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Witness:	Martin J. Lyons, Jr.
Sponsoring Party:	Union Electric Company
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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2008-0318

REBUTTAL TESTIMONY

OF

MARTIN J. LYONS, JR.

ON

BEHALF OF

UNION ELECTRIC COMPANY
d/b/a AmerenUE

****DENOTES HIGHLY CONFIDENTIAL INFORMATION****

St. Louis, Missouri
October, 2008

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REBUTTAL TESTIMONY

OF

MARTIN J. LYONS, JR.

CASE NO. ER-2008-0318

I. INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

A. My name is Martin J. Lyons, Jr. My business address is One Ameren Plaza, 1901 Chouteau Avenue, St. Louis, Missouri 63103.

Q. Are you the same Martin J. Lyons, Jr., who submitted direct testimony in this case on April 4, 2008?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. My rebuttal testimony responds to certain arguments made by Staff witness Lena Mantle in the Staff's August 28, 2008 Cost of Service Report ("Staff Report"), in the August 28 and September 11, 2008 direct testimonies of Missouri Industrial Energy Consumers ("MIEC") witness Maurice Brubaker, in the August 28 and September 11, 2008 direct testimonies of Noranda, Inc. ("Noranda") witness Donald Johnstone, in the August 28, 2008 direct testimony of State of Missouri witness Martin Cohen, and in the September 4, 2008 direct testimony of Office of the Public Counsel ("OPC") witness Ryan Kind.

Q. What are these witnesses' basic positions on the fuel adjustment clause ("FAC")?

A. Mr. Brubaker does not oppose AmerenUE's FAC request but advocates certain modifications to it. In fact, Mr. Brubaker testified that the structure of the FAC proposed by AmerenUE is appropriate.[1] The other witnesses mentioned above contend that the proposed FAC should be rejected.

Q. Please summarize your conclusions as reflected in this rebuttal testimony.

A. In response to the claims of the above-referenced witnesses, my primary conclusions are as follows:

- The large and continuing under-recoveries of AmerenUE's fuel costs and the substantial uncertainty around AmerenUE's net fuel costs demonstrate that an FAC is appropriate for AmerenUE under the statutory criterion contained in Senate Bill 179 (SB 179) — that an FAC be reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity ("ROE"). These facts also demonstrate that the first of the three non-statutory factors previously considered by the Commission — that fuel costs be substantial enough to have a material impact on revenue requirements and the financial performance of the business between rate cases — is also satisfied by AmerenUE's request for an FAC in this case.

  - The under-recoveries referenced above for coal costs alone will have totaled approximately **____** million from January 1, 2007 through the date rates set in this case would take effect (March 1, 2009) (based on AmerenUE's coal budget). Without an FAC, these under-recoveries would total approximately an *additional* **___** million from the time rates set in this case take effect through the likely end of a possible next rate case filed in mid-2009, based upon the budgeted and high case figures outlined by AmerenUE witness Robert K. Neff in his direct testimony. This means that lack of an FAC is leading to coal cost under-recoveries alone that would exceed **____** million from 2007 to 2010. These under-recoveries could be significantly greater under Mr. Neff's high coal cost case.

  - The financial impact of these under-recoveries caused by the lack of an FAC for AmerenUE exacerbates AmerenUE's difficulty in accessing capital given the significant problems that have occurred in the financial markets in recent weeks. As this testimony is being filed, AmerenUE's access to the commercial paper market and access to other forms of capital has been materially restricted.

- The volatility and uncertainty in national and international fuel markets and the uncertainty of AmerenUE's overall net fuel costs demonstrates that AmerenUE also

[1] Brubaker August 28, 2008 Direct, p. 6, l. 12-13.

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meets the second of the three non-statutory factors previously considered by the Commission — that fuel costs be beyond the control of utility management. This is in part due to the unpredictability of fuel and power markets.

- Substantial volatility in net fuel costs exists despite AmerenUE's prudent hedging programs. In the absence of an FAC, AmerenUE's volatile net fuel costs would cause significant swings in income and cash flows, which satisfies the third non-statutory factor previously considered by the Commission.

- In the event an FAC is approved, if off-system sales revenues were to increase enough in a given year to offset any higher fuel costs, customers would benefit by receiving 95% of any net fuel cost decreases.

- The Company will retain significant incentives to properly manage its net fuel costs, in addition to the 95%/5% sharing mechanism approved for Aquila, Inc. ("Aquila") and the Empire District Electric Company ("Empire") and proposed by the Company in this case. These additional incentives include the incentives provided by:

    - The Powder River Basin, Wyoming ("PRB") coal pool, through which AmerenUE and its unregulated affiliates pay the same price for coal;
    - Individual employee incentives relating to fuel procurement, making off-system sales, and generation plant operations;
    - Prudence reviews by the Commission;
    - Cash flow lags inherent in the use of historical costs in an FAC, as mandated by the Commission's FAC rules;
    - Heat Rate/Efficiency Testing requirements and monitoring; and
    - The periodic review of any FAC that is granted in any future rate case.

- Ms. Mantle and Mr. Brubaker both ignore the significant uncertainties surrounding AmerenUE's net base fuel costs, including uncertainties arising from two separate and very large components of net base fuel costs: volatile and uncertain coal and gas costs and volatile and uncertain off-system sales revenues.

- Mr. Johnstone's claim that an FAC is not needed to address AmerenUE's credit metrics and need to access capital at a reasonable price is incorrect.

- Mr. Cohen's opposition to an FAC reflects an out-of-the-mainstream position apparently rooted in his general opposition to any rate adjustment mechanism under any circumstances. Mr. Cohen's out-of-the-mainstream position is demonstrated by Schedules MJL-RE8 and RE9, attached to this rebuttal testimony.

Q. Do other AmerenUE witnesses also address FAC-related issues in rebuttal testimony?

A. Yes. Various FAC-related points raised in the above-referenced Staff Report and intervenor testimonies are also addressed in the rebuttal testimonies of other AmerenUE witnesses:

- The rebuttal testimony of **Robert K. Neff** addresses the volatility and uncertainty of coal costs, despite the Company's robust hedging program, the severe under-recoveries of coal costs that AmerenUE has experienced and would expect to continue to experience due to the regulatory lag inherent in time-consuming rate cases, and the incentives that those who manage AmerenUE's coal supply have to continue to manage those costs prudently with or without an FAC.

- The rebuttal testimony of **Scott A. Glaeser** addresses the volatility and uncertainty of natural gas costs, the limitations on the ability to hedge natural gas costs for generation and AmerenUE's strong track record in properly managing its natural gas costs while operating under a cost adjustment mechanism like an FAC, the purchased gas adjustment ("PGA") clause.

- **Ajay K. Arora's** rebuttal testimony addresses various claims about the volatility of AmerenUE's coal costs and the uncertainty surrounding those coal costs despite the Company's hedging programs, and demonstrates that the Company is exposed to fuel and power price volatility and uncertainty, and lacks the ability to control its net fuel costs, much like the exposure and lack of control observed for Aquila and Empire. Mr. Arora also demonstrates that Staff witness Mantle and MIEC witness Brubaker's analyses both ignore the impact of including off-system sales revenues as a component of the Company's net fuel costs in its proposed FAC.

- AmerenUE witness **Gary M. Rygh's** rebuttal testimony demonstrates how the Commission's treatment of AmerenUE's FAC request relates to the overall impact of the perceived regulatory environment for AmerenUE, which in turn has a significant effect on perceptions of debt and equity investors, AmerenUE's credit ratings, its access to capital, and the cost of the capital it can access. Mr. Rygh addresses the current state of and outlook for the financial markets as it pertains to AmerenUE's need for capital, the importance debt and equity investors place on regulatory treatment of a regulated utility like AmerenUE, and these investors' keen awareness and understanding of that treatment, including in particular the importance of an FAC for AmerenUE's ability to access needed capital at a reasonable cost.

- The rebuttal testimony of AmerenUE witness **Michael G. O'Bryan** responds to Mr. Johnstone's incorrect suggestion that circumstances affecting AmerenUE's affiliates may have significantly affected AmerenUE's credit standing, explaining that in fact the lack of an FAC and AmerenUE's own financial metrics are the drivers of AmerenUE's current credit ratings. Mr. O'Bryan also addresses the very real and profound effect the current and expected capital market conditions we are all hearing and reading about on a daily basis are now having on AmerenUE's ability to access capital.

- Finally, AmerenUE witnesses **Wilbon Cooper**, **Shawn Schukar** and **Mark Birk** also address various FAC-related issues raised in other parties' testimonies.

Q. On what grounds do Ms. Mantle and Messrs. Kind, Johnstone and Cohen urge rejection of AmerenUE's proposed FAC?

A. Ms. Mantle claims that AmerenUE does not meet some of the criteria the Commission has previously considered when deciding whether to grant an FAC and thus, in her view, AmerenUE should not be granted an FAC. Mr. Kind provides no details about why OPC opposes an FAC (OPC has opposed each FAC filing of Missouri utilities) but simply states "OPC opposes UE's request that the Commission permit it to use an FAC." Among other objections, Mr. Johnstone claims that AmerenUE would have an insufficient incentive to control costs if an FAC is granted and also expresses concerns about what he terms "rate yo-yo." Finally, Mr. Cohen raises a number of general objections to any adjustment mechanism, including mechanisms specifically authorized by Senate Bill 179 ("S.B. 179"), such as an FAC. Mr. Cohen claims that any such mechanisms violate what he calls "test year principles" and implies (incorrectly) that utilizing an FAC would be unusual or outside the mainstream of utility regulation. In short, it is apparent that Mr. Cohen is philosophically opposed to any kind of rate adjustment mechanism, including those already approved by the Commission.

Q. What is your response to these witnesses' opposition to the proposed FAC?

A. I will demonstrate that AmerenUE in fact meets the earnings criterion relating to when an FAC is appropriate in Missouri that is contained in S.B. 179. I will further demonstrate that AmerenUE also meets the three factors, not listed in S.B. 179, that the Commission has chosen to examine in relation to FACs in other cases.

II. S.B. 179 EARNINGS CRITERION AND OTHER FAC-RELATED FACTORS

Q. You mentioned a specific criterion listed in S.B. 179 which relates to FACs. To what are you referring?

A. S.B. 179 states that the Commission must find that the FAC is "reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity." The Commission discussed this earnings criterion in its Report and Order in Case No. ER-2007-0004 (the *Aquila Order*) and in its Report and Order in Case No. ER-2008-0093 (the *Empire Order*). Each of these utilities' requests for an FAC were granted in part because of the earnings problems presented by regulatory lag in the context of steadily rising fuel costs and under-recoveries of those fuel costs when relying on what the Commission itself characterizes as "the time-consuming rate-making process."[2] In sum, S.B. 179 indicates that an FAC is justified when regulatory lag could, absent an FAC, deprive the utility of a sufficient opportunity to earn a fair ROE.

[2] *Aquila Order*, p. 36. The Commission noted that Aquila was continuing to experience escalating fuel costs, and risks substantial under-recovery without an FAC (*Id.*, p. 24) and noted the same problem for Empire (*Empire Order*, p. 42).

Q. Do others address this statutory earnings criterion?

A. Not really. Those who oppose the FAC make little mention of the statutory criterion. For example, the Staff states (incorrectly) that the "Commission utilized three criteria for determining whether an electric utility should be allowed to implement a FAC."[3] In fact, while the Commission considered these three non-statutory criteria, or factors, it also properly applied the statutory criterion I reference above. (See, e.g., *Empire Order*, p. 35).

Q. What are the three non-statutory factors that the Commission has examined in the past when deciding if an FAC should be allowed?

A. In addition to applying the statutory earnings criterion I discuss above, the Commission has considered three other factors, which require fuel costs to be:

1. Substantial enough to have a material impact upon revenue requirements and the financial performance of the business between rate cases;

2. beyond the control of management, where utility management has little influence over experienced revenue or cost levels; and

3. volatile in amount, causing significant swings in income and cash flows if not tracked.

(*Empire Order*, p. 37).

A. <u>Opportunity to Earn the Allowed Return on Equity – Material Impact on Revenue Requirement.</u>

Q. The statutory earnings criterion and the first factor described in the *Empire Order* appear to be closely related. Please address how an FAC for AmerenUE is justified based on these two points.

[3] Staff Report, p. 60.

A. As already noted, the statute supports use of an FAC when it is needed to provide the utility with a sufficient opportunity to earn a fair ROE. The first non-statutory factor previously used by the Commission similarly suggests that an FAC is warranted if fuel costs are substantial enough to have a material impact upon the revenue requirement and the financial performance of the business between rate cases. AmerenUE's recent history, even with having now filed its second general rate case within just 10 months after the conclusion of its last rate case, demonstrates that the time-consuming rate case process fails to give AmerenUE a sufficient opportunity to earn a fair ROE and that fuel costs are in fact large and are having a material impact on AmerenUE's financial performance between rate cases.

Q. Please elaborate.

A. AmerenUE's normalized fuel (coal, gas, nuclear fuel) and purchased power costs total approximately $820 million annually. This is nearly 50% of the Company's Missouri jurisdictional operating and maintenance expenses. There is (or should be) no debate about whether these costs "have a material impact upon revenue requirements" given that even a modest percentage variation in these costs will materially impact the financial performance of the business. Consider, however, that AmerenUE's *net* fuel costs have an even greater impact on the Company's revenue requirement and financial performance because they include significant off-system sales revenues. AmerenUE's normalized off-system sales revenues are approximately $460 million. While these revenues are deducted from total fuel costs to determine net fuel costs, off-system sales revenue uncertainty adds to the magnitude of the uncertainty that affects AmerenUE's revenue requirement and financial performance. Thus, the total FAC-related dollar amounts that can materially impact AmerenUE's revenue requirement and financial performance are comprised of over $820 million in fuel and purchased power costs as well as more than $460 million in off-system sales revenues.[4]

Q. But won't off-system sales reduce rather than add to the fuel and purchased power related risks?

A. No. The fact that off-system sales are a component of AmerenUE's net fuel costs actually increases uncertainty. As Mr. Arora showed in his direct testimony, off-system sales may decrease while AmerenUE's fuel costs increase. This means one cannot look to AmerenUE's *net* fuel costs when assessing the impact that fuel, purchased power, and off-system sales can have upon revenue requirements and the financial performance of AmerenUE between rate cases.

Q. Please illustrate how these very large dollar items affect the Company's financial performance and its opportunity to earn a fair ROE.

A. Recognizing that gas costs, nuclear fuel costs, and off-system sales revenues can also have a significant impact on AmerenUE's ROE and its overall financial performance, for simplicity's sake, let me first focus on the impact that just changes in the cost of delivered coal can have on AmerenUE's earnings. Anticipated (based upon the budgeted figures from Mr. Neff's direct testimony in this case) 2009 and 2010 delivered coal cost increases alone, which are shown by

[4] The figures cited in this answer are based upon the Company's Supplemental Direct Testimony (AmerenUE witness Gary Weiss) filing on June 4, 2008. These off-system sales figures, which include MISO Day 2 revenues and capacity revenues, will be slightly different once updates filed in connection with AmerenUE

an examination of Tables RKN-R1 through RKN-R3 in Mr. Neff's rebuttal testimony, are approximately **____** million with a range from approximately **___** million to a high of approximately **____** million. This would cut AmerenUE's earnings by approximately **___** in 2010, unless recovered in rates. Without an FAC, but assuming a rate case were filed in July 2009, as Mr. Neff's tables also show, almost **___** million of these budgeted coal cost increases (and possibly ranging to as much as **____** million in the high case) will not be recovered in rates.

This is true even if AmerenUE were to file another rate case in approximately mid-2009 in an attempt to reflect in rates[5] the large coal cost increases that will occur on January 1, 2010. The problem with relying on a series of rate cases – the "time-consuming rate-making process" the Commission has referred to – in order to recover rising fuel costs is that the utility will *never* in fact recover its fuel costs due to the regulatory lag inherent in that process. The Commission recognized this very problem in the *Empire Order*: "The mainstream of regulation [which utilizes FACs] recognizes that it is impossible for a utility to earn its allowed return on equity in a rising cost environment without a fuel adjustment clause." That is precisely the situation that exists at AmerenUE today, a point which I discuss further and summarize in Table MJL-R1 below.

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witnesses Shawn Schukar and Tim Finnell's rebuttal testimonies are taken into account and when net base fuel costs are finally calculated by Mr. Weiss as part of the true-up in this case.

[5] But those rates would not take effect until mid-2010.

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Q. Continuing to focus just on unrecovered delivered coal costs, what is the magnitude of these unrecovered delivered coal costs for AmerenUE in relation to the last and current rate cases?

A. As noted in my direct testimony, by filing its last rate case in mid-2006, AmerenUE was able to include in rates higher delivered coal costs that took effect on January 1, 2007. However, the effect of regulatory lag that is inherent in the rate case process meant that between January 1, 2007 and June 4, 2007, when the new rates took effect, AmerenUE failed to recover approximately $42 million of the delivered coal cost increases (as shown in Table MJL-R1 based on Mr. Neff's rebuttal testimony). The $42 million equates to almost a 100 basis point impact on earnings at a time when the Commission determined that AmerenUE was under-earning by $43 million annually. Thus, AmerenUE's unrecovered (and forever unrecoverable) 2007 coal costs alone effectively wiped out the entire amount of the annual rate increase the Commission provided in the Company's last rate case in 2007.

The same problem continues to exist today. The delivered cost of coal went up again on January 1, 2008, will increase again on January 1, 2009, and will rise further on January 1, 2010. New rates from this case will not take effect until March 1, 2009. Consequently, because only the 2007 increase has been reflected in current rates, AmerenUE will fail to recover approximately **___** million (as also shown in Table MJL-R1) of higher delivered coal costs for the period January 1, 2008 through February 28, 2009, simply because of the regulatory lag inherent in the rate case process, despite having filed a second rate

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case only 10 months after the Commission authorized the most recent rate increase.

Table MJL-R1, derived from Mr. Neff's Tables RKN-R1 through RKN-R3, summarizes the under-recoveries discussed above that are caused by recovering fuel costs simply through reliance on the historic test years without an FAC.[6] The table also shows under-recoveries assuming the Company would (and actually could) file new rate cases on July 1 in every one of the next several years.

**__________

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Q. How would reliance on the historic test year rate case model without an FAC affect AmerenUE's ability to recover those higher 2010 delivered coal cost increases?

A. In the absence of an FAC, reliance on the historic test year rate case model would result in a very large under-recovery of costs. As demonstrated by Mr. Neff in his rebuttal testimony (Tables RKN-R1 through RKN-R3), even if AmerenUE were

[6] These figures are derived from Mr. Neff's Tables RKN-R1 through RKN-R3, where Mr. Neff summarizes the under-recoveries caused by regulatory lag based upon the budgeted, high and low cases for coal that were presented in Mr. Neff's direct testimony.

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to file another rate case within just a few months after this rate case is over (e.g., by July 1, 2009) to include the January 1, 2010 coal cost increases in rates, AmerenUE would fail to recover coal cost increases that will occur on January 1, 2009, as well as the higher coal costs starting January 1, 2010 until new rates from that next rate case would take effect on approximately June 1, 2010.

As Mr. Neff explains and I have summarized in Table MJL-R1, based upon AmerenUE's budgeted expenditures from his direct testimony, this under-recovery related to the January 1, 2009 and January 1, 2010 cost increases would be approximately **___** million. However, the under-recoveries associated with a July 1, 2009 rate case filing could be as large as approximately **____** million in Mr. Neff's "high" coal cost case. This represents an approximately **___** (in fact, up to over **___** in the high case) basis point impact on the Company's earnings.

Without an FAC this will continue to be a significant problem for AmerenUE even beyond the possible filing of a 2009 rate case and even if the Company were to file a rate case every 12 months. The possible under-recoveries summarized in Table MJL-R1 could be larger simply because it may not be practical for AmerenUE to file rate cases every 12 months or to time them solely based the objective of minimizing coal cost increases.

In summary, even with a series of traditional rate cases – July 7, 2006, April 4, 2008, and assuming another rate case on July 1 each year thereafter through 2011 – the lack of an FAC could cause AmerenUE to under-recover its delivered coal costs by approximately **____** million, with an uncertainty

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range of **____** to **____** million, through 2012, based upon the budgeted figures from Mr. Neff's direct testimony.

Q. Are there other components of net fuel costs which could result in large impacts on the Company's ROE?

A. Yes, most notably, off-system sales revenues. As discussed by Mr. Schukar in both his direct and rebuttal testimonies, there exists substantial uncertainty around what the level of off-system sales might be in any given future period. As explained by Mr. Arora in both his direct and rebuttal testimonies, the off-system sales uncertainty magnifies fuel-cost-related uncertainties that significantly impact AmerenUE. In addition to the quantification of this high level of uncertainty by Mr. Schukar, the high level of off-system sales uncertainty is also demonstrated by the wide variation in the estimates of future off-system sales revenues on the part of various experts in this and the previous Company rate case.

In the last rate case, for example, some parties (the State and OPC) argued that off-system sales margins should be set at $276 million (AmerenUE's budgeted off-system sales margins at that time), the Company estimated margins at $202.5 million, and the Staff argued that margins should be set at approximately $230 million.[7] The difference between the high and the low of this range of estimates represents approximately 150 basis points of AmerenUE's ROE. As it turned out, actual off-system sales margins for 2007 were only

[7] As experts in that case noted was likely, no one turned out to be right – actual margins in 2007 were approximately $225 million, as noted in Mr. Schukar's rebuttal testimony.

approximately $225 million, even with the value-added by AmerenUE's Asset Management and Trading Group, as addressed by Mr. Schukar in his rebuttal testimony. Had the Commission built $276 million of off-system sales margins in the Company's base rates, the Company would have fallen short on off-system sales margins by about $50 million dollars, which would have impacted the Company's ROE by approximately 100 basis points. With an FAC like the one proposed in this case, the ROE impact would have been greatly minimized, thus preserving a sufficient opportunity to earn a fair ROE as contemplated by S.B. 179.

In this rate case the variance of off-system sales recommendations is even larger. The difference between intervener/OPC recommendations (Mr. Dauphinais and Mr. Kind) and Mr. Schukar's recommendations for off-system sales alone amounts to a revenue requirement impact ranging from $65 million to $90 million. The high end of this range translates to an ROE impact of nearly 200 basis points. An FAC would eliminate the significant risk that the Company's return would be reduced by some or all of that amount due to the vagaries of national electric power markets and the difficulty of determining the correct base amount.

Q. Does the FAC, as proposed by the Company, provide the same protection to customers if the Company exceeds expectations regarding off-system sales?

A. Yes, it does. As noted above, the range by which different experts' initial recommendations for off-system sales in this case reduces the Company's revenue requirements is as much as $90 million. If the smaller off-system sales-related reduction to the Company's revenue requirement is approved and if, in fact, off-system sales ended up being much higher customers would receive 95% of the benefit of those higher off-system sales, and the impact on the Company's ROE would have again been minimized, thus preserving a sufficient opportunity to earn a fair ROE contemplated by S.B. 179.

Q. Don't these illustrative impacts on the Company's ROE caused by variations in off-system sales revenues assume that the Company's other costs remain constant? What if other costs go down?

A. These illustrations do assume the Company's other costs remain constant, and indeed that is not a realistic assumption. As I noted earlier, and as outlined in Mr. Neff's direct and rebuttal testimonies, AmerenUE's delivered coal costs are certain to increase substantially in 2009 and 2010. Moreover, as discussed by Messrs. Voss and Gordon, other costs in the Company's business are also rising at a fairly substantial pace. The trend in these other costs will make it even more difficult for the Company to earn a reasonable rate of return. The point is that there is simply no reason to believe that there is any chance at all that cost reductions in other areas of AmerenUE's business would offset higher fuel costs. This is precisely why an FAC is critical to providing the Company with a sufficient opportunity to earn a fair ROE.

Q. But what if higher off-system sales did happen to offset those higher costs?

A. Nobody knows whether changes in off-system sales will increase or decrease net fuel costs. However, as explained and quantified in Mr. Arora's direct and rebuttal testimonies, even if off-system sales partially offset higher costs in some instances, customers will benefit from 95 cents of every dollar of off-system sales that offsets, either in whole or in part, higher Company costs. This is why an FAC makes so much sense – it provides protection for the Company against failing to have an opportunity to earn a fair ROE because it prevents the large under-recoveries of fuel costs outlined earlier, but it also protects customers from "missing out" on the benefit of higher off-system sales revenues, if they materialize, by passing 95% of that benefit through to them.

B. <u>Lack of Control</u>

Q. Please address the second factor previously considered by the Commission – control over net fuel costs.

A. The Commission already found in the Company's last rate case that markets for coal, coal transportation, natural gas, oil and nuclear fuel are established by national or international markets that the Company cannot control. (Report and Order, Case No. ER-2007-0002, p. 22.) This fact was also recognized by the Commission in the *Aquila* and *Empire Orders*. Indeed, as discussed by Messrs. Glaeser and Neff in both their direct testimonies and in more detail in their rebuttal testimonies, these markets are subject to even less control by the Company today than they were just a couple of years ago as evidenced by the fact that these witnesses' expectations for highs and lows in these markets over a five year period have already been tested or exceeded in just the last five or six months. For coal, this is because of the increasing influence of countries such as China and Australia. For natural gas, the markets are also becoming more volatile and less subject to Company control because of the increasing impact of liquefied natural gas on world gas markets and price arbitrage by speculators in the financial markets.

And while the Commission noted in the last case that AmerenUE, "has some ability to negotiate better rates from coal producers and railroads" because it is a large coal buyer and transporter from the Power River Basin, this ability is quite limited. As Mr. Neff points out, there are only two railroads available to move coal from Wyoming to the Company's plants, both of which are operating at or near capacity and both of which are simply not taking additional coal transportation business. They have consistently forced price increases on the Company for several years, and there is no evidence that this trend will abate any time soon. As Mr. Neff's rebuttal testimony shows, while the Company is able, over time, to dampen volatility in its coal commodity costs through hedging, the Company simply cannot control its coal costs. Mr. Glaeser's rebuttal testimony demonstrates the same thing regarding gas markets, and no one has ever contended that AmerenUE can control the power markets into which off-system sales are made.

Q. So when Ms. Mantle and Mr. Brubaker suggest that AmerenUE has "some control" or an ability to "influence" costs, are they incorrect?

A. Yes and no. The Company has no "control" over fuel costs. "Control" implies an ability to take an action that would result in a change in the markets that determined the prices it pays for fuel or the prices achieved on power sales. Can the Company *influence* what it pays for fuel? To the extent it can enter into long-term contracts, then to some extent, yes. Can the Company influence what it receives for power sold? The answer is the same. The Company can hedge some of its excess power, though a large portion of it must remain unhedged due to the variability of the Company's native load-serving obligations. However, at the end of the day the fuel and power markets will move up and down irrespective of what the Company does and, over time, the Company's long-term contracts will follow those markets. We have seen this in recent years as coal and coal transportation costs continue to rise, with the Company's long-term contracts continuing to rise with the markets. Moreover, there is always a large portion of AmerenUE's net fuel costs that remain entirely exposed to the uncontrolled variability of the markets. This is because AmerenUE cannot hedge all of its fuel needs and available power at any given time, nor would it be prudent for the Company to do so.

Q. But isn't it true that AmerenUE has at least some control over factors such as plant availability, which influences its level of off-system sales and, consequently, net fuel costs?

A. Yes, up to a point, as Mr. Brubaker points out. To the extent the Company maintains its generating plants well and manages outages at its plants well, the amount of energy available to sell in the off-system sales markets will be maximized, thus maximizing off-system sales revenues. This could lower net fuel costs, depending on what power prices do. I believe everyone would agree that AmerenUE has a very well-operated generating fleet, and AmerenUE has every intention and incentive to continue to run a well-operated generating fleet in the future and to otherwise minimize net fuel costs, with or without an FAC. But

AmerenUE cannot control coal, gas, nuclear fuel and power markets, which means its level of net fuel costs is very uncertain over time. What is certain is that fuel costs continue to increase substantially and unpredictable off-system sales revenues or other cost reductions cannot be counted on to provide a meaningful offset to those substantially rising costs.

Q. You mention incentives to minimize net fuel costs. Some witnesses, in particular Mr. Johnstone and Mr. Cohen, suggest, in Mr. Johnstone's words, that an FAC would "eviscerate" the Company's incentives in this area. How do you respond?

A. Mr. Johnstone far overstates the impact an FAC has on a utility's incentive to control its net fuel costs. The Commission has already recognized that an FAC does not "eviscerate" (i.e., to deprive of an essential part of)[8] a utility's incentive. For example, the Commission noted in both the Empire and Aquila decisions, where it has granted FACs, that the combination of prudence reviews and a 95%/5% sharing of changes from base fuel costs preserves the utility's incentives. Even with an FAC, AmerenUE would retain a number of incentives to control its net fuel costs:

- **<u>95%/5% Sharing.</u>** This was the financial incentive ordered by the Commission in both the Empire and Aquila cases. The sharing would subject AmerenUE to the risk of losing, or gaining, millions of dollars in net fuel costs. Although most FACs in effect throughout the country contain no sharing percentage at all, AmerenUE has included this financial incentive in its proposed

[8] *Websters New World College Dictionary*, (4th ed. 2001)

FAC to remain consistent with the Commission's decisions in the Empire and Aquila cases.

- **<u>Coal Pool.</u>** As discussed by Mr. Neff in his testimonies, AmerenUE's Powder River Basin (Wyoming) (PRB) coal is purchased via a coal pool that includes coal purchases for unregulated Ameren merchant generating companies operating in Illinois. As a consequence, AmerenUE's unregulated affiliates must pay the exact same prices as AmerenUE for coal purchased from the pool. This creates a significant financial incentive for AmerenUE's coal procurer, AmerenEnergy Fuels and Service Company, to minimize coal costs for the pool.
- **<u>Individual Employee Incentives.</u>** There are three key groups of employees who have the most impact on minimizing net fuel costs: AmerenUE's Asset Management and Trading Group ("AM&T") (which makes off-system sales), AmerenUE's Power Operations Group ("Power Operations") (which runs the Company's fossil-fueled power plants), and AmerenEnergy Fuels and Services ("AFS") (AmerenUE's fuel procurement agent). Each of these groups has specific financial incentives designed to make sure those employees make decisions that lead to lower net fuel costs, which I discuss in more detail below.
- **<u>Prudence Reviews</u>**. The Legislature (which specifically included mandatory prudence reviews in S.B. 179) and the Commission both recognize that prudence reviews provide a powerful incentive for electric utilities to properly and prudently manage net fuel costs. Regulators commonly use prudence reviews to ensure only prudently incurred fuel costs are flowed through to customers. Notably, this Commission has effectively utilized prudence reviews

for Missouri gas utilities' purchased gas adjustment clauses for more than 40 years.

- **Cash Flow Lags.** As Mr. Voss's direct testimony indicates, the Company faces very large investment needs in the coming years, and the likelihood of needing to build a large baseload generating plant within a decade. Given the fact that Missouri is one of the few states that requires FAC adjustments based on historical rather than projected costs, there is a substantial lag between AmerenUE's incurrence of its fuel costs and its recovery of those fuel costs from customers. This puts added pressure on the Company's credit metrics, which will tend to increase capital costs and decrease the Company's earnings and stock price. The problem is exacerbated by the long (12 month) recovery period in the Company's proposed FAC which, while less than ideal, was proposed to mitigate rate impacts from net fuel cost changes to customers. The Company has the incentives to reduce fuel costs to the extent possible to mitigate these cash flow pressures.

- **Heat Rate/Efficiency Testing.** The Commission's FAC rules require a detailed heat rate/efficiency testing plan, which is outlined in the testimony of Mark Birk. This plan establishes not only an objectively-measured baseline of the Company's generating unit efficiency today, but provides for ongoing monitoring and reporting of that efficiency throughout the period when the FAC will operate. This provides a powerful tool that allows the Commission to guard against imprudent operation and maintenance of the Company's generating units and any resulting higher net fuel costs.

- **<u>Periodic Review of any FAC.</u>** The Commission put it this way: "A fuel adjustment clause is a privilege, not a right, which can be taken away if the company does not act prudently."[9] Under Missouri's FAC statute and regulations, each time an electric utility files a rate case, its FAC once again is at issue, and indeed it must be addressed in a rate case no less frequently than every four years. It would indeed be foolish on the Company's part to stop acting prudently to manage its net fuel costs when the Company knows it will have to stand before this Commission again to justify its FAC in the near term.

Q. You listed individual employee incentives as one of the Company's incentives to continue to properly manage its net fuel costs with an FAC. Please elaborate.

A. Messrs. Neff, Schukar and Birk all address the relationship between properly managing AmerenUE's fuel costs through the incentive compensation metrics on which the employees responsible for managing fuel costs rely for their incentive compensation. These testimonies demonstrate that those with the most influence over minimizing net fuel costs consistent with proper hedging and risk management practices have a personal financial stake in doing so.

Q. One of the incentives you list is the 95%/5% sharing mechanism adopted by the Commission in both the Aquila and Empire cases, which AmerenUE has also proposed in this case. While Mr. Brubaker does not oppose AmerenUE's proposed FAC, he does take issue with the 95%/5% sharing

[9] *Empire Order*, p. 45-46.

percentages. Do you agree with Mr. Brubaker that the 95%/5% sharing "does not provide adequate incentives to AmerenUE"?

A. No. I believe I have already demonstrated that Mr. Brubaker is not correct. Sharing 5% provides significant incentives that are adequate, particular in the context of the additional incentives discussed above. Moreover, in an increasing fuel cost environment as AmerenUE and the rest of the industry faces today, Mr. Brubaker's proposal would simply result in the under-recovery of 20% of the already-known fuel cost increases, which would penalize AmerenUE relative to the 5% sharing the Commission approved for Aquila and Empire. It would also not be reasonably designed to provide AmerenUE with a sufficient opportunity to earn a fair return on equity.

Q. Please elaborate.

A. For example, if one considers just the $137 million in increased coal costs for 2009 and 2010 based upon Mr. Neff's budgeted figures, as outlined in his direct and rebuttal testimonies, Mr. Brubaker's sharing proposal would force AmerenUE to absorb approximately $27 million of coal costs alone in 2010. If Mr. Neff's high case applied, this 20% absorption would grow to almost $60 million. While a portion of these FAC-related under-recoveries could be mitigated by filing a rate case in mid 2009, there is no justification for forcing a utility to absorb these kinds of cost increases under an FAC. The Commission has twice rejected calls by others to put utilities in the position of under-recovering more than 5% of their fuel costs, recognizing that even the Commission's 95%/5% sharing mechanism is outside the mainstream. The Commission has stated: "Of the states that allow fuel adjustment clauses, the vast majority of those states allow 100 percent pass-through of fuel costs."[10] I believe it would be poor public policy for the Commission to again place itself far outside the mainstream by adopting a punitive 20% sharing mechanism like the one proposed by Mr. Brubaker.

Q. Are there other flaws in Mr. Brubaker's proposal?

A. Yes. Mr. Brubaker's analysis is flawed because of his failure to account for the fact that AmerenUE's earnings are exposed to much greater uncertainty than Mr. Brubaker contends. Mr. Brubaker bases his uncertainty analysis on AmerenUE's approximately $360 million on net fuel costs, when he should have considered the uncertainty inherent with each of the components of net fuel costs. This involves uncertainty associated with approximately $820 million in total fuel and purchased power costs and uncertainty associated with approximately $460 million in off-system sales revenues.

To illustrate the point, consider the case of a hypothetical utility that may have large fuel costs and that may also have off-system sales that equal these fuel costs, resulting in net base fuel costs of zero. In that case, Mr. Brubaker's percentage change would be applied to zero net base fuel costs. This would suggest that that there is *no impact* on the utility's ROE due to uncertainty in net base fuel costs, which highlights the logical flaw in Mr. Brubaker's approach. This cannot be true given that it is beyond reasonable debate that significant uncertainties exist both with respect to fuel costs and off-system sales. By

[10] Id., p. 41.

ignoring these uncertainties, Mr. Brubaker's illustration understates AmerenUE's exposure and the possible ROE impacts that exposure creates.

In addition, Mr. Brubaker's analysis of the ROE impact of a 35% change to AmerenUE's net base fuel costs significantly understates the likely and possible changes to the Company's net fuel costs. As shown in Table 1 of Mr. Arora's direct testimony, AmerenUE's net fuel costs could more than double in the next three to four years.[11] Table 1 of Mr. Arora's direct testimony shows that net fuel costs could increase from an expected level of $294 million in the test year to an expected level of $618 million for 2012 – an increase of over 100%, significantly more than the 35% used by Mr. Brubaker in his analysis. As noted, there is also uncertainty around these expected levels as outlined in Table 1 in Mr. Arora's direct t testimony; i.e., there is a 25% probability that the net fuel costs could be $727 million or more in 2012, and a 10% probability that they could be $807 million or more. These uncertainties far exceed the impacts evaluated by Mr. Brubaker.

Q. Mr. Brubaker also claims the Company has not provided adequate justification for the 95%/5% sharing mechanism. Do you agree?

A. No, I do not agree. As shown in Mr. Arora's direct testimony, there is a 50% chance in 2009 that the Company's net fuel costs could swing by more than $150

[11] Table 1 on p. 31 of Mr. Arora's direct testimony shows that we expect net fuel costs to double by 2012, and that they could double by 2010. Note that this table contains net fuel cost figures, as opposed to the "net base fuel costs" calculated by Mr. Weiss. The main difference is that Mr. Weiss adds MISO related charges and certain other miscellaneous charges that are determined outside the production cost modeling that produced Mr. Arora's net fuel cost numbers. The point remains the same, however – whether we look at net fuel costs without these other charges that Mr. Weiss must add to arrive at net base fuel costs or whether we look at net base fuel costs, the expectation is that these numbers will double by 2012, or earlier.

million (5% of which equates to about 15 basis points of ROE) and a 20% chance they could swing by more than $285 million (5% of which is about 30 basis points of ROE). I can assure the Commission that the Company considers this to be "real money" and has every incentive to manage its net fuel costs so as to not risk these kinds of impacts to its ROE, particularly in the very challenging, rising cost environment in which the Company is operating today. Moreover, other substantial incentives exist in addition to the 95%/5% sharing, as discussed earlier in my testimony.

Q. Do any other witnesses suggest something similar to Mr. Brubaker's proposal?

A. Yes. State witness Marty Cohen also proposes an 80%/20% split, but without the 50 basis point cap included in Mr. Brubaker's proposal and, alternatively, proposes a completely asymmetrical 85%/15% sharing if net fuel costs exceed the base, but a 95%/5% sharing if net fuel costs are lower than the base, with no caps.

Q. Please comment on Mr. Cohen's proposal.

A. Mr. Cohen's 80%/20% proposal is unreasonable and unnecessary for the same reasons I have addressed in response to Mr. Brubaker. In addition, Mr. Cohen's asymmetric proposal is patently unfair. Mr. Cohen acknowledges that AmerenUE's fuel costs have been increasing and that the trend may indeed continue to be upward. Indeed, we know, because AmerenUE hedges some of its fuel, that AmerenUE faces large known fuel cost increases in the near-term, both in 2009 and to an even greater degree in 2010. What this means is that even a facially symmetrical sharing mechanism (the 95%/5% mechanism proposed by the Company, or an 80%/20% mechanism), has an inherent asymmetrical bias. Mr. Cohen simply exacerbates this bias by building more asymmetry into the structure of his alternative proposal. For that reason, and because of the large negative impact that such a proposal would have on AmerenUE's opportunity to earn a fair ROE, Mr. Cohen's alternative proposal should be rejected.

C. Volatility/Uncertainty.

Q. You have addressed the first two factors applied by the Commission in previous cases, as well as the statutory criterion regarding ensuring that the utility has a sufficient opportunity to earn a fair return. Staff and intervenor witnesses place much focus on the third discretionary factor – the level of volatility in the Company's net fuel costs. Are AmerenUE's net fuel costs volatile and uncertain?

A. The answer is an unqualified "yes." As demonstrated by Mr. Arora's direct testimony, in both 2009 and 2010 there is a 50% chance net fuel costs could vary by more than \$157 million – i.e., a swing of more than 300 basis points of AmerenUE's ROE. These are very large numbers ranging from a low of \$171 million in 2009 to a high of \$328 million in 2009 (the 25th and 75th percentiles) and a low of \$347 million up to a high of \$503 million (the 25th and 75th percentiles) in 2010. No one knows where net fuel costs will fall within these ranges. In fact, there is a 50% chance they could fall outside these wide ranges and thus have an even greater impact on ROE. The point is that net fuel costs are highly uncertain and can swing substantially.

Q. Why are net fuel costs so volatile and uncertain?

A. Net fuel costs are so volatile and uncertain because the components of net fuel costs are volatile and uncertain. This includes uncertainty in coal costs (despite the significant hedging undertaken by AmerenUE), as well as significant uncertainty in the dollar amounts accounted for by natural gas, purchased power, and off-system sales.

Q. But is it not true that AmerenUE's hedging programs eliminate most of this volatility?

A. Absolutely not. All one has to do is examine the situation that existed at AmerenUE as it approached the test year in this case to see that even with the robust hedging programs AmerenUE has in place, substantial uncertainty remains. Going into the test year, AmerenUE had hedged a high percentage of its coal needs, had also hedged about 50% of its gas needs (for electric generation), and its nuclear fuel costs were known. It had also hedged about one-third of its off-system sales. However, as Mr. Arora demonstrated in his direct testimony, even with all of this hedging, substantial uncertainty remained.

Indeed, Mr. Arora showed that going into the test year there was a 50% chance that AmerenUE's net fuel costs would fall outside the range from $251 million to $334 million. This 50% uncertainty range of $83 million translates to more than 160 basis points possible swing in the Company's ROE. This means there is a 50% chance AmerenUE's earned ROE could be more than 80 basis points above or below the ROE that would be earned based upon an expected level of net fuel costs. The range – even with substantial hedges in place – is due to the volatility of the underlying fuel and power commodities and the potential variability of loads and generation availability. This should not be surprising. Given the significant dollar amounts spent on coal, even the small portion of unhedged coal leaves significant cost uncertainty. When that uncertainty is combined with the unhedged dollar amounts related to natural gas and off-system sales, the resulting uncertainty in net fuel costs is extremely large as Mr. Arora has quantified. The bottom line is that hedging mitigates some volatility and uncertainty, but it doesn't come close to eliminating it and AmerenUE remains exposed to potentially large variations in the Company's net fuel costs and ROE, absent an FAC.

Q. Doesn't Ms. Mantle's Table LM1 demonstrate that AmerenUE is not substantially exposed to volatile markets?

A. No. As Mr. Arora's rebuttal testimony demonstrates, Ms. Mantle's Table LM1 is incomplete and misleading. In fact, Ms. Mantle's Table LM1 is entirely irrelevant to the FAC AmerenUE has actually proposed in this case because Ms. Mantle completely ignores the fact that off-system sales are included in AmerenUE's proposed FAC as a reduction to gross fuel and purchased power expense. If off-system sales are added to Ms. Mantle's analysis, the proportion of natural gas and power related dollar amounts flowing through the FAC for AmerenUE are similar to the proportions Ms. Mantle shows for Aquila and Empire. In summary, AmerenUE's exposure to volatility is quite similar to the other two utilities in Missouri that have already been granted FACs by the Commission.

Second, Ms. Mantle's analysis implicitly assumes that coal is necessarily less volatile or can be hedged better than natural gas. As both Mr. Neff and Mr. Arora have demonstrated, however, the volatility of coal prices has been very similar to the volatility of natural gas prices. Regarding the ability to hedge price volatility, utilities that rely on natural gas or purchased power to supply base load needs have a similar or even greater ability to hedge these costs than utilities that rely on coal. This is because gas and power are traded in more liquid markets than coal. Ms. Mantle's attempt to differentiate Empire and AmerenUE consequently is flawed in that respect.

Finally, Ms. Mantle's rationale implicitly suggests that AmerenUE should not receive a FAC because the Company did a better job than Aquila and Empire in (1) developing a low-cost fuel mix and (2) hedging its fuel costs. In my opinion, Ms. Mantle's rationale would make poor public policy. I believe it makes no sense to penalize AmerenUE for its good performance by denying it an FAC, while this regulatory mechanism is used by the other eligible Missouri electric utilities and virtually all other electric utilities in Midwestern and non-restructured states, including coal-intensive utilities like AmerenUE.

Q. Ms. Mantle essentially argues that it appears the Company will file another rate case in 2010, and therefore, the Company ought to just rely on the historic test year rate case method to recover its fuel costs. How do you respond?

A. The question of when a next rate case might be filed simply is not a sound basis upon which to decide whether a FAC is appropriate. Not surprisingly, the

Commission has not considered the timing of future rate cases in approving an FAC for Empire and Aquila. In fact, the Commission explicitly rejected this argument when OPC made it in the Empire case.[12] Perhaps more importantly, as I previously demonstrated, even if a rate case is filed very soon, AmerenUE would still be unable to recover a significant portion of its fuel costs due to regulatory lag.

III. OTHER ISSUES RAISED BY FAC OPPONENTS

Q. Mr. Johnstone implies that AmerenUE should not be granted an FAC because it is AmerenUE's "affiliate circumstances" that have driven AmerenUE's credit metrics down. Does AmerenUE need an FAC simply because of events that occurred in Illinois in recent years?

A. No. As AmerenUE witness O'Bryan demonstrates in his rebuttal testimony, this is not the case. In fact, it is AmerenUE's own financial circumstances, notably due to the lack of an FAC, that continue to impact AmerenUE's credit ratings.

Q. Mr. Johnstone also claims that an FAC does not address what he characterizes as AmerenUE's "declining financial health," and suggests adopting an FAC now is "premature." How do you respond?

A. It appears that Mr. Johnstone's theory is that sometime in the future, if AmerenUE builds a new baseload plant – a decision which would not be made until at least 2011 – the capital needed for such a baseload plant may put great pressure on AmerenUE's finances. Indeed, this could be true, depending upon AmerenUE's cash flows at that time (the predictability of which could be

[12] *Empire Order*, p. 39.

improved considerably by an FAC), and depending upon AmerenUE's ability to timely reflect large capital expenditures for a new baseload plant in rates. But none of this has anything to do with whether volatile and uncertain net fuel costs *today* lead to under-recoveries of fuel costs or large swings in the Company's ROE, absent an FAC. Moreover, AmerenUE's need for an FAC to help provide the more timely cash flows needed to invest in its system today and tomorrow, without regard to building a baseload plant years into the future, is even more acute now given the extreme tightening being observed in the credit markets today, as discussed in much more detail in Messrs. O'Bryan's and Rygh's rebuttal testimonies. As they both indicate, if AmerenUE does not have an FAC it will be at an even greater disadvantage in accessing ever-tightening supplies of credit at a reasonable cost, given market conditions now and for the foreseeable future.

AmerenUE's financial health today and in the next few years is primarily dependent upon AmerenUE receiving reasonable regulatory treatment. This includes reasonable treatment with respect to the need to manage the very real effect regulatory lag is having on AmerenUE's business in an environment of rising and uncertain costs and significant capital investment needs, which are being experienced in the industry generally. An important component of such treatment includes granting the Company an FAC. Mr. Johnstone's speculation about AmerenUE's financial health later when a baseload plant would likely have to be built has nothing to do with the very real fact that FACs, when utilities have them, are supportive of higher credit quality and thus, ultimately, improve access to capital and lower borrowing rates, and that lack of an FAC tends to lower credit quality and thus tends to reduce access to capital and increases borrowing rates.

The bottom line is that FACs do address regulatory lag caused by the inability of time-consuming rate cases to keep up with rising fuel costs and mitigates exposure to volatile markets. All of these things are supportive of credit quality and, consequently, will tend to lower the cost of the large sums of debt the Company will have to carry to meet its capital needs, which in turn lowers customers' rates. Given these factors, it should not be surprising that almost all of the electric utilities in the country, including almost all coal-based electric utilities like AmerenUE, are able to operate under an FAC. As I have pointed out, of 37 electric utilities in neighboring and other Midwestern states, 36 of them operate under an FAC, including 26 out of 27 coal-intensive electric utilities. Mr. Johnstone's theory and recommendations are entirely beyond what should be considered the regulatory mainstream.

Q. Do the current financial market conditions add to the importance of granting AmerenUE's request for an FAC?

A. Yes, absolutely. The financial implications for AmerenUE of not being able to operate under an FAC exacerbate AmerenUE's difficulty in accessing capital given the current turmoil in financial markets, as discussed by Messrs. O'Bryan and Rygh. As this testimony is being filed, AmerenUE is unable to sell commercial paper and access to other forms of capital has been materially restricted as well. AmerenUE's inability to timely recover its fuel costs negatively impacts its credit rating and investor perceptions. This further diminishes the Company's access to and increases the cost of the capital it needs.

Q. Mr. Johnstone argues that generator outages and subsequent replacement power insurance recoveries could create a yo-yo effect on rates. How do you respond?

A. Mr. Johnstone's testimony greatly overstates the significance of this issue. Over the last 20 years, excluding the Taum Sauk failure (which did not impact customers' rates), AmerenUE has recovered a total of only approximately $14 million in replacement power insurance payments, or an average of less than $1 million per year. The largest single recovery over the 20-year period was approximately $8 million, an amount that is not very material in the context of AmerenUE's overall fuel budget.

Q. Mr. Johnstone focuses on the market in which Noranda operates, arguing that an FAC does not give enough consideration to those markets. How do you respond?

A. Lack of an FAC fails to give sufficient consideration to the need to ensure that AmerenUE has a sufficient opportunity to earn a fair ROE, and has sufficient access to the capital it needs to continue to deliver safe and adequate service to customers at reasonable rates. While we understand Noranda's exposure to market forces, as I have already explained, AmerenUE has substantial exposure to uncontrollable fuel and power markets itself, and finds itself at a distinct disadvantage vis-à-vis other similarly situated rate-regulated utilities (including those with heavy reliance on coal-fired generation) in competing for capital on favorable terms due to its lack of an FAC. Mr. Johnstone's argument is simply that the Commission should keep AmerenUE out of the mainstream of utility regulation because in his view doing so benefits his client.

Q. How does Mr. Johnstone's view of an FAC for AmerenUE square with his statement that customers should pay the costs incurred to provide the service – "no more and no less."

A. That is precisely the point of the Company's FAC – customer rates would reflect, no more and no less – the actual net fuel costs being incurred to serve the customer, subject to the 95%/5% sharing mechanism included in the FAC.

Q. Mr. Cohen, also opposes an FAC for AmerenUE. What is the basic thesis of Mr. Cohen's testimony?

A. Viewing Mr. Cohen's testimony in totality, it is apparent that Mr. Cohen simply objects to any kind of rate adjustment mechanisms, including those authorized by S.B. 179 and twice recently by this Commission, not to mention those authorized by the Commission for Missouri's gas utilities during the last 40 years in the form of the PGA. Indeed, he spends several pages touting the virtues of addressing all costs and revenues using only time-consuming full rate cases, and specifically condemns use of rate adjustment mechanisms as single issue ratemaking. He appears to imply that utilization of a fuel adjustment clause somehow would be outside the mainstream and would be violative of "traditional" regulatory principles, when indeed just the opposite is true, as I have shown in my direct testimony and as this Commission has specifically recognized in all of its FAC orders to date. Given Mr. Cohen's opposition to all adjustment mechanisms, his testimony should not be given serious consideration.

Q. You addressed just how mainstream FACs are in your direct testimony and noted earlier in this testimony that the Commission has recognized the same thing. Do you have any updated information about the widespread use of FACs in utility regulation?

A. Yes. As outlined in my direct testimony, as of the time my direct testimony was filed, there were 85 out of 94 utilities in other non-restructured states that operate with FACs, including 36 of 37 in other Midwestern states and 26 of 27 with a heavy reliance on coal-fired generation, like AmerenUE. Today, only several months since I filed my direct testimony, two more utilities now have FACs,[13] bringing the number to 87 out of 94 outside Missouri. Many of these utilities have operated with FACs for decades.[14] The almost universal prevalence of FACs is also depicted on Schedule MJL–E8, attached to this rebuttal testimony. In addition, attached Schedule MJL-E9 shows these data on two maps, illustrating that the vast majority of electric utilities in other non-restructured states operate under an FAC. As the second map shows, FACs are particularly prevalent in the Midwest and Eastern U.S., including the regions with coal-intensive electric utilities. Even within Missouri, one of the electric utilities without an FAC is Kansas City Power & Light Company, which agreed not to use an FAC through 2010 as part of its Missouri regulatory plan. (Note, however, that KCP&L

[13] These utilities are MDU Resources in Montana and Public Service Company of New Mexico.
[14] As have Missouri's gas utilities, and formerly, Missouri's electric utilities, until a Missouri Supreme Court decision struck down the use of FACs, that is, until S.B. 179 was enacted.

operates under an FAC in Kansas.) Contrary to Mr. Cohen's contentions, the Commission has recognized these facts when it adopted FACs for two of the electric utilities under its jurisdiction, noting that SB 179 has "merely transported Missouri back into the mainstream of utility regulation."[15]

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

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[15] *Empire Order*, p. 34.

Fuel Adjustment Clauses Used by Utilities in Other Non-Restructured[1] States

	Number of Utilities by Jurisdiction	*Number with a FAC*	*Number with FAC Pending*	*Number of Remaining Utilities*	*Percentage with a FAC*	*Percentage with FAC Pending*	*Percentage for Remaining Utilities*
Other Non-Restructured[1] States (Excluding Missouri)	**94**	**87**	**3**	**4**	**93%**	**3%**	**4%**
Neighboring and Other Non-Restructured[1] Midwestern[2] States	**37**	**36**	**0**	**1**	**97%**	**0%**	**3%**
Utilities with More Than 50% Coal Capacity in Neighboring and Other Non-Restructured[1] Midwestern[2] States	**27**	**26**	**0**	**1**	**96%**	**0%**	**4%**
Neighboring and Other Non-Restructured[1] Midwestern[2] States where FAC Approval by Commission is Not Mandatory[3]	**23**	**23**	**0**	**0**	**100%**	**0%**	**0%**
Utilities with More Than 50% Coal Capacity in Neighboring and Other Non-Restructured[1] Midwestern[2] States where FAC Approval by Commission is Not Mandatory[3]	**17**	**17**	**0**	**0**	**100%**	**0%**	**0%**

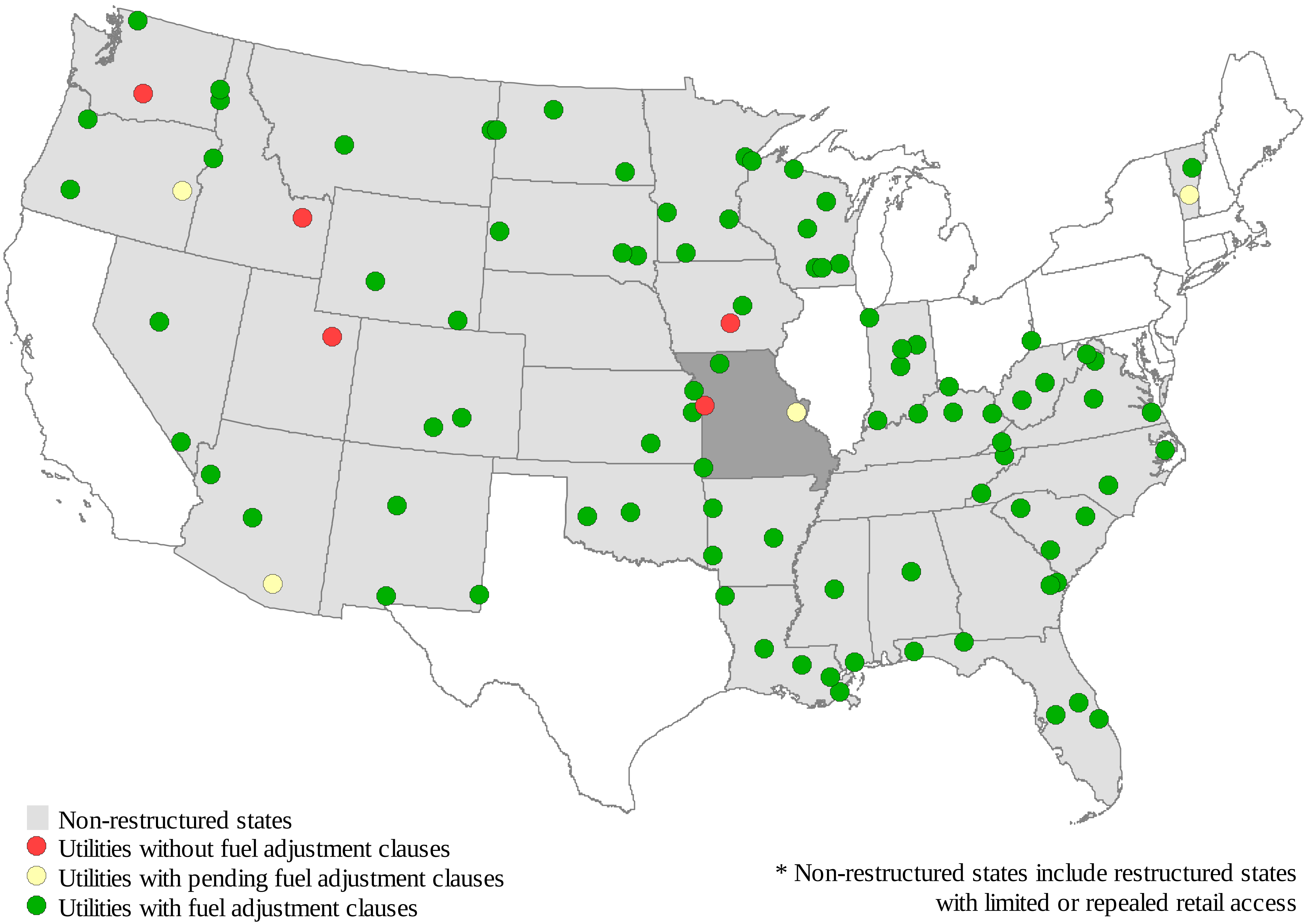
Sources and Notes:

[1]: Non-restructured states include restructured states with limited or repealed retail access.

[2]: Midwestern states based on DOE's definition of East North Central and West North Central: includes IA, IL, IN, KS, MI, MN, MO, ND, NE, OH, SD, and WI.

[3]: Mandatory vs. non-mandatory FAC approval status based on updated 2006 survey.

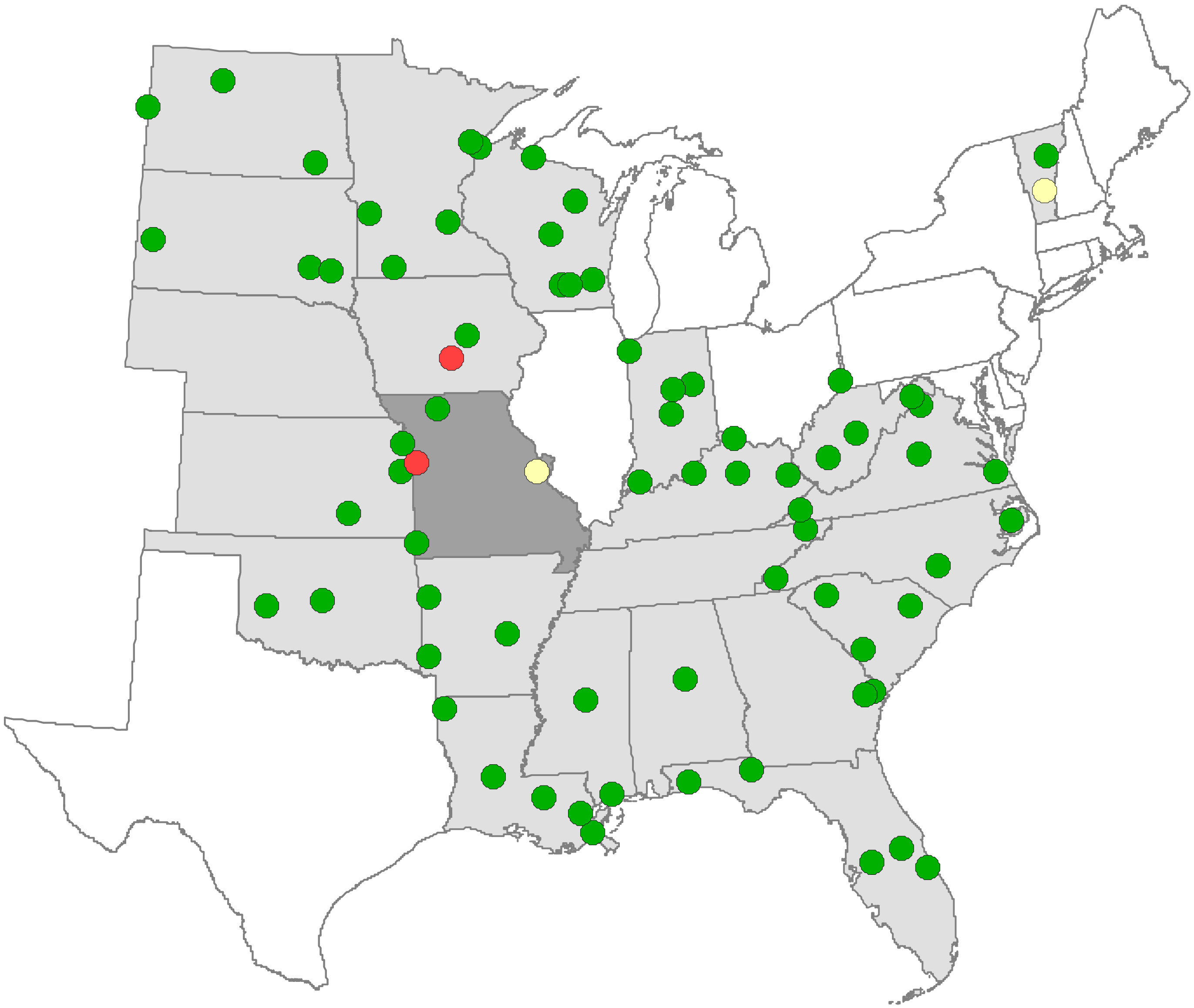
Investor-Owned Utilities in Non-Restructured* States



* Non-restructured states include restructured states with limited or repealed retail access

Schedule MJL-RE9-1

Investor-Owned Utilities in Non-Restructured* States in the Eastern Interconnect



Non-restructured states
Utilities without fuel adjustment clauses
Utilities with pending fuel adjustment clauses
Utilities with fuel adjustment clauses

* Non-restructured states include restructured states with limited or repealed retail access

Schedule MJL-RE9-2

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-2008-0318

AFFIDAVIT OF MARTIN J. LYONS, JR.

STATE OF MISSOURI)
) ss
CITY OF ST. LOUIS)

Martin J. Lyons, Jr., being first duly sworn on his oath, states:

1. My name is Martin J. Lyons, Jr. I work in the City of St. Louis, Missouri, and I am employed by Ameren Corporation, Union Electric Company d/b/a AmerenUE and other Ameren subsidiaries as Senior Vice President and Chief Accounting Officer.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of Union Electric Company d/b/a AmerenUE consisting of 38 pages, and Schedules MJL-RE8 through MJL-RE9, 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.

Martin J. Lyons, Jr.

Subscribed and sworn to before me this 14th day of October, 2008.

Amanda Tesdall
Notary Public

My commission expires:

Amanda Tesdall - Notary Public
Notary Seal, State of
Missouri - St. Louis County
Commission #07158967
My Commission Expires 7/29/2011