

Exhibit No.:

Issue(s):

Witness/Type of Exhibit:

Sponsoring Party:

Case No.:

Fuel Adjustment Clause

Kind/Direct

Public Counsel

ER-2007-0002

DIRECT TESTIMONY

OF

RYAN KIND

Submitted on Behalf of
the Office of the Public Counsel

UNION ELECTRIC COMPANY D/B/A AMERENUE

Case No. ER-2007-0002

December 29, 2006

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

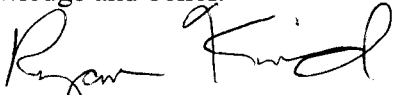
In the Matter of Union Electric Company d/b/a)	
AmerenUE for Authority to File Tariffs Increasing)	Case No. ER-2007-0002
Rates for Electric Service Provided to Customers)	Tariff No. YE-2007-0007
in the Company's Missouri Service Area.)	

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 direct testimony.
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

Subscribed and sworn to me this 29th day of December 2006.



JERENE A. BUCKMAN
My Commission Expires
August 10, 2009
Cole County
Commission #05754036



Jerene A. Buckman
Notary Public

My commission expires August 10, 2009.

TABLE OF CONTENTS

I.	INTRODUCTION AND RECOMMENDATIONS	1
II.	COMMISSION DISCRETION IN APPROVING FAC APPLICATIONS	2
III.	THE COMMISSION'S ASSESSMENT OF PUBLIC INTEREST CONSIDERATIONS	4
IV.	COMMISSION ASSESSMENT OF WHETHER THE UE'S FAC PROPOSAL COMPLIES WITH THE COMMISSION'S RULES	10

DIRECT TESTIMONY
OF
RYAN KIND
UNION ELECTRIC COMPANY
CASE NO. ER-2007-0002

1

2

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

3

A. Ryan Kind, Chief Energy Economist, Office of the Public Counsel, P.O. Box 2230,
4 Jefferson City, Missouri 65102.

4

5

**Q. ARE YOU THE SAME RYAN KIND THAT SUBMITTED DIRECT TESTIMONY IN THIS CASE
6 ON DECEMBER 15, 2006 REGARDING REVENUE REQUIREMENT ISSUES?**

6

7

A. Yes, I am.

8

I. INTRODUCTION AND RECOMMENDATIONS

9

Q. PLEASE IDENTIFY THE ISSUES THAT YOU WILL BE ADDRESSING IN YOUR TESTIMONY.

10

A. The major issues that are addressed in this testimony include:

11

- Whether the Commission should approve a Fuel Adjustment Clause (FAC) for
12 UE in this case;

12

13

- The Commission's discretion to approve, modify or reject FAC applications;

14

- The appropriate framework for assessing the public interest consideration in FAC
15 applications and how these considerations apply to UE's situation; and

15

- Whether the unique circumstances of UE with respect to the Taum Sauk and Electric Energy, Inc. (EEInc) Joppa plants prevent UE from being able to have a FAC that meets the requirements of 4 CSR 240-20.090.

Q. DOES PUBLIC COUNSEL BELIEVE THE COMMISSION SHOULD APPROVE THE ESTABLISHMENT OF A FUEL ADJUSTMENT CLAUSE FOR UE IN THIS CASE?

A. No. Public Counsel believes that that Commission approval of a FAC for UE would not be consistent with the public interest and that UE does not have a need for a FAC.

II. COMMISSION DISCRETION IN APPROVING FAC APPLICATIONS

Q. WHAT FACTORS SHOULD THE COMMISSION CONSIDER IN DECIDING WHETHER TO PERMIT UE TO HAVE A FUEL ADJUSTMENT CLAUSE?

A. The factors that Public Counsel believes should be considered by the Commission include the following:

- Would permitting UE to use a FAC be consistent with the public interest?
- Does UE have a need for a FAC because it would face a substantial threat to its financial viability if it did not have the ability to recover any increased costs of fuel and purchased power in between rate cases without a FAC?
- Would permitting UE to use a FAC be consistent with the Commission's rules for FACs?

Q. DOES PUBLIC COUNSEL BELIEVE THE COMMISSION HAS THE DISCRETION TO DENY A FAC BASED ON ITS ASSESSMENT OF THE CONSIDERATIONS LISTED IN THE PRECEDING ANSWER?

A. Yes, both SB 179 and the Commission rules that implemented the legislation (4 CSR 240-3.161 Electric Utility Fuel and Purchased Power Cost Recovery Mechanisms Filing

and Submission Requirements and 4 CSR 240-20.090 Electric Utility Fuel and Purchased Power Cost Recovery Mechanisms) make it clear that the Commission is **permitted** to approve a fuel adjustment clause but that it is **not required** to do so. There are at least two portions of 4 CSR 240-20.090 that address the Commission's discretion to approve, modify or reject applications to establish a rate adjustment mechanism (RAM).

Q. HOW IS THE TERM "RAM" DEFINED IN 4 CSR 240-20.090?

A. This term is defined in 4 CSR 240-20.090(1)(G) as follows:

(G) Rate adjustment mechanism (RAM) refers to either a fuel adjustment clause or an interim energy charge.

Q. WHICH SECTIONS OF 4 CSR 240-20.090 GIVE THE COMMISSION THE DISCRETION TO APPROVE, MODIFY OR REJECT AN APPLICATION FOR A FAC?

A. Section (2) and subsection (2)(A) of 4 CSR 240-20.090 give the Commission the discretion to decide whether to approve, modify or reject applications to establish either a fuel adjustment clause or an interim energy charge. Section 2 states:

(2) Applications to Establish, Continue or Modify a RAM. Pursuant to the provisions of this rule, 4 CSR 240-2.060 and section 386.266, RSMo, only an electric utility in a general rate proceeding may file an application with the commission to establish, continue or modify a RAM by filing tariff schedules. Any party in a general rate proceeding in which a RAM is effective or proposed may seek to continue, modify or oppose the RAM. **The commission shall approve, modify or reject such applications to establish a RAM only after providing the opportunity for a full hearing in a general rate proceeding.** The commission shall consider all relevant factors that may affect the costs or overall rates and charges of the petitioning electric utility. (Emphasis added)

This section makes it clear that the Commission must review FAC applications and determine whether such an application should be approved based on the evidence presented in a general rate proceeding. This section also requires that the Commission make its determination based upon its consideration of "all relevant factors that may affect the **costs or overall rates and charges** of the petitioning electric utility." (Emphasis added). Public Counsel's interpretation of the preceding excerpt from the rule

1 is that if the Commission finds that the implementation of a FAC will tend to put upward
2 pressure on costs (e.g. due to decreased incentives for the utility to acquire fuel and
3 purchased power at the lowest cost), the Commission can reject a FAC application.

4 The other provision in 4 CSR 240-20.090 which makes it clear that the Commission must
5 exercise its judgment in determining whether to approve, modify or reject applications to
6 establish a either a FAC is subsection (2)(A) which states:

7 (2)(A) The Commission **may approve** the establishment, continuation or
8 modification of a RAM and associated rate schedules provided that it
9 finds that the RAM it approves is reasonably designed to provide the
10 electric utility with a sufficient opportunity to earn a fair return on equity
11 and so long as the rate schedules that implement the RAM conform to
12 the RAM approved by the commission. (Emphasis added)

13 The above quoted sub-section also makes it clear that the Commission is permitted to
14 approve a RAM, but is not required to do so. I believe this section also makes it clear that
15 the Commission must make a finding in its approval of a RAM that the proposed RAM is
16 expected to result in the utility earning a “fair return.” If the Commission finds that a
17 proposed RAM is expected to result in the utility earning more than a fair return, this rule
18 provision would make approval of such a RAM unlawful. I believe this provision also
19 makes it clear that an approved RAM would be “reasonably designed” if it provides the
20 utility with an “opportunity” to earn a fair return but that a RAM would not be
21 “reasonably designed” if it went beyond providing an “opportunity” to earn a fair return
22 by essentially guaranteeing the level of return on equity that a utility will earn.

23 **III. THE COMMISSION’S ASSESSMENT OF PUBLIC INTEREST**
24 **CONSIDERATIONS**

25 **Q. HOW DOES PUBLIC COUNSEL BELIEVE THE COMMISSION SHOULD UTILIZE THE**
26 **DISCRETION THAT IS HAS, PURSUANT TO THE RULE, TO EITHER APPROVE, MODIFY OR**
27 **REJECT AN APPLICATION FOR A FAC?**

Direct Testimony of
Ryan Kind

1 A. Public Counsel believes that the Commission should utilize its discretion in the same
2 manner that it makes most of its other regulatory decisions. The basic standards that the
3 Commission should rely on are:

- 4 • Will departing from the traditional mode of Missouri utility regulation by
5 approving a FAC be consistent with the public interest?
- 6 • Will the rates resulting from the exercise of its discretion to approve, modify or
7 reject applications to establish a FAC be “just and reasonable”?

8 **Q. HOW SHOULD THE COMMISSION GO ABOUT DETERMINING WHETHER APPROVING A**
9 **FAC FOR UE WILL BE CONSISTENT WITH THE PUBLIC INTEREST?**

10 A. There are a large number of relevant factors that must be considered in making this
11 determination. These factors include:

- 12 • The impact that the new mode of regulation will have on UE’s incentives to
13 minimize (subject to risk considerations) its fuel and purchase power costs.
- 14 • Whether the proposed FAC is reasonably designed so it does not (1) guarantee
15 that UE will achieve at least some given return on equity or (2) provide the utility
16 with an opportunity to earn excessive returns above the level that is reasonable.
- 17 • Whether the projected combined impact of all of the provisions in the proposed
18 FAC and the rate schedules that implement it are consistent with the public
19 interest.

20 **Q. DO YOU BELIEVE THAT COMMISSION APPROVAL OF A FAC FOR UE WOULD HAVE AN**
21 **ADVERSE IMPACT ON ITS INCENTIVES TO MINIMIZE (SUBJECT TO RISK**
22 **CONSIDERATIONS) ITS FUEL AND PURCHASE POWER COSTS?**

23 A. Yes. The change in incentives that occurs when a utility uses a fuel adjustment clause has
24 even been acknowledged by the former President and CEO of Ameren and UE, Charles

Mueller. In Mr. Mueller's "Chairman's Letter" that was part of Ameren's 1998 Annual Report to Shareholder's, Mr. Mueller stated:

We continue to reduce costs by increasing operating efficiency through the effective use of technology. These initiatives range from installation of remote sensing devices on our distribution lines to expansion of our automated meter system — now the world's largest. **We are also focused on lowering fuel costs. In 1998 in Illinois, we chose to eliminate the fuel adjustment clauses, which called for offering credits if certain fuel costs dropped or increasing customer bills if they rose. That decision, coupled with the fact that we have operated for several years without a fuel adjustment clause in Missouri, has given us additional incentive to continue to manage our fuel costs effectively.** Our four AmerenUE coal-fired power plants continue to use substantial quantities of lower cost, low-sulfur Western coal, reducing production costs and emissions. In 1998, AmerenCIPS' Newton Plant began using Western coal. We will continue to aggressively explore these and other options to reduce our fuel costs. (Emphasis added)

Mr. Mueller's statement about the "additional incentive" for Ameren to manage its fuel cost that occurred when the Company eliminated its fuel clause in 1998 for Ameren's regulated utility operations in Illinois demonstrates the strong impact that the presence or absence of a fuel clause can have on the financial incentives to manage fuel costs. The paragraph that is quoted above starts at the bottom of the first page of the "Chairman's Letter" (see page 2 of Attachment 1).

Q. THE COMMISSION OFTEN NEEDS TO ASSESS THE UNIQUE SITUATION OF EACH UTILITY AND THE BUSINESS ENVIRONMENT IN WHICH IT OPERATES AS IT MAKES DECISIONS ABOUT HOW A UTILITY SHOULD BE REGULATED, THE RETURN ON EQUITY THAT IT SHOULD HAVE AN OPPORTUNITY TO EARN, AND THE LEVEL OF RATES THAT IT SHOULD BE PERMITTED TO CHARGE ITS CUSTOMERS. IS THAT TYPE OF ASSESSMENT REQUIRED IN THE COMMISSION'S EXERCISE OF ITS DISCRETION TO APPROVE, MODIFY OR REJECT A UTILITY'S FAC APPLICATION?

A. Yes, definitely.

1 **Q. WHAT ARE SOME OF THE ASPECTS OF A UTILITY’S SITUATION THAT SHOULD BE**
2 **ASSESSED BY THE COMMISSION AS IT MAKES DETERMINATIONS ABOUT FAC**
3 **APPLICATIONS IN RATE CASES?**

4 A. Public Counsel believes that the unique circumstances that should be assessed include the
5 following:

- 6 • Is the utility’s power supply cost structure vulnerable to changes in fuel and
7 purchased power costs and if so, is this vulnerability due to factors that are
8 beyond the utility’s control?
- 9 • If the utility’s power supply cost structure is vulnerable to changes in fuel and
10 purchased power costs, is this vulnerability, combined with the present status of
11 the utility’s financial health, so great that the financial viability of the utility could
12 be threatened by future increases in the cost of fuel and purchases power?
- 13 • Has the utility taken prudent action to hedge its vulnerability to increases in fuel
14 and purchased power costs through (1) appropriate planning and acquisition of
15 supply and demand-side resources and (2) appropriate hedging of generation fuel
16 costs?

17 **Q. DOES PUBLIC COUNSEL BELIEVE THAT UE’S CIRCUMSTANCES WITH RESPECT TO THE**
18 **FACTORS LISTED ABOVE SHOULD LEAD THE COMMISSION TO CONCLUDE THAT**
19 **APPROVING UE’S FAC APPLICATION IS CONSISTENT WITH THE PUBLIC INTEREST?**

20 A. No. UE relies largely on its nuclear and coal-fired generation assets to provide the energy
21 that it needs to serve its customers. The Commission has approved updating UE’s cost to
22 January 1, 2007 so the Company’s coal and nuclear fuel costs will already be set at a
23 level that will reflect UE’s fuel contracts for 2007. UE has a program for hedging its gas
24 costs and it has not shown that its vulnerability to changes in gas costs are great enough
25 to merit moving to different mode of regulation with a FAC where the public would lose

1 the protection that it currently receives from existing incentives for UE to manage its fuel
2 costs wisely.

3 UE's failure to retain its 40% share of the output from the EEInc plant has probably
4 increased the Company's vulnerability to changes in the price of natural gas but this is a
5 vulnerability that UE chose to create so customers should not have this vulnerability to
6 natural gas prices transferred to them.

7 **Q. WHAT ARE SOME OF THE CHARACTERISTICS OF A UTILITY'S OPERATING**
8 **ENVIRONMENT THAT SHOULD BE ASSESSED BY THE COMMISSION AS IT MAKES**
9 **DETERMINATIONS ABOUT FAC APPLICATIONS IN RATE CASES?**

10 A. Public Counsel believes that the characteristics of a utility's operating environment that
11 should be assessed include the following:

- 12 • Are the prices of some or all of the fossil fuels that the utility burns in its
13 generating units expected to have substantial volatility over the next few years?
- 14 • Are the wholesale electric markets from which the utility obtains energy and
15 capacity expected to have substantial volatility over the next few years?

16 **Q. DOES PUBLIC COUNSEL BELIEVE THAT THE CHARACTERISTICS OF UE'S OPERATING**
17 **ENVIRONMENT WITH RESPECT TO THE FACTORS LISTED ABOVE SHOULD LEAD THE**
18 **COMMISSION TO CONCLUDE THAT APPROVING UE'S FAC APPLICATION IS**
19 **CONSISTENT WITH THE PUBLIC INTEREST?**

20 A. No. UE has a portfolio of generation resources that permits it to limit its use of natural
21 gas and its reliance on wholesale power markets as a source of energy to serve its native
22 load. As I stated previously, UE's failure to retain its 40% share of the output from the
23 EEInc plant has probably increased the Company's vulnerability to changes in the price

1 of natural gas but this is a vulnerability that UE chose to create so customers should not
2 have this vulnerability to natural gas prices transferred to them.

3 **Q. THE COMMISSION OFTEN NEEDS TO ASSESS THE COMBINED IMPACT OF A NUMBER OF**
4 **FACTORS TO DETERMINE THE LIKELY NET IMPACT THAT ITS DECISIONS WILL HAVE ON**
5 **THE INTERESTS OF THE PUBLIC. IS THAT TYPE OF ASSESSMENT REQUIRED IN THE**
6 **COMMISSION’S EXERCISE OF ITS DISCRETION TO APPROVE, MODIFY OR REJECT A**
7 **FAC APPLICATION?**

8 A. Yes, the impacts of implementing a major change in the way an electric utility is
9 regulated, such as the changes accompanying a FAC clause, are numerous and complex.
10 In order to estimate the net impact on consumers of approving an FAC application, the
11 Commission would need to look at the net impact of a number of factors, including:

- 12 • The decreased ROE, if any, that will be reflected in the approved revenue
13 requirement and customers’ rates due to transfer of risk from shareholders to
14 ratepayers.
- 15 • The increased costs that will likely be passed through to consumers as a result of
16 the decreased incentive for a utility to minimize its fuel and purchased power
17 costs.
- 18 • The increased costs that may be passed through to consumers if the Commission’s
19 resource planning oversight is not able to counteract the perverse incentives that
20 utilities with an FAC have to rely more heavily on natural gas generating
21 resources due to: (1) the FAC mechanism for passing through changes in gas
22 prices when they fluctuate and (2) the lower capital costs associated with gas-fired
23 generation compared to coal and nuclear generation.
- 24 • In the Commission’s order of rulemaking in Case No. EX-2006-0472 (page 9), the
25 Commission appeared to acknowledge the risk that some aspects of the new rule

may not work out as expected where it stated that “in light of the fact that these rules are highly complex, establish an entirely new procedure and are likely to contain provisions that will need to be altered, added or deleted, the Commission finds it appropriate to leave in the date certain by which the rules will be reviewed.”

IV. COMMISSION ASSESSMENT OF WHETHER THE UE’S FAC PROPOSAL COMPLIES WITH THE COMMISSION’S RULES

Q. THE PARTIAL COLLAPSE OF THE TAUM SAUK RESERVOIR AND THE UNIQUE CIRCUMSTANCES SURROUNDING THAT COLLAPSE HAVE RAISED SOME UNIQUE ISSUES IN UE’S RATE CASE. HOW WILL THE BREACH OF THE TAUM SAUK RESERVOIR IMPACT UE’S PROPOSAL FOR A FAC?

A. I have not seen any UE testimony that addresses this issue. After the reservoir breach, UE accepted blame for the incident and has stated that it will hold ratepayers harmless in the current rate case. UE has asserted that it attempted to hold ratepayers harmless by running its fuel model under the assumption that Taum Sauk was still operating. In other words, UE asserts that for purposes of its fuel modeling, it has pretended that the Taum Sauk generating resource is can still be dispatched to serve its native load and sell into the wholesale energy market.

However, I am not aware of any testimony from UE witnesses that attempts to assure customers that they will be held harmless from increased costs flowing through the FAC due to the unavailability of the Taum Sauk plant. Without such an assurance, ratepayers would probably see an immediate pass through of fuel costs that are higher than the costs that result from fuel model projections due to the unavailability of the Taum Sauk Plant.

1 **Q. COULD UE RESOLVE THIS PROBLEM BY OFFERING TO STRUCTURE THE FAC SO IT**
2 **PASSED THROUGH COSTS THAT ARE BASED ON FUEL MODEL PROJECTIONS OF COST**
3 **CHANGES, RATHER THAN PASSING ACTUAL HISTORICAL COSTS THROUGH THE FAC?**

4 A. No. Even if UE made such a proposal (which it has not) in an attempt to protect
5 ratepayers from the adverse impacts of the loss of the Taum Sauk plant, it would not
6 comply with the requirement in 4 CSR 240-20.090(2)(F) that periodic adjustments for
7 fluctuations in fuel costs and purchased power costs be based on actual historical costs
8 that have been incurred by the utility. Sub-section (2)(F) of 4 CSR 240-20.090 states:

9 (2)(F) The RAM and periodic adjustments thereto shall be based on
10 historical fuel and purchased power costs.

11 **Q. ARE THERE ANY OTHER PROVISIONS IN THE RULE THAT WOULD BE RELEVANT TO**
12 **UE’S SITUATION WITH THE LOSS OF THE TAUM SAUK GENERATING FACILITY?**

13 A. Yes, the increased costs that result from the dam collapse at UE’s Taum Sauk facility are
14 the type of costs that are addressed by the Commission’s prudence standard in sub-
15 section (1)(B) of 4 CSR 240-20.090. This subsection states:

16 (1)(B) Fuel and purchased power costs means prudently incurred and
17 used fuel and purchased power costs, including transportation costs.
18 **Prudently incurred costs do not include any increased costs resulting**
19 **from negligent or wrongful acts or omissions by the utility.** If not
20 inconsistent with a commission approved incentive plan, fuel and
21 purchased power costs also include prudently incurred actual costs of net
22 cash payments or receipts associated with hedging instruments tied to
23 specific volumes of fuel and associated transportation costs. (Emphasis
24 added)

25 The above highlighted language in sub-section (1)(B) of 4 CSR 240-20.090 applies to the
26 circumstances surrounding the collapse of the Taum Sauk generating facility so the rule
27 would clearly prohibit UE from passing on the actual historical fuel and purchased power
28 costs that it incurs while operating its system without the Taum Sauk plant.

29 The above provision regarding “prudently incurred and used fuel and purchased power
30 costs” would also prevent UE from being able to pass fuel and purchased power costs

Direct Testimony of
Ryan Kind

1 through the FAC that are higher than such costs would have been if UE had taken the
2 prudent step of continuing to take advantage of the low cost output from the Joppa plant
3 that its 40% ownership share entitles it to take.

4 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

5 A. Yes.

6

7

8

1998 ANNUAL REPORT

S t r o n g
Fundamentals
EFFECTIVE
Solutions



Ameren

Chairman's Letter

To Our Owners

Over the past year, we have followed a well-defined strategy to capitalize on our generating assets, grow earnings, reduce costs and effectively manage regulatory and market uncertainties. We have enhanced the performance of our existing assets and made necessary investments to prepare for an increasingly competitive environment. That strategy has proved both durable and successful.

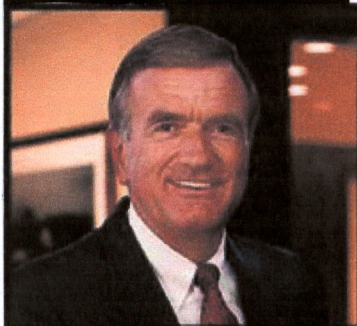
We continue to seek opportunities to maximize our generating assets. Ameren ranks 11th in the nation in generation capacity. 1998 was marked by several initiatives to secure and enhance this position by increasing the availability of our coal-fired plants and sustaining the already strong performance of our nuclear unit. Our Labadie and Rush Island plants set all-time generation records in 1998, while our Callaway Nuclear Plant needed only 31 days to complete its ninth refueling, tying the record set during the plant's last refueling in the fall of 1996. This record was the second shortest of any of the 27 nuclear plant refuelings conducted in the spring of 1998. Callaway continues to rank as one of the nation's best managed nuclear plants, earning recognition for operating efficiency and safety in a period of increased regulatory scrutiny.

These generation resources paid dividends in the summer of 1998 when utilities were paying unprecedented prices for power purchases. We effectively managed power costs in the face of soaring wholesale electricity prices, and these abnormally high prices had little impact on Ameren's financial results, unlike the experience of several other utilities. The year also marked further development of our energy trading and marketing affiliate. AmerenEnergy is now poised to capitalize on Ameren's strong generation assets. Finally, in 1998 we signed contracts that set the stage for the installation of combustion turbines that, by the year 2001, will add more than 700 megawatts to our generating capacity. We continue to grow earnings through core business development and investment in new products and energy-related ventures. We are developing a stream of attractive products and services that will benefit our customers and enhance our company's earnings growth. These include a number of technologically sophisticated products, from an automated bill consolidation service Ameren Ability to an energy management product Ameren Abacus that allows business or institutional customers to track energy use by process, building or facility.

Another of Ameren's major ventures involves partnerships with design and engineering firms. Foremost among these is Gateway Energy Systems, a firm that designs, builds, finances, owns and operates utility systems for large institutional and industrial customers. In 1998, Gateway Energy sealed a 20-year contract to build a \$20 steam facility for a Fortune 500 company.

We continue to reduce costs by increasing operating efficiency through the effective use of technology. These initiatives range from installation of remote sensing devices on our distribution lines to

Charles W. Mueller
Chairman, President,
and Chief Executive Officer
Ameren Corporation



Our year was
characterized by
*efficient use
of resources*
AND EXPANDED
SERVICE OPTIONS
for all
customers

expansion of our automated meter system — now the world's largest. We are also focused on lowering fuel costs. In 1998 in Illinois, we chose to eliminate the fuel adjustment clauses, which called for offering credits if certain fuel costs dropped or increasing customer bills if they rose. That decision, coupled with the fact that we have operated for several years without a fuel adjustment clause in Missouri, has given us additional incentive to continue to manage our fuel costs effectively. Our four AmerenUE coal-fired power plants continue to use substantial quantities of lower cost, low-sulfur Western coal, reducing production costs and emissions. In 1998, AmerenCIPS' Newton Plant began using Western coal. We will continue to aggressively explore these and other options to reduce our fuel costs.

In addition, we realize that increased productivity is critical to controlling operating costs. In 1998 we eliminated more than 400 positions, essentially without layoffs, through a hiring freeze and a targeted separation plan. These reductions will yield savings of approximately \$20 million to \$25 million annually.

Ameren's entire work force now stands at approximately 7,450 employees — the level of employment for Union Electric alone in 1987. Compared to a decade ago, Ameren companies are serving 8% more customers — with 24% fewer employees. In 1998, Public Utility Fortnightly, a leading industry publication, recognized Ameren as one of the nation's most efficient utilities, ranking our company as the second "most improved" and 11th most efficient.

Earnings Per Share



*Excluding an extraordinary charge of \$.38.

We will continue to improve our efficiency as we refine our strategies and determine the skills that are most important in meeting the challenges of a competitive environment.

Finally, we are effectively managing the market and regulatory uncertainties we face by remaining visible and active in the industry restructuring debate and on other issues. We have continually communicated to a range of government officials that we cannot support initiatives aimed at increasing competition in ways that do not adequately protect our shareholders and our customers.

On the environmental front, we are using our resources to propose alternatives to the several stringent, technically flawed regulations that federal environmental officials proposed and established in 1998. We continue to research, investigate and test technologies that offer workable and affordable alternatives.

Going forward, our strategy's operating model will increasingly be based on a business line approach. These business lines include generation; energy transmission and distribution; retail customer service; business and corporate services; and non-regulated operations. Business line teams spent 1998 planning and developing strategies that will yield added revenue and cost savings.

These efforts will keep our management and employees focused on the specific strategies that bring bottom line results in an ever-changing competitive environment. As we mark the completion of

our first full year as Ameren Corporation, we can tell you that our strategy has brought results.

1998 Financial Performance In 1998, our company earned \$386 million, or \$2.82 per share. This compares to 1997 earnings of \$335 million, or \$2.44 per share, including a 1997 extraordinary charge. That charge of \$52 million, net of income taxes, reduced 1997 earnings 38 cents per share. Excluding nonrecurring charges, ongoing earnings for 1998 were \$2.93 per share, compared to \$2.77 per share for 1997.

Electric revenues were up slightly in 1998 over 1997, despite rate decreases and a \$43 million credit to Missouri electric customers. These reduced earnings 6 cents and 18 cents per share, respectively. Kilowatthour sales to retail customers within our service territory were up 4%. Our annual sales growth — in a now-expanded, economically strong service area — stands at better than 2%.

Electric Industry Restructuring in Illinois Ameren continued to develop technology, organize staffs and contribute to working groups the state created to respond to the multiple requirements of 1997 legislation setting the stage for provider choice. Certain large commercial and industrial customers in Illinois can choose their energy providers in late 1999, with all business and residential customers able to choose providers by May 2002. The law also called for a 5% rate reduction that began Aug. 1, 1998, for our Illinois residential customers. That rate decrease is expected to reduce future annual revenues by approximately \$14 million (\$8 million over 1998).

Electric Industry Restructuring in Missouri Missouri legislators and regulators continue to analyze the issue of provider choice. As members of various restructuring task forces and committees, Ameren's managers continue to be very active in promoting the interests of its investors and customers.

In Summary Ameren Corporation is a stronger and more focused company than ever before. We are confident that our operating performance, growth initiatives and strategic direction will make Ameren a success in any competitive environment.

We are investing in the people, technology and facilities that support our core energy business. Through our merger and direct sales initiatives, we are expanding our market area and customer base. We continue to develop products that retain and attract customers, as we selectively pursue non-regulated business opportunities. While we do not underestimate the challenges, we enter the new era committed to returning value to you, our shareholders.

Going forward, we are enthusiastic about the opportunities that are open to a financially strong company, like ours. We realize that you will be best served by a company that can maintain its low-cost advantage, meet customers' total energy needs and deliver superior earnings growth.

Service Area
Kilowatthour
Sales
In Billions



Our thanks go to our employees and to our dedicated directors who have been actively involved in charting our course.

Sincerely,

A handwritten signature in black ink, appearing to read "C. W. Mueller", with a long horizontal flourish extending to the right.

Charles W. Mueller

Chairman, President and Chief Executive Officer

February 10, 1999