

1998 ANNUAL REPORT

Strong
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Solutions



Ameren

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operates, but does not own, transmission systems and maintains system reliability and security while alleviating pricing issues associated with the "pancaking" of rates. The Midwest ISO would be regulated by FERC. The FERC conditionally approved the formation of the Midwest ISO in September 1998, and it is expected to be operational by the year 2001. AmerenUE's membership in the Midwest ISO must be approved by the Missouri Public Service Commission (MoPSC). The Midwest ISO covers eight states and represents portions of 40,000 miles of transmission line and 62,000 megawatts of electric power. Collectively, the member companies serve more than seven million customers.

In addition, certain states are considering proposals or have adopted legislation that will promote competition at the retail level. In December 1997, the Governor of Illinois signed the Electric Service Customer Choice and Rate Relief Law of 1997 (the Law) providing for electric utility restructuring in Illinois. This legislation introduces competition into the supply of electric energy in Illinois.

Major provisions of the Law include the phasing-in through 2002 of retail direct access, which allows customers to choose their electric generation supplier. In addition, the Law includes a 5% rate decrease for residential customers, which became effective in August 1998. The decrease reduced electric revenues by approximately \$6 million in 1998 and is expected to reduce electric revenues by approximately \$14 million annually thereafter, based on estimated levels of sales and assuming normal weather conditions. In 1998, the Company eliminated its Uniform Fuel Adjustment Clauses (FACs) as allowed by the Law, which the Company expects to benefit shareholders in the future (see Note 1 - Summary of Significant Accounting Policies under Notes to Consolidated Financial Statements for further information). The Law contains a provision allowing for the potential recovery of a portion of stranded costs, which represent costs which would not be recoverable in a restructured environment, through a transition charge collected from customers who choose an alternate electric supplier. In addition, the Law contains a provision requiring a portion of excess earnings (as defined under the Law) for the years 1998 through 2004 to be refunded to customers. See Note 2 - Regulatory Matters under Notes to Consolidated Financial Statements for further information.

In December 1997, after evaluating the impact of the Law, the Company determined that it was necessary to write-off the generation-related regulatory assets and liabilities of its Illinois retail electric business. This extraordinary charge reduced 1997 earnings \$52 million, net of income taxes, or 38 cents per share. The Company has also concluded that its remaining net generation-related assets are not impaired for financial reporting purposes and that no plant writedowns are necessary at this time. See Note 2 - Regulatory Matters under Notes to Consolidated Financial Statements for further information.

In Missouri, where approximately 72% of the Company's retail electric revenues are derived, a task force appointed by the MoPSC investigated electric industry restructuring and competition. In 1998, the task force issued a report to the MoPSC that addressed many of the restructuring issues, but did not provide a specific rec-

ommendation or approach to restructure the industry. In addition, in 1998, the MoPSC staff issued a proposed plan for restructuring Missouri's electric industry. The staff's plan addressed a number of issues of concern if the industry is restructured in Missouri. It also included a proposal for less than full recovery of strandable costs. The staff's plan has not been addressed by the MoPSC. A joint legislative committee is also conducting hearings on these issues. The Company is unable to predict the timing or ultimate outcome of electric industry restructuring in the state of Missouri.

In summary, the potential negative consequences associated with electric industry restructuring could be significant and could include the impairment and writedown of certain assets, including generation-related plant and net regulatory assets, lower revenues, reduced profit margins and increased costs of capital and operations expense. The Company is actively taking steps to mitigate these negative consequences. Most importantly, the Company will continue to focus on cost control to ensure that it maintains a competitive cost structure. Also, in Illinois, the Company's actions include strengthening its marketing operations to maintain its current customers and obtain new customers, as well as enhancing its information systems. In Missouri, the Company is actively involved in all major deliberations taking place surrounding electric industry restructuring in an effort to ensure that restructuring legislation, if any, contains an orderly transition and is equitable to the Company's shareholders. The Company is also actively involved in shaping the policies of the Midwest ISO to protect its shareholders' interests. At this time, the Company is unable to predict the ultimate impact of electric industry restructuring on the Company's future financial condition, results of operations or liquidity.

Year 2000 Issue

The Year 2000 Issue relates to how dates are stored and used in computer systems, applications, and embedded systems. As the century date change occurs, certain date-sensitive systems need to be able to recognize the year as 2000 and not as 1900. This inability to recognize and properly treat the year as 2000 may cause these systems to process critical financial and operational information incorrectly. The Company's primary concern is the potential for any interruption in providing electric and gas service to customers, as well as the potential inability to process critical financial and operational information on a timely basis, including billing its customers, if appropriate steps are not taken to address this issue. Management has developed a Year 2000 Plan (Plan) and Ameren's Board of Directors has been briefed about the Year 2000 Issue and how it may affect the Company.

The Company's Plan to resolve the Year 2000 Issue involves three phases: assessment, planning, and implementation/testing. Implementation of the Plan is directly supervised by each area's responsible Vice President. A Year 2000 Project Director coordinates the implementation of the Plan among functional teams who are addressing issues specific to a particular area, such as nuclear and non-nuclear generation facilities, energy management systems.

gas distribution, etc. Ameren has also engaged certain outside consultants, technicians and other external resources to aid in formulating and implementing the Plan.

The Company has completed its assessment phase, which included analyzing date-sensitive electronic hardware, software applications and embedded systems and has developed a compliance plan to address issues that were identified. Many of the major corporate computer systems at Ameren are relatively new and therefore are either Year 2000 compliant or only require minor modifications. Also, several of the operating hardware and embedded systems (i.e., microprocessor chips) use analog rather than digital technology and thus are unaffected by the two-digit date issue. In addition, the Company has contacted hundreds of vendors and suppliers to verify compliance.

The Company has also completed its planning phase. Items that have been identified for remediation have been prioritized into groups based on their significance to Company operations. The implementation/testing phase for all components/applications is approximately 45% complete as of December 31, 1998. The Company expects to complete remediation of its significant components/applications by the end of the third quarter 1999.

With respect to third parties, for areas that interface directly with significant vendors, the Company has inventoried vendors and major suppliers and is currently assessing their Year 2000 readiness through surveys, websites and personal contact. The Company plans to follow up with major suppliers and vendors and verify Year 2000 compliance, where appropriate. The Company has also queried its health insurance providers. To date, the Company is not aware of any problems that would materially impact its financial condition, results of operations or liquidity; however, the Company has no means of ensuring that these parties will be Year 2000 compliant. The inability of those parties to complete their Year 2000 resolution process could materially impact the Company.

The Company is also addressing the impact of electric power grid problems that may occur outside of its own electric system. The Company has started Year 2000 electric power grid impact planning through the system's various electric interconnection affiliations and is working with the Mid-American Interchange Network (MAIN) to begin planning Year 2000 operational preparedness and restoration scenarios. As of November 30, 1998 (the latest information available), MAIN was 88% complete with its assessment phase, 74% complete with its planning phase and 36% complete with the implementation/testing phase. In addition, the Company provides monthly status reports to the North American Electric Reliability Council (NERC) to assist them in assessing Year 2000 readiness of the regional electric grid. As of November 30, 1998 (the latest information available), NERC was 96% complete with its assessment phase, 82% complete with its planning phase and 44% complete with the implementation/testing phase. Through the Electric Power Research Institute (EPRI), an industry-wide effort has been established to deal with Year 2000 problems affecting digital systems and equipment used by the nation's electric power companies. Under this effort, participating utilities are working together to assess specific vendors' system problems and test plans. The assessment will be shared by the industry as a whole to facilitate Year 2000 problem solving.

In addressing the Year 2000 Issue, the Company will incur internal labor costs as well as external consulting and other expenses to prepare for the new century. The Company estimates that its external costs (consulting fees and related costs) for addressing the Year 2000 Issue will range from \$10 million to \$15 million. As of December 31, 1998, the Company had expended approximately \$2.4 million. The Company's plans to complete Year 2000 modifications are based on management's best estimates, which are derived utilizing numerous assumptions of future events including the continued availability of certain resources, and other factors. However, there can be no guarantee that these estimates will be achieved, and actual results could differ materially from those plans. Specific factors that might cause such material differences include, but are not limited to, the availability and cost of personnel trained in this area, the ability to locate and correct all relevant computer codes, and similar uncertainties.

The Company believes that, with appropriate modifications to existing computer systems/components, updates by vendors and trading partners, and conversion to new software and hardware in the ordinary course of business, the Year 2000 Issue will not pose significant operational problems for the Company. However, if such conversions are not completed in a proper and timely manner by all affected parties, the Year 2000 Issue could result in material adverse operational and financial consequences to the Company, and there can be no assurance that the Company's efforts, or those of vendors and trading partners, interconnection affiliates, NERC or EPRI to address the Year 2000 Issue will be successful. The Company is in the process of developing contingency plans to address potential risks, including risks of vendor/trading partners' noncompliance, as well as noncompliance of any of the Company's material operating systems. The first operational contingency plan addressing power grid issues is expected to be completed by the end of the first quarter 1999. Contingency plans related to the business areas are expected to be completed by the end of the second quarter 1999. At this time, the Company is unable to predict the ultimate impact, if any, of the Year 2000 Issue on the Company's financial condition, results of operations or liquidity; however, the impact could be material.

Contingencies

See Note 12 - Commitments and Contingencies and Note 2 - Regulatory Matters under Notes to Consolidated Financial Statements for material issues existing at December 31, 1998.

Market Risk Related to Financial Instruments and Commodity Instruments

Market risk represents the risk of changes in value of a financial instrument, derivative or non-derivative, caused by fluctuations in interest rates and equity prices. The following discussion of the Company's risk management activities includes "forward-looking" statements that involve risks and uncertainties. Actual results could differ materially from those projected in the "forward-looking" statements. The Company handles market risks in accordance with established policies, which may include entering into various deriv-