule WLB-1, as of 2005, AmerenUE's rates are approximately 30% *below* the national average and approximately 15% below average rates in the Midwest, and 18% below average rates in non-restructured states. AmerenUE's cost reductions, improved performance, and a constructive and improving regulatory environment have enabled the Company to decrease rates steadily for approximately 20 years. This is quite an accomplishment considering by how much prices for consumer goods and other utilities' rates have increased. For example, as Mr. Baxter's Schedule WLB-9 shows, since 1990 AmerenUE's rates have *decreased* 13% while average electricity rates in the United States have increased 20%, consumer prices have increased 45%, and consumer prices for other energy products such as gasoline, fuel oil, and natural gas have increased by between 87% and 133%.

AmerenUE's rates are low particularly when considering the higher costs of serving a major metropolitan area -- which typically includes higher add-on taxes, higher labor costs, higher real estate costs, higher costs of underground distribution facilities, and smaller customers that tend to be more costly to serve. In fact, because of AmerenUE's

[5] Moody's Credit Opinion, Dec. 16, 2005.

achievements, St. Louis enjoys some of the lowest rates of any large metropolitan area in the country, as shown in Mr. Baxter's Schedule WLB-2. In fact, that Schedule shows that after Seattle, St. Louis enjoys the lowest electricity rates of any of the major metropolitan areas in the country. Rates in St. Louis are also approximately 50% lower than those in other large metropolitan areas, and even lower than rates in small and mid-sized metropolitan areas in the Midwest as well as the rest of the country, as demonstrated by Mr. Baxter's Schedule WLB-3. Just how low AmerenUE's rates are was also confirmed in a recent survey: according to NUS Consulting Group's survey of the country's 24 largest utilities, only one utility was found to offer lower rates than AmerenUE. See Schedule DAS-1. The low rates enjoyed by AmerenUE's customers have also significantly contributed to the overall position of Missouri as a state with some of the lowest electricity rates in the country.[6] The combination of high quality service, high reliability, and high customer satisfaction levels, and low rates can also be credited for contributing to the strong economic resurgence so evident throughout the St. Louis metropolitan area.

Q. How has AmerenUE fared financially while providing high quality, reliable service at very low rates for its customers?

A. AmerenUE has fared well financially, which is another testament to both the performance of AmerenUE's management and to the constructive regulatory environment in which AmerenUE has been able to operate. These factors have also been noted by credit rating agencies.[7] Despite the significant challenges of increasing operating costs and

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[6] PSC News, *Missouri Electric Rates for Residential and Business Customers Among the Lowest in the Country*, June 28, 2006; see also PSC News, *Missouri Electric Rates for Homes, Businesses Among Lowest in Nation*, Dec. 19, 2005.

[7] Moody's Credit Opinion, Dec. 16, 2005.

investment requirements, AmerenUE has been able to keep its credit rating at BBB+, which is in the upper range of utility credit ratings.[8] As discussed in Mr. Baxter's testimony, AmerenUE has also been able to use the cash flows resulting from well-managed operations within a constructive regulatory environment to continue to make substantial investments in energy infrastructure.

Q. What conclusions do you draw from having observed the regulatory environment in Missouri generally and, in particular, AmerenUE's operations within that environment?

A. The principal conclusion I draw from my observations is that all stakeholders in Missouri within AmerenUE's service territory and the state as a whole have reaped the benefits of a constructive regulatory environment and AmerenUE's ability to achieve and maintain its superior performance within that environment. Moreover, as I discuss in more detail below, AmerenUE's ability within this environment to achieve superior performance at rates that are substantially lower than rates nationally and regionally demonstrates that public utility regulation is not a "zero-sum" game. Indeed, the balanced approach to regulation I see has promoted an alignment of the utility's interest with that of its customers: it allowed the utility to perform well while providing customers with low rates and high quality service.

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[8] See The Edison Foundation, *Why Electricity Prices Are Increasing: An Industry-Wide Perspective*, June 2006, p. 80, Figure 8-1 ("Credit Ratings of Electric and Combination Utilities").

Q. You discussed above your perspective on how Missouri's and AmerenUE's ability to work together has produced favorable results for AmerenUE and its customers. Is it possible for those kinds of favorable results to be sustained into the future?

A. Yes. I believe this is possible if the Commission, the Company, and other stakeholders do not "rest on their laurels" and forget that the goal of providing reliable, reasonably priced electric service does not preclude maintaining financially strong utilities. Regulators, utilities, and other stakeholders must take a long-term view if these positive results are to be continued into the future.

Q. Are there challenges facing the electric utility industry, regulators, and other stakeholders that exist today and that will likely exist into the foreseeable future?

A. Yes. Changing industry conditions are driving the need for electric utility rate increases across the entire country, including for AmerenUE.[9] A key challenge being seen across the industry is that fuel and purchased-power costs, which are by far the largest cost for an electric utility, are escalating substantially after many years of being flat or at times even declining. As explained in more detail by other AmerenUE witnesses, including Robert K. Neff, market prices for coal have almost doubled in the last three years and the cost of coal transportation is increasing as well. There are also challenges associated with coal transportation that may impact both coal availability and price. The cost of coal delivered to utilities has increased significantly during the last few years, but these costs will increase further as expiring long-term contracts need to be replaced at

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[9] For a discussion of these challenges and their impact on rates, see The Edison Foundation, *Why Electricity Prices Are Increasing: An Industry-Wide Perspective*, June 2006 (available at www.eei.org); see also Johannes Pfeifenberger, *Understanding Utility Cost Drivers and Challenges Ahead*, AESP Pricing Conference, Chicago, May 17, 2006.

much higher market prices. The prices of other fuels, in particular natural gas, have been increasing as well, and there are increasing concerns about the long-term adequacy of natural gas supplies, which also can affect market prices.

In addition to higher fuel prices, a number of other factors are increasing utilities' cost of service. These include significant infrastructure investment requirements for aging generation, transmission and distribution assets as well as for environmental compliance. Non-fuel operating costs, such as labor costs and including medical and pension-related costs, are increasing as well. The cost of key equipment and materials necessary to operate utilities, such as aluminum, are rising as well.

The industry also faces other challenges. The uncertainty surrounding full implementation of the Energy Policy Act of 2005 ("EPACT"), which included the repeal of the Public Utility Holding Company Act of 1935 ("PUHCA") creates risk and uncertainty for the entire industry. Electric utilities also operate in an environment where the volatility of wholesale power and other commodity prices present increasing challenges to utility operations, particularly for utilities whose cost of service is impacted substantially by off-system sales and power purchases.

Some of the challenges noted above are driven by global forces. These include the global demand for equipment, materials, and fuel which are increasingly impacting the availability of those items and consequently their cost. This further contributes to the volatility I mentioned earlier.

Uncertainty introduced by environmental policies and regulations that are or will be under consideration create a level of risk for electric utilities greater than has historically been observed. The possibility of a carbon tax is just one example of such a risk.

Q. Do you have an opinion about the impact of the kinds of challenges you discuss above on the overall level of risk in the electric utility business today?

A. Yes. The overall level of risk and uncertainty is materially higher today than in the past.

Q. What effect does that have on investor expectations and on the ability of utilities to attract the large amounts of capital necessary to continue to invest in necessary energy infrastructure?

A. Investors facing higher risks require higher returns. If those higher returns are not allowed, then the ability of utilities to attract the capital they need is compromised. This can undermine the financial strength of the utility.

Q. Why is it important to maintain financially strong utilities?

A. As I alluded to earlier, the utility business is a very capital-intensive business because of the high cost of the generation, transmission and distribution facilities required to provide reliable service. Moreover, the combination of rising electricity demand, aging infrastructure and additional capital needed for environmental compliance, means that utilities will have an increasing need for capital in the future. Financially strong utilities are better able to cost-effectively attract the capital they need and to make the necessary infrastructure investments, including discretionary investments that reduce rates in the long-term.

Q. Why is it beneficial to customers to have financially strong utilities?

A. AmerenUE's very low rates and high quality of service demonstrate the benefits to customers of being served by a financially strong utility. For example, financially strong utilities have access to lower cost capital, which contributes to lowered cost of service and thus lower customer rates. Financially strong utilities can also make infrastructure investments necessary to maintain and improve reliability for customers in a more timely fashion. Moreover, financially strong utilities have the financial flexibility to go beyond the minimum required to provide a basic level of service and can pursue beneficial discretionary investments, improve power quality, and offer low-income customer programs, community economic development initiatives, and other civic or public initiatives that benefit the regions they serve. Financially strong utilities also have a better opportunity to pursue environmental policies expected by their customers today.

Q. Aren't financially weak utilities also required to continue providing service to their customers?

A. Yes, they are. However, utilities that are limping along with substandard returns and weak cash flows will have to spend considerable time and effort addressing short-term financial challenges and can lose focus on providing service to their customers. While such utilities have no choice but make the non-discretionary investments needed to maintain a minimal level of service, they will generally find it more difficult to improve operations, improve reliability and environmental performance, or contribute as substantially to community and economic development. A financially weak utility simply will not have the wherewithal to provide superior service to customers over the long-term.

Q. Are there additional benefits associated with maintaining AmerenUE's financial strength?

A. Yes. Not only does AmerenUE's financial strength help keep rates low in the long-term, as we have seen, but it also puts AmerenUE in a stronger position to defend itself against possible acquisitions that would not be in the long-term interest of the state. I think Ameren and AmerenUE have been exemplary corporate citizens making significant contributions to the local community, including offering local employment opportunities, contributing significantly to state and local tax revenues, and donating generously to state and local economic development, low-income assistance, and charities. I think the State of Missouri enjoys a significant benefit by having its largest utility, which is one of only eight Fortune 500 companies headquartered in St. Louis, remain based in St. Louis. Decisions this Commission makes in this rate case, and in other regulatory proceedings, can have a profound impact on whether those benefits are enjoyed in the future.

Q. You addressed earlier the positive results obtained through a combination of a constructive regulatory environment, AmerenUE's strong performance, and challenges facing the industry. What, in your view, is necessary to allow Missouri to continue to enjoy the benefits of high quality electric service and reasonable rates?

A. A key, perhaps *the* key factor necessary for Missouri to continue to enjoy the benefits of high quality electric service at reasonable rates is to apply fundamental ratemaking principles; that is, to balance the interests, in particular the long-term interests, of all stakeholders. Those stakeholders are the customers, the utility, the utility's shareholders, and the public as a whole. Ratemaking policies should reflect an appropriate balancing of the long-term interests of all these groups.

Q. What does it mean to balance the interests of all stakeholders?

A. To advance fairly the interests of all stakeholders requires that the interests of each group be considered in the context of the interests of all other groups. To satisfy the interests of each group a commission needs to set rates that encourage desirable behavior by each group. In general terms, this means that rates should provide the incentive for utilities to lower costs, improve service quality and reliability, and become more innovative and efficient, all while maintaining financial strength and stability. Indeed, maintaining long-term financial strength and stability enables utilities to lower costs and improve service quality and reliability. For the utilities' shareholders, many of which are senior citizens and state residents, balancing these interests means that the rates should provide a fair opportunity to earn a return on their investment that is commensurate with the risk of their investment and that will justify their continued investment in the utility. Customers' needs are satisfied if rates encourage customers to neither over-consume nor under-consume electricity, and if they receive reliable, fairly-valued service. Finally, the general public's interest is advanced if the utility can maintain reliable, reasonably priced service through an energy infrastructure that supports the state's economic growth, employment opportunities and other public objectives.

Q. How can the Commission go about balancing those interests while reaching a rate case decision that results in just and reasonable rates?

A. In deciding this case, the Commission's task is more than to simply engage in what some might argue is a mechanical review of thousands of pages of numbers and charts designed to aid the Commission in reaching the "correct" analytical result. The Commission's task is much more than simply "crunching numbers." In addition to applying various analytic measures, the Commission must also weigh numerous important policy considerations impacted by its regulatory decisions. Its policy and rate determinations should help to create a climate in the state, which supports economic development, job creation, social, educational, civic, environmental, and other important public objectives in a fair, open and equitable fashion.

Regrettably, the sheer volume of material and information involved in a rate case and its complexity can stand as an obstacle to the setting rates that reflect regulatory policies that strike the appropriate balance between the various stakeholders affected by the Commission's decisions. Unfortunately, some advocates who take a short-term view, intentionally or unintentionally, use the seemingly endless sets of numbers and data and the complexity of ratemaking to argue for low, lower, and lowest rates *now*. They do this all while downplaying the important policy considerations and the Commission's legal duties to balance all stakeholder interests and to take a longer-term view of utility regulation and its impacts.

Q. Do you believe the Commission shares your view of its duty in setting rates?

A. Yes. The Commission has captured the essence of its duty, its mission, on its website, where the Commission states that "safe, reliable and reasonably priced utility services that allow investors the opportunity for a fair return" is central to what the Commission exists to do. As the Commission also recognized in its mission statement, its objective is to "support economic development", "maintain the quality of services provided to Missourians," and "provide an efficient regulatory process that is responsive to all parties."

Q. If the Commission shares your view of its duty, why is it important to discuss it in your testimony?

A. Because my experience as a former commissioner, NARUC President, and consultant in the industry teaches that despite the best of intentions, the aspects of the ratemaking process I discussed earlier can sometimes get in the way of sound regulatory policies. This is particularly true where some stakeholders argue for the lowest rates for themselves *now*, regardless of whether that result represents sound regulatory policy for the long run. It is noteworthy that the Commission itself recognizes that the guiding principle of setting rates is not to set the lowest possible rates, but rather is to set rates that result in reasonably priced utility services that maintain financially healthy utilities capable of supporting economic development in the long-run.

IV. <u>PERSPECTIVE ON AMERENUE'S CURRENT REQUEST</u>

Q. Given all the performance gains AmerenUE has been able to achieve, is it surprising to you that AmerenUE is requesting a rate increase of nearly 18% in the aggregate?

A. No. While the proposed 17.7% aggregate rate increase might not be what anyone would prefer, it is not unusual or unreasonable given the challenges the utility industry faces today. Importantly, however, as discussed in greater detail in the testimony of AmerenUE witness Warner L. Baxter, AmerenUE's rates will have increased by less since its last rate case in 2002 than the rates of other utilities in Missouri, the Midwest, other non-restructured states, and the nation as a whole. Moreover, AmerenUE's new rates will be no higher than they would have been in 2002 when considering general consumer price inflation trends. While the proposed rate increase is a material one, it is not surprising, unusual or inappropriate considering that AmerenUE's rates have been declining for almost two decades and given that the rate increase request is driven by fundamental changes in industry conditions (most notably sharply higher fuel prices, among other factors which I discussed earlier) that have had and are continuing to have similar if not more significant effects on other utilities in the region and around the country.

Q. Apart from the actual amount of the requested rate increase, with what other aspects of AmerenUE's rate filing are you familar?

A. I am not intimately familiar with each and every detail of AmerenUE's rate filing given the size and complexity of this rate proceeding. However, I am aware of certain aspects of the filing. First, AmerenUE is requesting, as I understand it subject to finalization of administrative rules, the use of a fuel adjustment clause mechanism and an environmental cost rider that will insure that only the Company's actual, prudently incurred fuel and environmental costs are recovered from customers. Second, AmerenUE's case includes a discussion of the possible use of an off-system sales margins sharing mechanism as a way to mitigate the impact of extreme volatility existing in power markets for the benefit of the Company and customers alike. Third, the Company is proposing to mitigate residential rate increases, is willing to consider continuing the kind of low-income assistance and community and economic development programs that the Company has been able to promote in the past; and is willing to consider implementation of additional demand response and renewable resources initiatives.

Q. What is your perspective on these aspects of AmerenUE's rate filing?

A. Overall, I believe these aspects of the filing evidence the fact that AmerenUE's rate proposal is balanced and consistent with the mainstream of constructive regulatory policies across the country. The use of a fuel adjustment clause is a common and useful tool to mitigate for utilities and customers alike the volatility and risk associated with fuel and purchased power costs.

Incentive mechanisms for items such as off-system sales, as discussed in AmerenUE's filing, are also constructive tools that can provide benefits to utilities and to customers, particularly for a utility like AmerenUE and its customers given that AmerenUE has a high proportion of coal-fired baseload generation and excess energy to sell during significant portions of the year.

AmerenUE's alternative off-system sales sharing mechanism provides sensible, yet balanced protection for AmerenUE against the inability to reach a "normal" level of off-system sales that would otherwise be set using traditional ratemaking principles. Utilities are at risk of not achieving that level of margin due to uncontrollable factors, including highly volatile energy and commodity markets. Conversely, in traditional ratemaking, ratepayers are "at-risk" of the utility achieving higher off-system sales margins than were set in base rates. A balanced sharing mechanism can address both of these utility and customer risks.

AmerenUE's alternative sharing mechanism provides reasonable protection for the Company, with meaningful sharing with customers that would allow customers to realize a net benefit through the sharing mechanism versus under traditional regulation in circumstances where the Company is able to only modestly exceed the "normal" level of expected off-system sales margins reflected in the Company's filing. The mechanism's cap, above which customers receive 100% of off-system sales margins, is a fair way to allow customers to realize all of those benefits if extremely high prices or other factors lead to unusually high sales. The fact that under no circumstance would customers effectively share in less than 72% of all off-system sales margins demonstrates the fairness of the mechanism.

Q. Does this conclude your direct testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a AmerenUE for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area.	)))))	Case No. ER-2007-0002

AFFIDAVIT OF DAVID A. SVANDA

STATE OF MICHIGAN)
) ss
COUNTY OF Ingham)

David A. Svanda, being first duly sworn on his oath, states:

1. My name is David A. Svanda. I am principal in Svanda Consulting.

2. Attached hereto and made a part hereof for all purposes is my Direct Testimony on behalf of Union Electric Company d/b/a AmerenUE consisting of 22 pages, Attachment A and Schedule DAS-1, all of which have been prepared in written form for introduction into evidence in the above-referenced docket.

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

David A. Svanda

Subscribed and sworn to before me this 6th day of July, 2006.

Heather M. Bostater
Notary Public

My commission expires:

Heather M. Bostater
Notary Public, Ingham County, MI
My Comm. Expires Mar 25, 2012
Acting in County of Ingham

EXECUTIVE SUMMARY

David A. Svanda

Principal, Svanda Consulting

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The purpose of my testimony is to: (1) discuss key regulatory and public policy considerations and principles that should guide the Commission's ratemaking decisions in this case; (2) address AmerenUE's superior performance and its comparatively low customer rates; (3) discuss the challenges faced by AmerenUE and the electric industry as a whole and the critical importance, in light of those challenges, of maintaining a financially healthy utility which can operate in a balanced and constructive regulatory environment; and (4) put into perspective the magnitude of AmerenUE's requested rate relief.

The principal conclusions reflected in my testimony are as follows:

1. The Missouri Public Service Commission and the Missouri legislature have provided a generally constructive regulatory environment for utilities in Missouri in recent years. Missouri has avoided regulatory structural problems that have created significant difficulties in states such as California. Missouri has also adopted policies that have allowed AmerenUE to remain financially strong, while providing customers with reasonable rates, and it has successfully used incentives to create favorable outcomes for AmerenUE and its customers. Although the regulatory environment in Missouri was criticized by credit rating agencies only a few years ago, the Commission has taken steps to move its policies into the mainstream, particularly in the areas of depreciation

cost recovery, return on equity and, most recently, the adoption of proposed rules enabling electric utilities to utilize a fuel adjustment clause as permitted by statute.

2. In this environment, AmerenUE has achieved superior performance resulting in a "win-win" situation for the Company and its customers. This superior performance includes high service quality, reliable service, impressively low rates compared to other electric utilities, and satisfied customers. In addition, AmerenUE has remained financially healthy enough to make significant investments in its infrastructure, maintain a solid credit rating, and pay reasonable returns to its investors.

3. The electric utility industry is facing a number of new challenges. Rate increases of the type sought by AmerenUE in this case are being necessitated across the country by rising fuel and purchased power costs, increases in other operating costs, substantial infrastructure investment needs, and increased costs of environmental compliance. The industry is facing additional uncertainties due to the increase in global competition for resources, the enactment of the Energy Policy Act of 2005 (which, among other things, repealed PUHCA), and the risk that additional, more restrictive environmental regulations will be enacted.

4. In this challenging environment, the regulator's key duty is to appropriately balance the interests of all stakeholders. Ratemaking is not simply an exercise in applying mechanical formulas and "crunching numbers" to calculate the lowest possible level of rates for the short-term. Rather,

regulators must set policies that will operate in the long-term interest of consumers, utilities and ultimately the state in which they are employed. Maintaining a financially healthy electric utility benefits customers over the long term by maintaining credit ratings, lowering financing costs, and providing access to the capital necessary to finance current and future infrastructure and environmental investment timely and efficiently. Ratemaking is *not* a zero sum game where maintaining financially healthy utilities can only come at the expense of ratepayers over the long run.

5. The rate relief AmerenUE has requested is balanced, and it will result in rates that, when adjusted for inflation, are no higher than they were in 2002. Even with the proposed rate increase, AmerenUE's rates will have increased by less than the rates in the rest of the state, the Midwest, rates in other non-restructured states, and the nation as a whole. AmerenUE's rates will still be among the lowest in the country, and they will insure that AmerenUE maintains the financial strength to continue to invest in infrastructure and continue to provide customers with superior service at reasonable rates over the long-term.

6. Incentive mechanisms for items such as off-system sales, as discussed in AmerenUE's filing, are constructive tools that can provide benefits to utilities and to customers, particularly for a utility like AmerenUE and its customers given that AmerenUE has a high proportion of coal-fired baseload generation and excess energy to sell during significant portions of the year. AmerenUE's alternative off-system sales margin sharing mechanism provides

reasonable protection for AmerenUE against not achieving a "normal" level of off-system sales margins, while providing meaningful sharing for customers that would allow customers to realize a net benefit through the sharing mechanism versus under traditional regulation, even where AmerenUE is able to only modestly exceed the normal level of expected off-system sales.

Oil prices help boost industrial power costs - NUS Higher oil costs are here to stay and with them will come increased industrial electricity costs which could drive up the costs for goods and services, a utility cost-recovery consultant said in an annual study issued on Monday. Also, Texas experienced the sharpest increase -- about 44 percent -- in power costs in the past year ending in April, according to NUS Consulting Group of Park Ridge, New Jersey. The average U.S. business cost for electricity in April was 8.82 cents per kilowatt hour, NUS said, up from 7.95 cents in April 2005. The study conducted price surveys including the biggest 24 investor-owned utilities in the United States. NUS is an independent consultant for businesses looking to save on their energy and telecommunications expenses and did not include residential power costs in its study."As world oil prices rise so do the natural gas markets followed by the electricity markets, said Richard Soultanian, co-president of NUS. "Those people looking for some level of relief need to understand that higher prices are here to stay." Texas power prices were up dramatically, NUS inferred, because of the highly deregulated marketplace for power there. TXU Corp. prices went up 46.4 percent and Reliant Energy Inc. in Texas prices went up 42.3 percent, the study showed. "As demonstrated in previous surveys, the highest power prices can be found in those States that have deregulated their retail electricity markets," NUS said in a press statement. "Considered in the past by many as a means of lowering electricity prices, the central promise of deregulation has yet to be fulfilled for many consumers." As in past years, the highest prices were paid by electricity customers in California, New Jersey and New York, the study found. The biggest price jumps by percentage were the two Texas utilities, Florida Power & Light Co., a subsidiary of FPL Group Inc. at 28.7 percent, Public Service Electric & Gas Co. in New Jersey, a subsidiary of Public Service Enterprise Group Inc. at 28.4 percent and Progress Energy Florida Inc. at 24.3 percent. The utilities charging the most were Consolidated Edison Co. of New York Inc., an arm of Consolidated Edison Inc. , at 14.56 cents per KWh; Reliant Energy in Texas at 14.01 cents per KWh; Public Service Electric and Gas in New Jersey at 12.72 cents per KWh; Texas Utilities at 12.33 cents per KWh; and National Grid in New York, a subsidiary of National Grid . While still charging the highest prices, Con Ed industrial rates fell 1.9 percent compared with a year ago, NUS said. **Lowest per kilowatt hour prices were reported from Dominion Power in Virginia at 5.18 cents; Duke Power Co. in North Carolina, a subsidiary of Duke Energy , at 5.46 cents per KWh; AmerenUE in Missouri, a subsidiary of Ameren Corp. , at 5.46 per KWh; Ohio Power, a subsidiary of American Electric Power Co. Inc. , at 5.50 cents per KWh; and Xcel Energy in Minnesota, a subsidiary of Excel Energy Inc. , at 5.73 cents per KWh.** Reuters News, May 1, 2006