EXHIBIT

Exhibit No.:	______
Issue(s):	SO2 Emission Allowance Revenues
Witness/Type of Exhibit:	Kind/Rebuttal
Sponsoring Party:	Public Counsel
Case No.:	EC-2002-1

REBUTTAL TESTIMONY

OF

RYAN KIND

Submitted on Behalf of
the Office of the Public Counsel

UNION ELECTRIC COMPANY

NP

Case No. EC-2002-1

______ Exhibit No. 107 NP
Date 7/10/02 Case No. EC-2002-1
Reporter KEm

May 10, 2002

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION, Complainant,	)	
vs.	)	Case No. EC-2002-1
UNION ELECTRIC COMPANY, d/b/a AmerenUE, Respondent.	)	

AFFIDAVIT OF RYAN KIND

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

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

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

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 38 and Schedules RK-1 through RK-6.

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

Ryan Kind

Ryan Kind

Subscribed and sworn to me this 10th day of May 2002.

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

Kathleen Harrison

Kathleen Harrison
Notary Public

My commission expires January 31, 2006.

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REBUTTAL TESTIMONY

OF

RYAN KIND

UNION ELECTRIC COMPANY D/B/A AMERENUE

CASE NO. EC-2002-1

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

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

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND.

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

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

Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE THIS COMMISSION?

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

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

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

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

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

I. SUMMARY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony will provide Public Counsel's recommendations for:

- A $23,412,500 adjustment to the SO2 emission allowance revenues that should be reflected in the total UE (Missouri and Illinois) cost of service that the Commission uses as the basis for determining the revenue requirement used to set rates in this case, and

- Modifying the authority that the Commission gave UE in Case No. EO-98-401, to manage, within certain limits, its SO2 allowance inventory. This previous grant of authority should be substantially narrowed to ensure that UE does not have blanket authorization that would allow it: (1) to enter into favorable SO2 allowance deals with its affiliates at the expense of ratepayers or (2) to engage in SO2 transactions which are structured and timed in a manner that will prevent the pass through or sharing of SO2 allowance revenues with ratepayers.

Q. PLEASE BRIEFLY EXPLAIN THE BASIS FOR THE ADJUSTMENT TO THE UE SO2 EMISSION ALLOWANCE REVENUES.

A. This adjustment is based primarily on the following factors:

- Normalized SO2 emission allowance sales revenues are based on: (1) those UE SO2 emission allowance transactions for which I recommend imputing revenues during the test year and (2) the SO2 allowance sales that occurred after the UE Experimental Alternative Regulation Plan (2nd EARP) ended on June 30, 2001. Public Counsel only has about 8 months of SO2 allowances sales revenue data for the year beginning July 1, 2001 and we reserve the right to update our recommended adjustment for a normalized level of SO2 allowance transaction revenues after UE provides all of the requested information about SO2 allowance transactions during 2002 that it has thus far refused to provide.

- Ameren's internal documents show that Ameren: (1) gave extensive consideration to the ratemaking implications of making SO2 allowance sales and other transactions during the final two years of the EARP (the second of which is the test period ordered by the Commission in this case) and (2) changed the structure and timing of UE's SO2 transactions during the last year of the EARP in response to ratemaking considerations. Therefore, the level of sales taking place during the test year can not be used without adjustments that impute the amount of SO2 allowance revenues that would have been realized during the year if UE had not manipulated its earnings during the last year of the EARP.

Q. PLEASE SPECIFIY OPC'S RECOMMENDATION TO MODIFY THE AUTHORITY THAT THE COMMISSION GAVE UE IN CASE NO. EO-98-401, TO MANAGE, WITHIN CERTAIN LIMITS, ITS SO2 ALLOWANCE INVENTORY.

A. The authority previously granted to UE to manage, within certain limits, its SO2 allowance inventory should be modified so that:

- Unless UE obtains prior commission to do so, UE is not allowed to engage in SO2 transactions that generate more revenues annually than the level of SO2 allowance transaction revenues that are reflected in the revenue requirement and rates that the Commission approves in this case, and

- UE no longer has authority to engage in any type of SO2 transactions with affiliated entities without prior Commission approval.

Q. PLEASE BRIEFLY EXPLAIN THE BASIS FOR PUBLIC COUNSEL'S RECOMMENDATION THAT THE COMMISSION MODIFY THE AUTHORITY THAT IT GAVE UE IN CASE NO. EO-98-401, TO MANAGE, WITHIN CERTAIN LIMITS, THE COMPANY'S SO2 ALLOWANCE INVENTORY.

A. This recommendation is based primarily upon the following factors:

- Ameren's internal documents show that Ameren: (1) gave extensive consideration to inappropriate factors including the ratemaking implications of making SO2 allowance sales and other transactions during the final two years of the EARP (the second of which is the test period ordered by the Commission in this case) and (2) changed the quantity, magnitude, structure and timing of the SO2 transactions during the last year of the EARP in response to ratemaking considerations and other inappropriate considerations.

- Ameren's internal documents show that Ameren: (1) gave extensive consideration to determining how a substantial number of UE's emission allowances could be transferred to Ameren's unregulated generation affiliate, Ameren Energy Generating Company (AEG), in a manner that provided the greatest financial benefit to UE's holding company, Ameren, rather than transferring allowances in a manner that would provide the greatest financial benefit to UE and (2) changed the structure and timing of the SO2 transactions with its affiliate, AEG, during the last year of the EARP in response to considerations of the financial interest of Ameren and its subsidiary AEG, rather than UE.

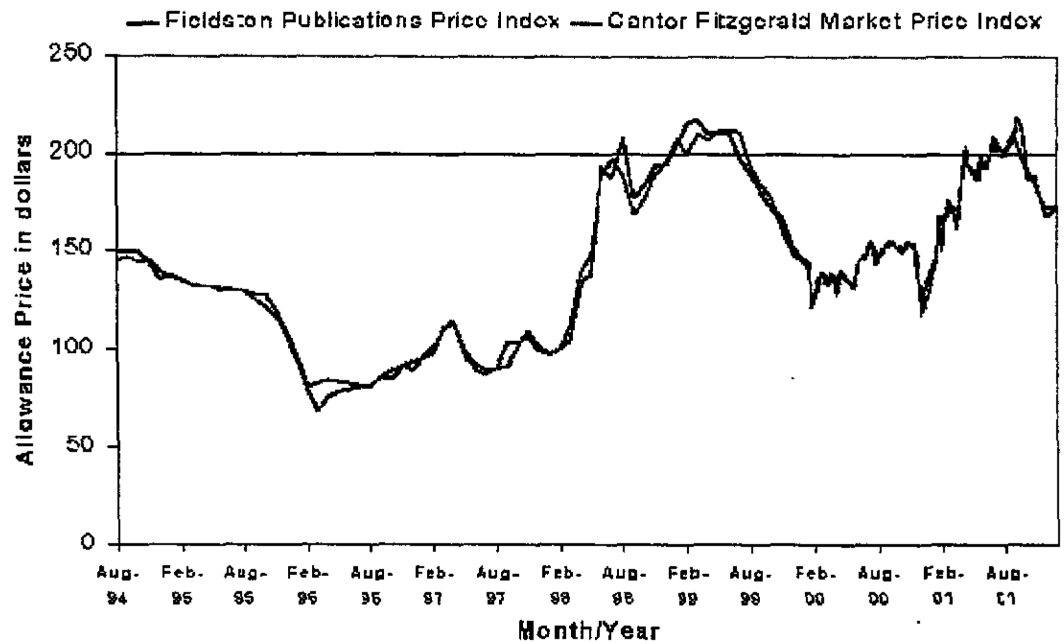
- Ameren entered into an agreement on April 29, 2002 to acquire another Illinois electric utility, Cilcorp Inc. Like the last Illinois utility that Ameren acquired, CIPS, Cilcorp has a significant amount of coal generating capacity (1100 MW) that will have an ongoing need for SO2 emission allowances. If the Commission prohibits SO2 allowance transactions between UE and its affiliates without prior Commission approval, it will eliminate the opportunity for UE to enter into "sweetheart" SO2 allowance deals with this Illinois utility that now appears likely to become a new UE affiliate.

- When the Commission granted UE limited authority to manage its SO2 allowance inventory several years ago, it was not anticipated that the manner in which Ameren managed the UE SO2 allowance inventory would be strongly driven by ratemaking and affiliate transactions considerations that were intended to benefit shareholders at the ratepayers expense.

Q. PLEASE EXPLAIN WHY YOU BELIEVE THAT THE AMOUNTS OF REVENUES FROM SO2 TRANSACTIONS REFLECTED IN TEST YEAR SHOULD BE GIVEN CLOSE SCRUTINY.

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

Figure 1 - Historical SO2 Emission Allowance Market Price Data



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

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

Q. IS OPC'S ASSERTION IN CASE NOS. EM-96-149 AND EC-2002-1059 THAT UE MANIPULATED THE EARNINGS RELATED TO ITS SO2 ALLOWANCE TRANSACTIONS UNDER THE EARP RELATED TO THE ADJUSTMENT THAT OPC IS PROPOSING IN THIS CASE?

A. Yes. UE's purposeful manipulation of earnings related to SO2 allowance transactions under the EARP has caused the unadjusted test year historical data about revenues related to SO2 allowance transactions during the test year to be entirely unrepresentative of the level of SO2 transactions revenue that would be expected in a typical year.

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

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

Q. CAN YOU PROVIDE A GRAPH THAT ILLUSTRATES HOW THE PATTERN OF UE'S SO2 TRANSACTIONS CHANGED ONCE THE EARP ENDED AND UE KNEW THAT ITS SHAREHOLDERS MIGHT BE ABLE TO RETAIN 100% OF THE EARNINGS FROM EMISSION ALLOWANCE TRANSACTIONS?

A. Yes. Please see Schedule RK-6.

II. BACKGROUND INFORMATION REGARDING FEDERAL ENVIRONMENTAL REGULATION OF SO2 EMISSIONS.

Q. BEFORE TURNING TO A MORE COMPLETE EXPLANTION OF THE BASIS FOR PUBLIC COUNSEL'S RECOMMENDATIONS REGARDING THE NORMALIZED LEVEL OF SO2 EMISSION ALLOWANCE REVENUES TO INCLUDE IN THE UE COST OF SERVICE, PLEASE PROVIDE SOME BACKGROUND INFORMATION ABOUT THE FEDERAL ENVIRONMENTAL LAWS THAT CAUSED UE TO RECEIVE AN ANNUAL ALLOCATION OF SO2 EMISSION ALLOWANCES.

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

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

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

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

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

A. Ameren estimated the market value of UE's emission allowance inventory during the test year to be approximately ** **

III. BACKGROUND INFORMATION REGARDING PSC OVERSIGHT OF UE'S SO2 EMISSION ALLOWANCE TRANSACTIONS.

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

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

Q. HOW DID THIS COMMISSION FIRST GET INVOLVED IN OVERSEEING UE'S SO2 EMISSIONS ALLOWANCES TRANSACTIONS?

A. On March 23, 1998, UE filed an application with the Commission wherein it sought authorization to manage its SO2 emission allowance inventory. On December 15, 1998 the Commission issued an order approving a Stipulation and Agreement which granted UE limited authority to manage its SO2 allowance inventory.

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

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

> 1. AmerenUE will have the authority to manage its allowance inventory, with the restrictions discussed below. The Staff and the Office of Public Counsel reserve the right to reexamine and modify their positions respecting the Commission granting AmerenUE the authority to manage its sulfur dioxide emission allowance inventory, when the New Experimental Alternative Regulation Plan resulting from the Union Electric Company- CIPSCO, Inc. merger Case No. EM-96-149 expires on June 30, 2001. Any profits or losses that are realized from the sales or any other transactions associated with allowances, will be booked to utility operating income according to generally accepted accounting principles. **The regulatory treatment of these profits and losses as well as the prudence of any allowance transaction is subject to review and adjustment as part of any audit and/or examination in a future sharing calculation or future rate case.** (emphasis added)
>
> 2. **The Company is authorized to manage the entire allowance inventory, but may sell only up to one-half of all Phase I allowances without seeking specific Commission approval.** This includes sales to AmerenCIPS and other utilities. AmerenUE may request authorization to sell additional allowances, above this level, through a filing with the Commission. (emphasis added)
>
> 3. Sales in combination with other transactions, such as power contracts, are also authorized as a portion of the level discussed above. However, the Company must book a profit from the sale of the allowances at least equal to the current market value as established by the monthly price index published by Cantor Fitzgerald Environmental Brokerage Service. Should either the Staff, the Office of the Public Counsel or the Company wish to use a different index for this purpose in the future, notice will be given to the other parties and all parties will negotiate in good faith to agree on a substitute. The Commission will be asked to resolve the matter if no agreement is reached in a reasonable time period.
>
> 4. The Company will be required to provide detailed reporting of all the transactions involving allowances once each year. The reporting date will be August 31 for the previous twelve months ending on June 30. The database to support allowance transactions and inventory balances will be maintained and available to the Staff upon request during the year.

Q. THE LAST SENTENCE OF THE FIRST ITEM IN THE ABOVE STIPULATION AND AGREEMENT CONCERNS THE RATEMAKING TREATMENT ASSOCIATED WITH THE ALLOWANCE TRANSACTIONS THAT WERE PERMITTED BY THE COMMISSION'S ORDER IN CASE NO. EO-98-401. HOW DOES THAT SENTENCE IMPACT THE SO2 ALLOWANCE REVENUE ADJUSTMENT THAT PUBLIC COUNSEL IS PROPOSING?

A. Counsel advises me that that sentence indicates that the Commission's decision in Case No. EO-98-401 to permit UE certain flexibility to engage in SO2 allowance sales and otherwise manage its SO2 allowance inventory preserved for a later date any Commission determinations regarding the ratemaking treatment of UE's SO2 allowance transactions. From a layman's perspective, the statement in the stipulation that:

> The regulatory treatment of these profits and losses as well as the prudence of any allowance transaction is subject to review and adjustment as part of any audit and/or examination in a future sharing calculation or future rate case.

appears to be very straightforward and self-explanatory in its applicability to this general rate proceeding.

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

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

Q. ARE YOU AWARE OF ANY ADDITIONAL COMMISSION ORDERS THAT PERTAIN TO UE'S MANAGEMENT OF ITS SO2 ALLOWANCE INVENTORY?

A. Yes. Section 7 of the Stipulation and Agreement approved by the Commission in Case No. EM-96-149 contains terms that the parties agreed to regarding the New Experimental Alternative Regulation Plan (2nd EARP). Attachment C to the Stipulation and Agreement contains additional details about implementation of the 2nd EARP. Item 2.a. on page 1 of Attachment C states that:

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

Q. PLEASE EXPLAIN THE SIGNIFICANCE OF THE COMMISSION'S ORDERS IN THE TWO CASES DISCUSSED ABOVE, CASE NOS. EO-98-401 AND EM-96-149 TO THE SO2 ALLOWANCE REVENUES ADJUSTMENT THAT OPC IS RECOMMENDING IN THIS CASE.

A. The Commission order in Case No. EO-98-401 gave UE limited flexibility to engage in SO2 transactions while preserving Commission ratemaking treatment of the transactions until future rate cases or cases where sharing calculations are made in the context of the second EARP. The Commission order in Case No. EM-96-149 provided the guideline that allowance sales "shall be reflected above-the line in the ROE calculation." While the Commission's order in Case No. EO-98-401 explicitly preserved the Commission's authority to make future determinations regarding the prudence and ratemaking treatment for UE's allowance transactions, the second order gave UE specific guidance about how it should report allowance transactions to the Commission when it filed its earnings reports under the EARP.

Regrettably, UE and its affiliates within the Ameren holding company structure reacted to the signal that the proceeds from allowance transactions would have to be shared with consumers in accordance with the sharing grid set forth in the EARP by altering their decisions about the magnitude, type, and timing of its SO2 allowance transactions while the EARP was still in effect. In addition to reacting to the ratemaking incentives under the EARP in their decisions regarding allowance transactions, UE and its affiliates were guided by other improper considerations including: (1) the present and potential future needs of UE's non-regulated affiliates for SO2 emission allowances and (2) the impact that allowance transactions between UE and its affiliates would have on the financial performance of UE's unregulated affiliates and the overall financial performance of Ameren.

IV. IMPACT OF THE AMEREN HOLDING COMPANY STRUCTURE ON THE AMEREN AND UE DECISIONS REGARDING UE'S SO2 ALLOWANCE TRANSACTIONS.

Q. DOES THE AMEREN HOLDING COMPANY AND MANAGEMENT STRUCTURE PROVIDE AMEREN AND UE WITH GREATER MOTIVATION TO PURSUE IMPROPER OBJECTIVES IN THE MANAGEMENT OF SO2 ALLOWANCES AND IN OTHER AREAS THAN WOULD EXIST IF UE WAS A "STAND ALONE" REGULATED UTILITY?

A. Yes, I believe so.

Q. PLEASE EXPLAIN.

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

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

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

A. No. The achievement of outstanding operating results by UE that came at the expense of its affiliates or the overall financial performance of Ameren would not be expected to occur unless the senior management of Ameren was ineffective at pursuing its fiduciary responsibilities to the holding company shareholders. An effective management at the holding company level would be certain to communicate the overriding importance of the holding company's financial performance to UE's senior management and hold them accountable for not achieving good financial operating results at the UE level that come at the expense of the holding company's performance.

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

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

V. UE DOCUMENTS REGARDING SO2 ALLOWANCE TRANSACTION STRATEGIES

Q. WHAT IS THE BASIS FOR YOUR EARLIER STATEMENT THAT "UE AND ITS AFFILIATES WITHIN THE AMEREN HOLDING COMPANY STRUCTURE REACTED TO THE SIGNAL THAT THE PROCEEDS FROM ALLOWANCE TRANSACTIONS WOULD HAVE TO BE SHARED WITH CONSUMERS IN ACCORDANCE WITH THE SHARING GRID SET FORTH IN THE EARP BY ALTERING THEIR DECISIONS ABOUT THE MAGNITUDE, TYPE, AND TIMING OF ITS SO2 ALLOWANCE TRANSACTIONS WHILE THE EARP WAS STILL IN EFFECT?"

A. This statement is based on documents discovered by Public Counsel during the audit that it performed as part of this case and the audit to assess the earnings report that UE submitted for the last sharing period of the second EARP. Those audits found evidence that UE had manipulated its earnings related to SO2 transactions during the last sharing period of the second EARP. The year covered by this sharing period, July 1, 2000 through June 30, 2001, is the same year as the test year ordered by the Commission in this case. The manipulation of SO2 allowance earnings that Public Counsel observed during the sharing period was one of the factors that led Public Counsel to file a complaint (Case No. EC-2002-1059) regarding the earnings information that UE submitted in the final sharing period of the second EARP.

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

A. Yes.

Q. HAVE YOU REVIEWED DOCUMENTS AS PART OF YOUR AUDIT OF UE FOR THE SHARING CASE AND FOR THIS COMPLIANT CASE THAT LEAD YOU TO BELIEVE THAT AMEREN CONSIDERED THE POSSIBILITY OF GETTING UE'S GENERATION ASSETS REMOVED FROM MISSOURI RATEMAKING JURISDICATION ALONG WITH THE EMISSION CREDITS ASSOCIATED WITH UE'S GENERATION ASSETS IN ITS DECISIONS ABOUT THE MAGNITUDE, TYPE, OR TIMING OF SO2 TRANSACTIONS THAT IT WOULD MAKE DURING THE TEST YEAR?

A. Yes.

Q. HAVE YOU REVIEWED DOCUMENTS AS PART OF YOUR AUDIT OF UE FOR THE SHARING CASE AND FOR THIS COMPLIANT CASE THAT LEAD YOU TO BELIEVE THAT AMEREN CONSIDERED THE POTENTIAL FOR USING UE'S ** ** BANK OF EXCESS ALLOWANCES TO COVER ONGOING OR FUTURE DEFICITS IN THE AMOUNT OF ALLOWANCES NEEDED AT AMEREN'S NON-REGULATED POWER PLANTS IN ITS

DECISIONS ABOUT THE MAGNITUDE, TYPE, OR TIMING OF SO2 TRANSACTIONS THAT IT WOULD MAKE?

A. Yes. Documents that I have reviewed indicate that Ameren is interested in utilizing UE's ** ** bank of SO2 allowances to help it comply with environmental regulations at its existing non-regulated power plants and at new non-regulated plants that are under consideration.

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

A. There are two types of Ameren documents that revealed the extent to which UE and Ameren altered their decisions about the quantity, magnitude, type, and timing of its SO2 allowance transactions while the EARP was still in effect. The first type are the Ameren documents that described and analyzed the allowance trading strategies that Ameren could utilize. The second type of documents are those that document and summarize the transactions that took place over the last few years. I will discuss the second type of documents which summarize the transactions that took place over the last few years in a later section.

The first document that I will discuss is a copy of the minutes from the December 15, 2000 meeting of the Ameren Risk Management Steering Committee. It should be noted that members of the Senior Management of Ameren are members of, and participate in, meetings of the Ameren Risk Management Steering Committee. A portion of the minutes from the December 15, 2000 meeting that pertain to the management of Ameren's SO2 allowance inventory (the vast majority of allowances in the Ameren SO2 inventory belong to UE) are as follows:

> Risk Management pointed out how our current strategies will not prevent a fall in value over time of the [SO2 emission allowance] portfolio from around $ ** ** now to an expected $ ** ** in 2010. Suggested establishing a lower sharing number with ratepayers via legislature or regulators or getting credits as deregulated asset before 2005; Risk Management was unsure of the feasibility of these solutions.

A couple of items stated in the above quoted minutes require an explanation. The reference to an expected fall in value resulting from Ameren's current strategies of managing its UE SO2 allowance inventory is a reference to UE's failure to monetize the value of a substantial portion of its allowances through sales or other transactions even though the market value of these allowances was generally expected to fall sharply between 2005 and 2010. The reference to "getting credits as deregulated asset before 2005" was probably a reference to the Genco bill that Ameren was preparing to push in the Missouri Legislature during the next few months following the December meeting. The Genco bill that was written and promoted by Ameren would have facilitated the transfer of "generation plant and generation-related assets to an affiliated entity at historical net book value" with very little review by the PSC. The "generation-related assets" would have included SO2 emission allowances. This bill would have allowed Ameren to transfer UE's inventory of excess emission allowances to an unregulated affiliate at a "historical net book value" of $0 rather than the market value of $ ** ** million that Ameren references in the quote above.

Q. DOES THE ABOVE QUOTE FROM THE MINUTES OF THE DECEMBER 15, 2000 MEETING INDICATE THAT AMEREN BELIEVES THAT STRUCTURE OF THE SECOND EARP PROVIDED A DIS-INCENTIVE FOR AMEREN TO MANAGE UE'S SO2 ALLOWANCE INVENTORY IN THE MANNER THAT AMEREN BELIEVED WOULD MAXIMIZE ITS MONETARY VALUE?

A. Yes, it clearly does. There is no other explanation for Ameren's senior managers to be discussing how it would like to establish "a lower sharing number ratepayers via legislature or regulators or getting credits as deregulated asset before 2005." This statement in the minutes shows that under the terms of the second EARP, Ameren was reluctant to engage in SO2 transactions that would increase UE's earnings since a significant portion of UE's earnings must be shared with UE's Missouri ratepayers.

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

A. A December 20, 1999 memo from Dan Lidisky to Mike Mueller (the current Vice-President of Ameren Energy Fuels and Services) is attached as Schedule RK-1 and most of this memo appears below:

> Fossil Fuels assumed responsibility of the SO2 account from a procurement/trading and hedging perspective in October 1999. Corporate Planning and Environmental still are responsible for Ameren's environmental compliance strategies and corporate compliance.
>
> AmerenUE is allowed to market, subject to MPSC review, up to one half of the Phase I allowance credits under an order approved by the MPSC. Up until this year Ameren had not sold allowances in the program, in 1999 Ameren sold ** ** allowances and two call options contracts generating revenues of ** ** The call options expired out of the money and were not exercised.
>
> Going forward AmerenCIPS will be ** ** annually, with AmerenUE ** ** If we do nothing, we would eventually eat into the bank by transferring at the market credits from the AmerenUE to the GENCO. ** **The asset is on the books on a zero cost basis and with the AmerenUE incentive plan shareholders will only at best will be receiving half of the earnings.** Nonetheless, we just recently have been given the authority to take a more active roll in the hedging and trading of SO2 allowances and are developing a revised risk management policy to address these changes. (emphasis added)

The third paragraph of the memo quoted above shows that Ameren believed that because of the "regulated" nature of AmerenUE's emission allowances, "the incentive to sell or trade them is reduced." This same paragraph also shows that the terms of sharing earnings under the EARP had a negative impact on Ameren's motivation to engage in transactions that yielded increased earnings during the EARP where it states that "with the AmerenUE incentive plan shareholders will only at best will be receiving half of the earnings." This document shows that possible PSC ratemaking treatment of UE allowances had an impact on Ameren's decisions about the magnitude, type, and timing of UE's SO2 transactions.

The third paragraph in the quote above indicates that Ameren was going to move forward with additional SO2 allowance transactions while keeping ratemaking considerations in mind as it chose the type and structure of SO2 allowance transactions that it would pursue. The written testimony that follows will describe and analyze the allowance transactions that UE chose to engage in during the test year (the same year as the final sharing period of the second EARP) and point out the transactions and transaction terms that were driven by ratemaking considerations.

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

A. An October, 2000 document written by Jim Moore entitled "AmerenEGC SO2 Emission Allowance ** ** " is attached as Schedule RK-2. This document discussed three options that Ameren was considering for addressing the AmerenEGC (AEG) SO2 emission allowance ** ** The reference to "AmerenEGC" is a reference to the non-regulated generation subsidiary of Ameren that owns the coal plants that were part of

AmerenCIPS prior to deregulation in Illinois. This document describes several options that Ameren considered for addressing ** ____________________ ** The three options discussed in the document all depended on getting access to UE's excess emission allowances for use by AEG. In the document, Mr. Moore recommended the "Allowance Loan" option, but a handwritten note on the second page of the document indicates that "after meeting with Gary Rainwater, Warner Baxter, Connie Seabaugh, Tony Artman, Steve Whiteworth, Mike Mueller, and Dan Lidisky, it was decided to pursue the vintage swap." Three of the individuals listed in the handwritten note, Gary Rainwater, Warner Baxter, and Mike Mueller are senior corporate officers of Ameren. A couple paragraphs from this document pertaining to ratemaking considerations appear below:

> <u>**Allowance Sale**</u>
>
> The year 2000 budget included a line item to sell UE allowances to EGC at a market price. This sale would be done at current market prices and would cost EGC [AEG] about $ ** ___ ** million. **Taxes would take about 40% and what is left would go into the Missouri Alternative Regulation Plan.** (emphasis added)
>
> <u>**Vintage Swap**</u>
>
> ...
>
> The Tax department has indicated that this is considered a like kind exchange and has no income tax considerations if the exchange is done at market prices. The problem with a vintage swap is that the market is not very liquid and it is difficult to determine what the market prices for the later vintages are. ** ** **However, if UE generation is deregulated and moved into EGC sometime in the next few years,** ** ** (emphasis added)

The two paragraphs quoted above indicate that Ameren considered the ratemaking considerations associated with both the "Allowance Sale" and the "Vintage Swap" options for ** ** The paragraph that describes the ratemaking implications of the "Allowance Sale" option describes the strong regulatory disincentives that Ameren perceived for pursuing the "Allowance Sale" option where it notes that the after-tax earnings associated with the sale would "go into the Missouri Alternative Regulation Plan" where as much as 90% of the earnings would have to be returned to ratepayers through sharing credits.

The paragraph that describes the ratemaking implications of the "Vintage Swap" option notes that one of the main problems associated with this option of **

** The ultimate adverse impact of this disadvantage is, however, discounted where the memo notes that "however, if UE generation is deregulated and moved into EGC sometime in the next few years, **

** " and that if this deregulation occurs " **

** " Earlier in this testimony, I described the Ameren Genco legislative initiative in Missouri which was already underway at the time this memo was written. Ameren's senior management ultimately endorsed the "Vintage Swap" alternative for addressing **

** Later in this testimony, I explore the specific ratemaking implications of that choice on the test year and make recommendations to address the manipulation of earnings that resulted from Ameren's decision to consummate a "Vintage Swap" between two of its affiliates rather than the other options that AEG had ** **

Q. ALL OF THE DOCUMENTS REFERENCED ABOVE REFER TO THE DIS-INCENTIVE THAT AMEREN BELIEVED IT HAD TO ENGAGE IN EARNINGS-CREATING SO2 TRANSACTIONS WITH UE'S ALLOWANCE INVENTORY SO LONG AS THE INCENTIVE PLAN REMAINED IN EFFECT. HOW MANY OF UE'S SO2 ALLOWANCES WERE SOLD DURING THE FINAL SHARING PERIOD OF THE SECOND EARP ?

A. **

** the proceeds from this sale were pushed forward to a date beyond the sharing period. I will provide additional details on this one sale that took place during the test year as well as information on the sales that occurred between July 1, 2001 and the end of February in 2002 in later sections of this testimony.

Q. THE "AMERENEGC SO2 EMISSION ALLOWANCE ** ** " DOCUMENT THAT YOU DISCUSSED ABOVE INDICATED THAT AMEREN INTENDED TO UTILIZE UE'S EXTENSIVE BANK OF SO2 ALLOWANCES TO HELP IT COMPLY WITH ENVIRONMENTAL REGULATIONS AT ITS EXISTING NON-REGULATED COAL POWER PLANTS. HAVE YOU REVIEWED ANY OTHER DOCUMENTS AS PART OF YOUR AUDIT OF UE FOR THIS SHARING CASE THAT LEAD YOU TO BELIEVE THAT AMEREN WAS INTERESTED IN UTILIZING UE'S ** ** BANK OF SO2 ALLOWANCES TO HELP IT COMPLY WITH ENVIRONMENTAL REGULATIONS AT NEW NON-REGULATED COAL PLANTS THAT WERE UNDER CONSIDERATION BY AMEREN?

A. Yes. A 3/11/99 memo from Rick Voytas to Daniel Cole (the current President of Ameren Energy Resources) indicated that preserving some of UE's excess allowances for possible future use at new non-regulated Ameren coal plants was one of the factors considered by Ameren in its decisions about the magnitude, type, or timing of SO2 transactions that it would make on behalf of UE. In this memo, Mr. Voytas states that:

> In December 1998, we received MPSC approval to "manage" up to 50% (approximately 400,000 tons) of AmerenUE's SO2 allowance bank. The initial strategy was to sell as much of the allowances as possible within 3 years without impacting the market price.
>
> Several changes have taken place since the initial strategy development. ...Third, **there are new Ameren business proposals in unregulated coal businesses that may need a source of SO2 allowances.** (emphasis added)

The statement that "there are new Ameren business proposals in unregulated coal businesses that may need a source of SO2 allowances" shows that one of the reasons that Ameren altered its initial strategy of "sell[ing] as much as of the allowances as possible within 3 years without impacting the market price" was to be prepared for a higher Ameren-wide need for SO2 allowances because it was considering the needs of Ameren's unregulated operations that would increase Ameren's need for SO2 emission allowances.

Q. DO YOU BELIEVE IT WAS APPROPRIATE FOR AMEREN TO CONSIDER ITS "NEW AMEREN BUSINESS PROPOSALS IN UNREGULATED COAL BUSINESSES THAT MAY NEED A SOURCE OF SO2 ALLOWANCES" IN ITS DETERMINATION OF HOW TO MANAGE UE'S SO2 ALLOWANCE INVENTORY?

A. No. Ameren's needs for emission allowances to help further the objectives of its unregulated coal businesses should never have played a part in its decisions about how UE could best utilize its bank of excess allowances to further UE's public service obligations of providing safe and adequate service at just and reasonable rates. Considering the needs of Ameren's unregulated business when deciding how to best manage UE's emission allowance inventory was a flagrant example of affiliate abuse. Unfortunately, such instances of affiliate abuse are not surprising when you have the perverse incentives arising from the holding company corporate structure that was discussed towards the beginning of this testimony. How can one expect the senior management of UE to shepherd the interests of UE when the senior managements of UE and Ameren are one and the same?

VI. OPC'S RECOMMENDED ADJUSTMENTS ASSOCIATED WITH THREE KEY SO2 ALLOWANCE TRANSACTIONS OCCURING DURING THE TEST YEAR BUT NOT REFLECTED IN TEST YEAR SO2 ALLOWANCE REVENUES

Q. WHAT DID UE'S BOOKS SHOW FOR TEST YEAR EMISSION ALLOWANCE REVENUES?

A. UE's books indicated that the Company recognized $945,859 in emission revenues during the test year of which $912,216 was allocated to the Missouri jurisdiction.

Q. DID THE COMMISSION STAFF MAKE ANY ADJUSTMENT TO THE $912,216 FIGURE FOR SO2 EMISSION ALLOWANCE REVENUES AS PART OF THE ADJUSTMENTS THAT THEY MADE WHEN THEY FILED AN OVER-EARNINGS COMPLAINT IN CASE NO. EC-2002-1?

A. No, its my understanding that the Staff made no adjustments to UE's figures for SO2 allowance revenues and that the Staff did not perform an extensive evaluation of UE's SO2 emission allowance transactions during the test year.

Q. PLEASE SUMMARIZE THE ADJUSTMENTS THAT THAT PUBLIC COUNSEL BELIEVES SHOULD BE MADE TO UE'S TEST YEAR SO2 EMISSION ALLOWANCE TRANSACTION REVENUES.

A. Public Counsel recommends adjusting the earnings report filed by UE to reflect an additional $27,695,500 in revenues associated with SO2 emission allowance transactions. As I stated earlier, this includes the following three adjustments:

1) ** ** for a "vintage swap" transaction that took place on 1/22/01. Allowances for vintage years ** ** were transferred to UE's affiliate, Ameren Energy Generating Company (AEG) while AEG transferred allowances with vintages of ** ** to UE. OPC recommends imputing $ ** ** in allowance sales revenues for the test year to rectify this manipulation.

2) ** ** in revenues for a "forward sale" entered into on 3/13/01. The payable date for the sale proceeds was pushed forward outside the test year and

update period to 10/10/01. OPC recommends imputing UE's allowance sales revenues for the test year by $ ** ** to rectify this manipulation.

3) ** ** in revenues from the premium associated with a call option contract entered into on 11/3/00. The payable date for the premium was pushed forward outside the test year and update period to 10/10/01. OPC recommends imputing UE's allowance options sales revenues for the test year by $ ** ** to rectify this manipulation.

Q. PLEASE EXPLAIN PUBLIC COUNSEL'S RATIONALE FOR THE FIRST ADJUSTMENT RELATED TO THE ** ** "VINTAGE SWAP" TRANSACTION THAT TOOK PLACE ON 1/22/01.

A. Public Counsel recommends treating this swap as if it were a straight forward sale because the Ameren documents that were described and discussed earlier in this testimony provide a compelling case to show that Ameren structured UE's emission allowance transactions in a way that would best serve the overall financial and strategic interests of Ameren, not UE. Specifically, the documents described and discussed above that support this adjustment are:

- Minutes from the December 15, 2000 meeting of the Ameren Risk Management Steering Committee which noted that Ameren's current strategies of managing UE's allowance inventory were inadequate to prevent a decline in the value of the UE allowance inventory over time. These minutes noted that changes in the sharing proportions that would allow shareholders to retain a greater portion of transaction earnings should be made to remedy the problem. The clear implication was that transactions like straight forward sales, as opposed to swaps, which monetize the stored value of allowances and return it to ratepayers will **not** be emphasized so long as an alternative regulation plan with the current sharing grid was in place.

- A December 20, 1999 memo from Dan Lidisky to Mike Mueller regarding Ameren's SO2 inventory management and transactions strategies which noted that the **regulated** nature of the UE allowances reduces the incentive to sell or trade them. This memo refers specifically to the UE alternative regulation plan only allowing shareholders to receive, at most, half of the earnings from SO2 transactions. Under the traditional regulation that Ameren returned to at the conclusion of the EARP on July 1, 2001, Ameren can keep 100% of the allowance transaction earnings until some level of SO2 allowance earnings revenues are reflected in its rates (as a reducing factor) at the conclusion of a general rate proceeding.

- The October, 2000 document written by Jim Moore entitled "AmerenEGC SO2 Emission Allowance ** ** " which cited the financial disadvantages, from an "Ameren perspective," of providing UE's allowances to AEG through a straightforward sale instead of a vintage swap. This document also noted that the deregulation of UE's generation assets would transfer UE's allowance inventory to AEG and ** **

Q. HAVE YOU REVIEWED ANY ADDITIONAL AMEREN DOCUMENTS THAT SUPPORT PUBLIC COUNSEL'S RECOMMENDATION OF TREATING THIS VINTAGE SWAP AS IF IT WERE A SALE FOR RATEMAKING PURPOSES IN THIS COMPLAINT CASE?

A. Yes. One of the documents that UE provided to Public Counsel in discovery responses was a printout from a spreadsheet (see Schedule RK-3) that analyzed the UE/AEG vintage swap transaction. This spreadsheet looked at the value of the transaction in terms of the forward price curve for emission allowances. The forward price curve at the time of the transaction showed that the vintage ** ** allowances that UE would receive from AEG in return for its vintage ** . ** allowances had a much lower market value than the earlier vintage allowances that AEG was obtaining. **

**

Ameren's analysis indicated that UE's expected net gain on this $ ** ** transaction, prior to taking into account the time value of money, was only $12,600. I can not recall ever seeing a utility that voluntarily entered into a high risk $** ** transaction that was only expected to yield $12,600. The reason why Ameren chose the swap over the superior financial results that it could have achieved from a sale can only be explained by the affiliate relationship between UE, AEG, and the holding company, Ameren, that owns both of the affiliates involved in the transaction.

In addition to the quantitative analysis that the spreadsheet contained, it also noted "several ways to look at the soft margin on this transaction." Several of the ways that Ameren believed this transaction could be viewed must be brought to the Commission's attention because, in addition to the other three documents referenced above, they help complete the picture of why UE and Ameren chose to enter into a "vintage swap" with one of Ameren's affiliates, AEG, instead of a straight forward sale. The document stated that the ways that this transaction could be viewed included:

- "AmerenEGC saved the $ ** ** million they had budgeted to spend on allowances in 2000."

- "Ameren Corp saved about $ ** ** million they would have paid in year 2000 taxes if AmerenUE sold the tons to AmerenEGC."

- **"Ameren Corp saved about $ ** ** million that would have gone to ratepayers if AmerenUE sold the tons to AmerenEGC."** (emphasis added)

- "AmerenEGC saved the $ ** ** million they had budgeted to spend on allowances in 2000 – 2002."

- "Ameren Corp saved about $ ** ** million they would have paid in year '00, '01, and'02 taxes if AmerenUE had sold the tons to AmerenEGC."

While all of the Ameren "ways to look at the soft margin on this transaction" quoted above are troubling, the third bullet which explicitly examines the benefits that Ameren and UE would achieve by manipulating the sharing plan earnings report through engaging in a swap between affiliates, instead of a straight forward sale, is the most troubling. This statement shows that Ameren examined the impact that the vintage swap transaction would have from an Ameren-wide perspective and took the action that would most benefit its shareholders, even though Ameren recognized that UE ratepayers would be harmed from the reduction in their sharing credits.

Q. WHEN SOMEONE ENTERS INTO A VINTAGE SWAP TRANACTION, DO THEY USUALLY GET MORE ALLOWANCES IN RETURN THAN THE QUANTITY THAT THEY TRANSFERRED IN THE SWAP?

Q. Yes. The party that transfers away SO2 allowances with vintages that are useable immediately (in this case, UE) usually gets extra allowances in return as interest to compensate them for the time value of money and sometimes due to the expectation that the allowances received in return that aren't usable for several years (due to the vintage) have a lower market value. When UE entered into a vintage swap transaction with its affiliate, AEG, it received ** ** % more allowances in return than the allowances that it gave up. This is sometimes referred to as a ** ** % swap interest rate.

Q. HOW DID THE SWAP INTEREST RATE THAT UE OBTAINED FROM ITS TRANSACTION WITH AEG COMPARE TO THE INTEREST RATE THAT UE WAS RECEIVING ON COMPRABLE SWAP TRANSACTIONS THAT WERE TAKING PLACE AT THE SAME TIME?

A. The analysis that I have performed of comparable swap transactions that UE engaged in during the same time period as the AEG swap (see Schedule RK-4) showed that UE accepted a much lower swap interest rate from its affiliate than its was obtaining in swaps with non-affiliated entities. The average swap interest rate that UE obtained in swaps with non-affiliated entities at the time of the AEG transaction was ** ** %. The swap interest rate associated with the AEG transaction was only ** ** %. This additional evidence that Ameren and UE were more concerned about the financial well being of Ameren and AEG is another reason why the UE's SO2 allowance revenues for the test year should be imputed by $ ** ** which was the market value of the allowances that UE transferred to AEG as part of the swap.

Q. PLEASE EXPLAIN PUBLIC COUNSEL'S RATIONALE FOR THE SECOND ADJUSTMENT RELATED TO THE "FORWARD SALE" ENTERED INTO ON 3/13/01.

A. Public Counsel recommends that this forward sale be treated for ratemaking purposes as if the proceeds from the sale had been received on the transaction date because the Ameren documents that were described and discussed earlier in this testimony provide a compelling case to show that Ameren structured UE's emission allowance transactions in a way that would best serve the overall financial and strategic interests of Ameren, not UE. Specifically, the documents described and discussed above that support this adjustment are:

- Minutes from the December 15, 2000 meeting of the Ameren Risk Management Steering Committee which noted that Ameren's current strategies of managing UE's allowance inventory were inadequate to prevent a decline in the value of the UE's allowance inventory over time. These minutes noted that changes in the sharing proportions that would allow shareholders to retain a greater portion of transaction earnings should be made to remedy the problem. The clear implication was that transactions like straightforward sales, as opposed to forward sales, which monetize the stored value of allowances during the sharing period and return it to ratepayers will generally be avoided so long as an alternative regulation plan with the current sharing grid was in place.

- A December 20, 1999 memo from Dan Lidisky to Mike Mueller regarding Ameren's SO2 inventory management and transactions strategies which noted that the regulated nature of the UE allowances reduces the incentive to sell or trade them. This memo refers specifically to the UE alternative regulation plan only allowing shareholders to receive, at most, half of the earnings from SO2 transactions. Under the traditional regulation that Ameren returned to at the conclusion of the EARP on July 1, 2001, Ameren can keep 100% of the allowance transaction earnings until some level of SO2 allowance earnings revenues are reflected in its rates (as a reducing factor) at the conclusion of a general rate proceeding.

- The October, 2000 document written by Jim Moore entitled "AmerenEGC SO2 Emission Allowance ** ** " which cited the financial disadvantages, from an "Ameren perspective" of providing UE's allowances to AEG through a straightforward sale instead of a vintage swap. This document noted that most of the earnings from a sale would "go into the Missouri Alternative Regulation Plan."

Regarding the last document listed above, Ameren evidently believed (or hoped) that the earnings from a forward sale would go undetected by regulators and not have to "go into the Missouri Alternative Regulation Plan."

Q. HAS UE ENGAGED IN ANY "FORWARD SALES" SINCE THE EARP HAS ENDED AND IT HAS RETURNED TO TRADITIONAL REGULATION?

A. No. I don't believe so, but as I noted earlier, UE has thus far refused to provide complete information to Public Counsel about the SO2 transactions that it has engaged in since returning to traditional regulation. I frankly can not imagine any reason why UE would want to engage in any "forward sales" now that the incentive plan has ended. Buyers are available to purchase allowances at the market price so there appears to be little motivation for a utility to enter into a "forward sale" type of arrangement except as a way to manipulate and understate the earnings that are visible to regulators in an alternative regulation plan.

Q. PLEASE EXPLAIN PUBLIC COUNSEL'S RATIONALE FOR THE THIRD ADJUSTMENT RELATED TO ** ** IN REVENUES FROM THE PREMIUM ASSOCIATED WITH A CALL OPTION CONTRACT ENTERED INTO ON 11/3/00.

A. Public Counsel recommends that revenues from the premium associated with this call option contract be treated for ratemaking purposes as if they had been received on the transaction date because the Ameren documents that were described and discussed earlier in this testimony provide a compelling case to show that Ameren structured UE's emission allowance transactions in a way that would best serve the overall financial and strategic interests of Ameren, not UE. Specifically, the documents described and discussed above that support this adjustment are:

- Minutes from the December 15, 2000 meeting of the Ameren Risk Management Steering Committee which noted that Ameren's current strategies of managing UE's allowance inventory were inadequate to prevent a decline in the value of the UE's allowance inventory over time. These minutes noted that changes in the sharing proportions that would allow shareholders to retain a greater portion of transaction earnings should be made to remedy the problem. The clear implication was that transactions which yield substantial earnings during the sharing period should generally be avoided so long as an alternative regulation plan with the current sharing grid was in place.

- A December 20, 1999 memo from Dan Lidisky to Mike Mueller regarding Ameren's SO2 inventory management and transactions strategies which noted that the regulated nature of the UE allowances reduces the incentive to sell or trade them. This memo refers specifically to the UE alternative regulation plan only allowing shareholders to receive, at most, half of the earnings from SO2 transactions. Under the traditional regulation that Ameren returned to at the conclusion of the EARP on July 1, 2001, Ameren can keep 100% of the allowance transaction earnings until some level of SO2 allowance earnings revenues are reflected in its rates (as a reducing factor) at the conclusion of a general rate proceeding.

- The October, 2000 document written by Jim Moore entitled "AmerenEGC SO2 Emission Allowance ** ** " which cited the financial disadvantages, from an "Ameren perspective" of providing UE's allowances to AEG through a straight forward sale instead of a vintage swap. This document noted that most of the earnings from a sale would "go into the Missouri Alternative Regulation Plan."

Q. HAS UE ENTERED INTO ANY OPTIONS CONTRACTS WHERE PAYMENT OF THE PREMIUM ASSOCIATED WITH A CALL OPTION CONTRACT WAS DEFERRED TO A FUTURE DATE SINCE THE EARP HAS ENDED AND IT HAS RETURNED TO TRADITIONAL REGULATION?

A. No. I don't believe so, but as I noted earlier, UE has thus far refused to provide complete information to OPC about the SO2 transactions that it has engaged in since returning to traditional regulation. I frankly can not imagine any reason why UE would want to enter into this type of arrangement now that the incentive plan has ended. There appears to be little motivation for a utility to enter into this type of arrangement except as a way to manipulate and understate the earnings that are visible to regulators in an alternative regulation plan.

VII. SO2 ALLOWANCE TRANSACTIONS OCCURING AFTER THE TEST YEAR AND THE FINAL SHARING PERIOD

Q. DID A SIGNIFICANT INCREASE IN THE NUMBER OF SO2 ALLOWANCE SALES BY UE OCCUR SHORTLY AFTER THE END OF THE TEST YEAR WHICH ALSO COINCIDED WITH THE END OF THE FINAL SHARING PERIOD OF THE ARP?

A. Yes, most definitely. However, I am unable to give a full accounting of the sales that took place beyond the end of the test year because UE has thus far refused (despite the lack of a formal objection) to provide all of the information requested in OPC DRs. What I can say, based on the sketchy information that I have received, is that between October 1, 2001 and sometime in late February of 2002, UE had received ** ** in revenues from the sale of allowances. If the ** ** associated with the forward sale that took place during the sharing period is subtracted from this number, then UE's SO2 allowance sales revenues during the 8 month period from July 1, 2001 through February would be ** ** This number would be even higher if the sales associated with call options were included.

Curiously, the sharp increase in straightforward sales that took place after the end of the test year did not really take off until after the end update period (September 30, 2002) ordered by the Commission in this case.

VIII. CALCULATION OF NORMALIZED SO2 ALLOWANCE TRANSACTIONS REVENUE FOR THE TEST PERIOD.

Q. PLEASE EXPLAIN THE STEP THAT YOU TOOK TO NORMALIZE SO2 ALLOWANCE REVENUES FOR THE TEST YEAR.

A. The first step I took was to impute the revenues associated with the three transactions discussed in Section VI of this testimony to arrive at a new figure for non-normalized test year revenues. (See Schedule RK-5) Next, I looked at the only other representative time period of SO2 allowance sales data. This was the partial year beginning on July 1, 2001. As discussed previously, the data that UE has provided so far indicated that $19,129,500 in sales have occurred between July 1, 2001 and February 28, 2002. While I am still intending to include data from the months of March and April of 2002 in my calculation of a representative year of sales that has taken place since the end of the EARP and the end of the test year, UE has thus far refused to provide the requested data even though the Company has already acknowledged that this data has already been included in one of its data bases for SO2 transactions.

The calculation on Schedule RK-5 shows how I have arrived at OPC's proposed adjustment of $23,412,500 based on the data that I have at this time. I expect that UE will eventually provide the SO2 transactions data for the months of March and April in 2002 and I reserve the right to update OPC's adjustment at that time. I would note that the numbers discussed above and shown in Schedule RK-5 for "UE" are "total company UE" revenues. Accordingly, these revenue amounts should be appropriately allocated to Missouri retail jurisdictional operations utilizing appropriately developed energy allocators.

Q. DOES PUBLIC COUNSEL HAVE AN ALTERNATIVE RECOMMENDATION FOR AN ADJUSTMENT TO TEST YEAR SO2 ALLOWANCE TRANSACTIONS?

A. Yes. If the Commission decides that the SO2 allowance revenue data from the test year is so tainted due to UE's efforts to manipulate its earnings associated with SO2 allowance transactions during the last year of the EARP and that, even with the adjustments to the test year allowance transaction revenue data that I have proposed, that data from the test year should not be used as an input in the determination of normalized test year revenues, then I have an alternative recommendation. My alternative recommendation is to use only the information available on SO2 sales revenues occurring during the time period from July 1, 2001 through April 30, 2002. This alternative would result in an adjustment of $19,129,500 in "total UE" SO2 allowance revenues based on the data that is available at this time. The $19,129,500 figure should be updated to reflect allowance sales revenues from the months of March and April 2002, when that data becomes available.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.

To: Mike Mueller December 20, 1999

From: Dan Lidisky

Subject: SO2 Highlights for presentation

Status:

Fossil Fuels assumed responsibility of the SO2 account from a procurement/trading and hedging perspective in October 1999. Corporate Planning and Environmental still are responsible for Ameren's environmental compliance strategies and corporate compliance.

AmerenUE is allowed to market, subject to MPSC review, up to one half of the Phase I allowance credits under an order approved by the MPSC. Up until this year Ameren had not sold allowances in the program, in 1999 Ameren sold [redacted] allowances and two call options contracts generating revenues of [redacted]. The call options expired out of the money and were not exercised.

Going forward AmerenCIPS will be [redacted] annually, with AmerenUE [redacted]. If we do nothing, we would eventually eat into the bank by transferring at the market credits from the AmerenUE to the GENCO. Since the [redacted] is AmerenUE regulated allowances, the incentive to sell or trade them is reduced. The asset is on the books on a zero cost basis and with the AmerenUE incentive plan shareholders will only at best will be receiving half of the earnings. Nonetheless, we just recently have been given the authority to take a more active roll in the hedging and trading of SO2 allowances and are developing a revised risk management policy to address these changes.

Projected Ameren SO2 Allowance Bank

Year	Ameren	AmerenUE	AmerenCIPS
1999	[redacted]	[redacted]	[redacted]
2000	[redacted]	[redacted]	[redacted]
2001	[redacted]	[redacted]	[redacted]
2002	[redacted]	[redacted]	[redacted]
2003	[redacted]	[redacted]	[redacted]
2004	[redacted]	[redacted]	[redacted]
2005	[redacted]	[redacted]	[redacted]
2006	[redacted]	[redacted]	[redacted]
2007	[redacted]	[redacted]	[redacted]
2008	[redacted]	[redacted]	[redacted]

[redacted]

Note: AmerenUE account eligible for sale is [redacted]

Since Ameren UE can only sell half the Phase I [redacted], and we have already sold [redacted] credits we will have [redacted] remaining to market.

What we propose is selling up to [redacted] credits during 2000. We could use any combination of covered calls and shorts to accomplish this, as we enter into the transactions we can [redacted]. Also depending on the GENCO's position, we can take the opportunity to buy back some credits on the open market to fill their short position.

With the changes in Washington and at the EPA, it is difficult to determine what to expect in clean air policy. No one knows what rules we will be dealt in the future and what impact they will have on the value of SO2 credits going forward.

[redacted]

OCTOBER 2000

[redacted]

AMERENEGC SO2 EMISSION ALLOWANCE [redacted]

The latest emission data indicates that AmerenEGC needs about [redacted] SO_2 emission allowances to meet their obligation to EPA in 2000. There are three alternatives AmerenEnergy Fuels and Services ("AFS") has looked at [redacted].

AFS recommends that AmerenUE ("UE") loan the emission allowances to AmerenEGC ("EGC"). This option minimizes cash flow, tax implications and future EGC obligations.

ALLOWANCE SALE

The year 2000 budget included a line item to sell UE allowances to EGC at a market price. This sale would be done at current market prices and would cost EGC about [redacted] million. Taxes would take about 40% and what is left would go into the Missouri Alternative Regulation plan.

VINTAGE SWAP

A second alternative would be to complete a vintage swap between the two companies. UE would give vintage [redacted] allowances to EGC. EGC would in turn give UE vintage [redacted] allowances as follows:

	SO2 Tons			Market		Net
Vintage	Given	Received	Interest	Price	Value	Gain
2000	[redacted]			[redacted]	[redacted]	
2001	[redacted]			[redacted]	[redacted]	
2002	[redacted]			[redacted]	[redacted]	
2003	[redacted]			[redacted]	[redacted]	
2006		[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2007		[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2008		[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2009		[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
		[redacted]	[redacted]		[redacted]	[redacted]

The Tax department has indicated that this is considered a like kind exchange and has no income tax considerations if the exchange is done at market prices. The problem with a vintage swap is that the market is not very liquid and it is difficult to determine what the market prices for the later vintages are. [redacted]. However, if UE generation is deregulated and moved into EGC sometime in the next few years, [redacted].

ALLOWANCE LOAN

A third alternative is to loan EGC allowances for 175 days.

[redacted]

Date	Loan Rate	SO2 Tons			Market Price	Net Profit
		Loaned	Received	Interest		
10/20/00		[redacted]			[redacted]	
4/13/01	[redacted]		[redacted]	[redacted]	[redacted]	[redacted]

This loan would allow EGC to meet their year 2000 allowance requirements without any cash flowing between the companies. The only cost is that EGC transfers an additional [redacted] allowances to UE. This would slightly increase the EGC shortfall in 2001.

UE has completed several allowance loans to third parties in the allowance market this year at [redacted] UE has loaned a total of [redacted] allowances to [redacted] and completed three transactions for a total of [redacted] allowances to [redacted] at [redacted]. These third party loans have established that [redacted] is a fair market rate for 175 day allowance loans.

AFS intends to implement this loan in October unless directed to pursue a different course. A cost savings of about $[redacted] million will be realized by EGC as compared to budgeted amounts for emission compliance.

Jim Moore
x60638

NOTE: AFTER MEETING WITH

GARY RAINWATER
WARNER BAXTER
CONNIE SEABAUGH
TONY ARTMAN
STEVE WHITWORTH
MIKE MUELLER
DAN LIDISKY

IT WAS DECIDED TO PURSUE THE VINTAGE SWAP.

Vintage Swap

AmerenUE/AmerenEGC Swap

[redacted]

Vintage	SO2 Tons			Market Price	Value	Gain on Excess
	AmerenUE	AmerenEGC	Interest			
[redacted]	[redacted]	[redacted]		[redacted]	[redacted]	
[redacted]	[redacted]	[redacted]		[redacted]	[redacted]	
[redacted]	[redacted]	[redacted]		[redacted]	[redacted]	
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
	[redacted]	[redacted]			[redacted]	[redacted]

[redacted]

Several ways to look at soft margin on this transaction:

1 AmerenUE gained $[redacted] million on excess allowances--but, AmerenEGC gave that up.
2 AmerenEGC saved the $[redacted] million they had budgeted to spend on allowances in 2000.
3 Ameren Corp saved about $[redacted] million they would have paid in year 2000 taxes if AmerenUE sold the tons to AmerenEGC
4 Ameren Corp saved about $[redacted] million that would have gone to ratepayers if AmerenUE sold the tons to AmerenEGC
5 AmerenEGC saved the $[redacted] million they had budgeted to spend on allowances in 2000-2002.
6 Ameren Corp saved about $[redacted] million they would have paid in year '00, '01 & '02 taxes if AmerenUE sold the tons to AmerenEGC

Schedule RK-3

[redacted]

Comparable Swaps

Transaction Number	Date	Number of Allowances	Interest Quantity	Interest Rate
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Average of Comparables [redacted]

UE Affiliate Transaction

Transaction Number	Date	Number of Allowances	Interest Quantity	Interest Rate
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Normalization of SO2 Allowance Revenues

Imputed Test Year Revenues	27,695,500
Post Test Year Revenues (7/1/01 - 2/28/02)	19,129,500
Normalized Revenues	$ 23,412,500

Schedule RK-6
Has been deemed
"PROPRIETARY"
in its entirety.