

1 approach which gives utilities adequate cash flows
2 to make infrastructure investments.

3 So putting all those things
4 together, I am not aware of any customer that has
5 not come for that reason because, frankly, I
6 believe they're not worried about that at this
7 point in time.

8 Q You talk about rate shock that might
9 occur. Can you tell me how much of a customer's
10 bill today is due to net salvage?

11 A I could not tell you how much of our
12 customers' bill, no, I could not.

13 Q Is it as sizeable as return on
14 equity?

15 A Honestly, I haven't done an
16 analysis, so I do not know.

17 MR. SCHWARZ: I think that's all I
18 have.

19 JUDGE DIPPELL: All right. Believe
20 it or not, we've been in here for an hour and a
21 half, so I'm going to take a short break. We're
22 going to break until -- just for ten minutes, but
23 -- so come back at just about 17 till. Thank you.
24 Off the record.

25 (Off the record.)

1 JUDGE DIPPELL: Okay, let's go ahead
2 and go back on the record. Mr. Baxter is still on
3 the stand and we just finished cross examination
4 so we're ready to begin with questions from the
5 bench.

6 Commissioner Clayton, do you have
7 questions?

8 BY COMMISSIONER CLAYTON:

9 Q Good afternoon, Mr. Baxter.

10 A Good afternoon, Commissioner.

11 Q I've got all sorts of testimony up
12 here so this is not going to be a very organized,
13 well thought out examination, but I do have some
14 questions and I may bounce around so be patient
15 with me.

16 A Sure.

17 Q Is the primary reason that a utility
18 company, just speaking in general, is more
19 supportive of this traditional method -- is the
20 primary reason because it needs to improve its
21 present day cash position, or is the reason that
22 you want to receive the funds and accurately
23 prepare for the future expenditure of retirement
24 of the plant?

25 A Commissioner, I think there are

1 several reasons. I think certainly you point out
2 the issue associated with cash flows, and I'll
3 just say that is, being the Chief Financial
4 Officer, an important thing for me to make sure
5 that we have adequate cash flows and meet all of
6 our infrastructure and reliability needs.

7 And certainly given the fact that
8 the regulatory construct in Missouri does not
9 permit companies to put construction work in
10 progress in rate base, we prefund a lot of our
11 major infrastructure commitments before we can
12 start recovering from customers. So this is a
13 source of funds.

14 But I think as important is the
15 intergenerational equity issue. If you ultimately
16 back load these retirement costs, and I think Mr.
17 Byrne showed you how the growth factors were
18 really going to back end some of these things, and
19 you put inflation in there, there become some real
20 concerns from a customer standpoint these
21 significant rate increases that you may have down
22 the road. Certainly under Staff's approach is --
23 my understanding of Staff's approach. So from
24 intergenerational standpoint, that's certainly a
25 factor.

1 Rate volatility. I think other
2 things we consider, ourselves, consider important
3 is just that there is stability, relatively
4 speaking, in terms of rates. And I think when --
5 when the financial community looks at a regulatory
6 framework, they want to make sure that utilities
7 are recovering their real costs of the business,
8 not just their operating costs, but also costs for
9 their plant and all the costs associated with the
10 plant, which would include net salvage.

11 Q Well, that's the difference with
12 this type of depreciation analysis; it's not
13 recovery of a past expense, it's anticipation of
14 the future expense, is it not?

15 A It is in part, but I think what I
16 would suggest is we are estimating the pro rata
17 portion of that net salvage would be for a plant
18 which is basically in service today. So it -- it
19 is an estimate, but we're not looking to recover
20 sort of expenses for -- necessarily in the future
21 as much as we're just trying to allocate those
22 costs to today's customers who are using the plant
23 for their appropriate share. So it's --
24 semantics, this is little bit different, but then
25 -- I'm just trying to respond to your question.

1 Q Is it a fair statement that if --
2 and this kind of goes to, I believe, the stability
3 and volatility issues that you mentioned, that the
4 actual retirements that you would have year after
5 year after year would potentially vary quite a
6 great deal depending on what type of
7 infrastructure work you're doing?

8 A I think that's fair, Commissioner,
9 and I believe Mr. Stout offers in his testimony an
10 exhibit that shows the volatility and retirements
11 for a particular time period.

12 If -- if I may, I think it is in Mr.
13 Stout's exhibit, or testimony. No, that's the
14 supplemental, I need his direct. Excuse me,
15 Commissioner. It may be a good example to show
16 him --

17 MR. LOWERY: May I provide this to
18 the witness, Your Honor?

19 JUDGE DIPPELL: Yes.

20 THE WITNESS: Thank you. It is
21 Exhibit WMS-1. And on that exhibit, Your Honor,
22 it -- it shows how retirements do indeed fluctuate
23 rather significantly between years, and it also
24 shows, frankly, that there are increasing levels
25 of retirements which are taking place now into the

1 future. So there is some level of volatility on
2 the actual cash outflows for retirements.

3 Q (BY COMMISSIONER CLAYTON) WMS-1 is
4 the exhibit, that's the graph?

5 A Yes. Schedule, excuse me, Schedule
6 WMS-1. Ameren UE's net salvage costs for recent
7 retirements versus historical averages. That's an
8 example of the type of things that you may see in
9 terms of retirements over some period of time.
10 Importantly when you look at this schedule, you
11 certainly see the trend of net salvage costs
12 increasing and you certainly see a great deal of
13 volatility.

14 So under the standard approach, in
15 many respects what happens is that you would
16 estimate these net salvage costs, and what you
17 would recover from customers would be more of a
18 smoother trend line that would potentially be
19 upward.

20 Q On -- and I know this isn't your
21 schedule so you may not know the answer, but if we
22 look at this chart, where would the line be drawn
23 for the accrual, the standard approach for
24 depreciation be in comparison to the average ten
25 years net salvage costs and the annual net salvage

1 **costs of recent retirements?**

2 A Commissioner, I will take a guess at
3 it, but my guess is that you would be better
4 served asking Mr. Stout about that specific
5 question, but my sense is that what you would see
6 is a trend line somewhere in between those peaks
7 and valleys. That's my sense.

8 Now, again, Mr. Stout would probably
9 be able to tell you more definitively, but that
10 would be my sense. You wouldn't see the peaks and
11 valleys under the accrual approach. Whereas under
12 the Staff's approach, you may see the significant
13 increases go up and down at one point in time.

14 Q In the accrual approach with the
15 examples -- and we use these simple examples for
16 simple minds sitting on the bench, speaking for
17 myself, of course.

18 On the simple examples, does the
19 accrual approach have safeguards in it that would
20 affect a circumstance of, say, if you had plant
21 that had a ten year life and there was an accrual
22 of that cost of removal, but it ends up having a
23 20 year life and it stays in for longer? Now, do
24 you collect that thousand dollars for 20 years?

25 A No. No. The safeguard which is in

1 place, which would include the depreciation
2 studies which would be updated, coupled with the
3 true-up of the reserve account, would ensure that
4 at the end of the day you would only recover the
5 \$10,000. You may recover it, therefore, over a
6 long period of time.

7 And so customers, whenever you do
8 that depreciation study -- if you started, for
9 instance, in this example, Commissioner, you
10 started with the 10,000, and assume you thought it
11 had a ten year life and you go through year five
12 and you collect a thousand dollars a year.

13 Then, say, at that five year period,
14 you determine that really has a 20 year life,
15 well, then you would then collect that remaining
16 \$5,000 over the next 15 years as opposed to over
17 the remaining five. So those customers would have
18 a reduction in the net salvage that would be
19 recovered from them over the remaining months.

20 **Q So this one piece of the plant, of**
21 **the overall system would constantly be evaluated**
22 **in each case?**

23 **A** Yes. In these depreciation studies,
24 all the groups of accounts would be evaluated, and
25 the true-up mechanisms would be there. And

1 certainly to the extent that we did collect
2 moneys, say, for instance, in this case years one
3 through five that ultimately were corrected, the
4 other safeguard is in place is the offset to rate
5 base. And so, therefore, customers are earning a
6 return on moneys that we in effect borrow from
7 them in advance.

8 Q So there is a -- there is a time of
9 money value that's placed on this and built into
10 it to protect the rate payer if it's collected in
11 advance?

12 A Absolutely.

13 Q Now, this money that's collected
14 doesn't go into a separate account, does it? Do
15 you put it in a passbook account at the bank and
16 hold it until -- what's done with those funds?

17 A The first answer to your question is
18 no. We do not segregate that. I think Mr.
19 Oligschlaeger, part of his testimony suggested
20 that might be an alternative, and I clearly have a
21 view which I don't favor that.

22 But putting that aside, those moneys
23 are part of the overall rates we collect from
24 customers, and so, therefore, they come as part of
25 the general funds of the company that are utilized

1 for the utility to do any number of things,
2 including reinvesting in infrastructure, including
3 taking care of existing retirements, among other
4 things.

5 **Q Including paying regular expenses**
6 **associated with the account?**

7 A Sure. Absolutely. But, of course,
8 keep in mind -- that's true, but keep in mind as
9 part of the regulatory framework we also have
10 rates which are recovering the ongoing expenses of
11 the business, too. They are part of the rate
12 making process. Our tree trimming expenses, for
13 instance, that's part of the framework. But also
14 as part of the rates is the return of and return
15 on our investments and rate base. So that's all
16 commingled together as part of a customer's rate.

17 **Q With the basic depreciation, not the**
18 **cost of removal element, with the basic**
19 **depreciation return, you get a return of and a**
20 **return on that asset; is that correct?**

21 A That's correct, but not for the net
22 salvage.

23 **Q And on the net salvage you only get**
24 **a -- is it a return of?**

25 A Yes. Essentially that's really --

1 Q Okay.

2 A -- the estimate, the pro rata
3 portion. That's correct.

4 Q How old is this traditional method,
5 the standard approach, this age old method, time
6 tested method that you make reference to? How old
7 is this? Is this a recent phenomenon?

8 A No, I don't have the specific date,
9 but certainly it probably goes back to the uniform
10 system of accounts which goes back, I would
11 suggest, decades. Our witness, Marty Lyons, may
12 be able to tell you the specific date, but this is
13 a method that has been in use for, I would
14 suggest, for decades.

15 Q '60s, '50s, '40s?

16 A I -- yes is the simple -- I will
17 tell you for decades for our company, and it's my
18 understanding for other companies around the
19 country, it has been decades and decades. We're
20 talking '50s and '60s, if not even before that.
21 And, excuse me, Commissioner, Mr. Stout may be
22 able to respond to that more fully.

23 Q In Miss Schad's testimony on page 5,
24 she challenges some allegations or some statements
25 on your part, making reference to examples of

1 Ameren or Laclede ever being required to use this
2 standard or traditional approach. Are you
3 familiar with that part of her testimony?

4 A Commissioner, I have read it. If I
5 can get it in front of me, I might be able to
6 respond more fully to -- if you can give me the
7 page number again? I have the testimony here.

8 Q Page 5, line 17 through 21.

9 JUDGE DIPPELL: That's of the
10 supplemental rebuttal?

11 COMMISSIONER CLAYTON: Supplemental
12 rebuttal testimony.

13 THE WITNESS: I apologize,
14 Commissioner, please, if you don't mind reading
15 it?

16 Q (BY COMMISSIONER CLAYTON) Can I
17 read it to you?

18 A Please.

19 Q I'll read slowly. In fact, he has
20 not -- okay, I'll start this off, it's making
21 reference to you, unless there's another Mr.
22 Baxter?

23 A Not that I'm aware of.

24 Q In fact, he has not provided any
25 reference to even one Laclede or Ameren UE order

1 requiring it to accumulate the depreciation
2 reserve based on the, quote, "standard approach,"
3 closed quote, of net salvage, and has also failed
4 to demonstrate that the Commission has used a
5 standard approach for decades.

6 And I was wondering if you could
7 address that statement?

8 A Yes, Commissioner. Well, I think
9 with regard to -- I think that the statement is
10 correct, that I did not cite a specific order.
11 But certainly with regard to Ameren UE, I
12 certainly can go back and look at our records and
13 accounts and know exactly how we've handled
14 things.

15 Secondly, I don't think it's
16 terribly surprising in general that orders don't
17 specifically state how specific method should be
18 utilized. In fact, if it's not a contested issue,
19 orders often don't address a specific matter in
20 it. It's just accepted as that is the principle
21 that is utilized.

22 So just because every order which is
23 issued by this Commission or any commissions
24 around the country don't say, you must use the
25 standard approach wouldn't suggest to me that that

1 is indeed not something that's appropriate.

2 I think every -- otherwise, orders
3 would likely be hundreds and hundreds of pages
4 long based upon standard practice which is
5 utilized by the utilities.

6 Q The last, generally speaking, the
7 last issue that I wanted to bring up was also Miss
8 Schad's testimony. She has an example set out in
9 page 9 and 10 that would indicate potentially
10 intergenerational inequity or, quote unquote, "a
11 windfall" coming to the Company for a start
12 difference between the accrual method of
13 accounting and an actual or an averaging type of
14 accounting. And I wanted you to address that, if
15 possible, but I don't know if you have the --

16 A I have her testimony in front of me.

17 Q It's page 9 and 10. I don't even
18 know if I'm allowed to ask you that, since her
19 testimony hasn't been admitted. Is anyone
20 objecting? Good.

21 MR. BYRNE: I'm certainly not going
22 to object, Your Honor.

23 THE WITNESS: Your Honor, I've read
24 this. I'm not trying to duck your question. I
25 really believe Mr. Stout would probably be better

1 served to handle that.

2 Q (BY COMMISSIONER CLAYTON) That's
3 fine. That's fine. Your -- I'm sure you
4 supervise accounting, but I'm not sure if that's
5 your role necessarily in the company to do
6 accounting work. I think I asked Mr. Cooper the
7 same question. I mean, your role is generally
8 more of a financial market overview, is it not?

9 A That is true. Certainly the
10 accounting function and financial reporting
11 function does report to me, but on the day-to-day
12 activities, people like Marty Lyons, who is one of
13 our witnesses, would be closer to those types of
14 things, as well as Mr. Stout from more of a policy
15 perspective would be appropriate.

16 Q Let me conclude by asking you this
17 question. With regard to the increased cash flows
18 that this type of the accrual accounting method in
19 this instance would -- it would increase your cash
20 flows, would it be appropriate that -- that those
21 amounts should be tied to some sort of capital
22 investment or infrastructure investment or
23 removal? Is that even an appropriate step to
24 take?

25 A Well, Commissioner, it -- my sense

1 is that if the Commission felt that they had real
2 concerns about how Ameren, in this case, was
3 utilizing those moneys, and whether they had real
4 concern as to whether Ameren was not going to be
5 able to fulfill their obligation, certainly they
6 could consider something like that.

7 But for decades and decades and
8 decades, we've always been able to meet our
9 obligations for retirements, always been able to
10 meet our obligations for infrastructure. As you
11 probably well know, in our last rate case we
12 offered to do over \$2 billion of infrastructure
13 commitments as a result of that, which included
14 using this standard approach.

15 So I believe it's a protection which
16 is not necessary because if we would set, for
17 instance, those moneys aside or commit those funds
18 in that way, a couple things, I think, would have
19 to take place.

20 And it gets a little bit to what Mr.
21 Oligschlaeger had recommended as his sort of
22 setting these moneys aside. I think one is that
23 certainly we would put these moneys in, say, a
24 trust account that would earn some rate of return,
25 but my sense is that the Commission would want us

1 to invest those in very safe funds, and that would
2 have a low rate of return.

3 Prudent move, but at the same time
4 the customers would then lose the 8 to 9 percent
5 return on rate base that they get due to the
6 offset of the depreciation reserve as an offset to
7 rate base. So that would increase the cost to
8 customers.

9 Secondly, by us not having access to
10 those funds certainly would give us less
11 internally generated cash flows, and so,
12 therefore, we would have to go to the capital
13 markets more frequently and increase our
14 transaction costs.

15 Q If over time it was found that a
16 company, and I'm not being company specific, but a
17 utility was not meeting its infrastructure
18 obligations or its removal plan or after receiving
19 the enhanced return of this cost of removal over
20 time, would it be appropriate for some sort of
21 action at that time on the part of this
22 Commission?

23 A I think clearly the Commission has
24 that discretion. If they have concerns over a
25 particular utility, I think they could indeed

1 impose that if they felt that was appropriate.

2 Q If this Commission were to find that
3 inappropriate expenditure of funds, what would be
4 the most appropriate way for the Commission to
5 deal with a utility?

6 A Well, I guess, Commissioner, it
7 would depend upon the facts and circumstances.
8 And I'm not trying to duck you, but I'll give you
9 an example.

10 Q Sure you are.

11 A No, I'm really not. For instance,
12 if a utility was -- and that is not the case with
13 Ameren UE, and I'll tell you, but if a utility was
14 going out and investing wildly in some operations
15 which were not germane to the utility business or
16 its Missouri operations, certainly the Commission
17 could find a way to restrict how those moneys are
18 utilized.

19 In our particular case, we have a
20 utility money pool. We don't have the ability,
21 frankly, even under our current construct to take
22 regulated moneys and put it in any of our
23 unregulated enterprises. That's not possible even
24 today, but that could be a restriction imposed.

25 Certainly we could say, okay, we'll

1 break out these net salvage moneys and put them in
2 a separate account, that could be a potential
3 condition should the Commission find that
4 necessary. And depending upon the facts and
5 circumstances, you could probably devise all kinds
6 of safeguards which could include simply
7 monitoring the situation and not taking specific
8 actions. There's a wide range.

9 **Q Would there be a way of monitoring**
10 **that outside of a rate case? Or addressing it**
11 **outside of a rate case? A complaint case could be**
12 **filed?**

13 **A** Certainly, and my sense is that all
14 the utilities in Missouri have to file periodic
15 reports from the Staff, and it's not uncommon,
16 certainly not in a rate case, that we agree to
17 file even supplemental reports that wouldn't
18 necessarily be standard.

19 So those things could be devised so
20 the Staff and Office of Public Counsel and others
21 could monitor the situation to ensure that
22 whatever -- whatever goals the Commission were
23 trying to achieve could be reached.

24 **Q In comparing the two different**
25 **methods that are before us today, the actual and**

1 the accrual method, over a long period of time,
2 say a hundred years, would the amounts crisscross
3 on a graph? Like one would be higher or lower on
4 any given day? Or will the accrual always be a
5 higher amount -- the accrual method always require
6 a higher amount of funds in rates than the actual?

7 A Um --

8 Q Or will the lines on a graph
9 crisscross over time?

10 A Well, for instance, Commissioner, in
11 Mr. Stout's example, which I believe Mr. Schwarz
12 showed to me a little while ago, there was a
13 situation where they indeed did crisscross. And
14 in that particular situation -- mind you, you had
15 sort of a static amount of plant that was in
16 there, and there was clearly a crisscross maybe in
17 year 20 that those then -- that the accrual was
18 less than the actual cash outflows for
19 retirements.

20 Q Now, at that point would it be
21 appropriate for a party to come in and request a
22 change? For example, if the Company's requesting
23 the accrual method today and in ten years the
24 amounts change, would it be appropriate for the
25 Company to request a change in the depreciation

1 **reporting method at that time?**

2 A My sense would be no. If the
3 standard approach had been utilized from day one,
4 the utility is being made whole and will have the
5 flexibility and the financial wherewithal to meet
6 its obligations.

7 It would be unfair, for instance, if
8 the utility was collecting these moneys up front,
9 and these are all other things being equal, the
10 utility's collecting these moneys up front and see
11 their retirements starting to increase, and say,
12 now it's time to switch gears, so we're going to
13 collect more moneys, I think that would be counter
14 to the position that we've taken in this case.

15 COMMISSIONER CLAYTON: Okay. Thank
16 you.

17 JUDGE DIPPELL: Commissioner Murray,
18 did you have questions for Mr. Baxter?

19 COMMISSIONER MURRAY: Just one or
20 two, I believe. Thank you, Judge.

21 BY COMMISSIONER MURRAY:

22 Q **Good afternoon, Mr. Baxter.**

23 A Good afternoon, Commissioner Murray.

24 Q **The suggestion that there be a**
25 **separate fund for the accrued amounts, if that**

1 were the case, the -- is it your understanding
2 that the Commission rule that requires the 3
3 percent per annum on principal amount of the
4 depreciation funds would then take over and -- and
5 the customers would then earn 3 percent versus the
6 ability that they have right now to earn a rate
7 equivalent to the Company's rate of return?

8 A If I -- if I can caveat my response
9 to that, that's probably in part a legal
10 determination, but if we put it in a trust
11 account, and I think that was the example I was
12 walking through with Commissioner Clayton, my
13 sense is that that trust account would not have
14 certainly the same level of return they could have
15 on rate base because, number one, it would be in
16 safe funds, and, two, you would have transaction
17 costs. So it would be significantly less than the
18 8 or 9 percent return.

19 Now, whether that 3 percent rule
20 would kick in, I'll leave that to the attorneys to
21 determine that, but certainly it would be
22 significantly less than they would earn.

23 Q The money itself would earn
24 significantly less?

25 A That's correct.

1 COMMISSIONER MURRAY: I don't think
2 I have any other questions for you. Thank you.

3 JUDGE DIPPELL: Thank you.

4 Commissioner Davis, did you have
5 questions for Mr. Baxter?

6 COMMISSIONER DAVIS: Not at this
7 time.

8 JUDGE DIPPELL: Commissioner
9 Applling?

10 COMMISSIONER APPLING: No questions.

11 COMMISSIONER MURRAY: Sorry, I can't
12 let you get off that easily.

13 Q (BY COMMISSIONER MURRAY) Miss
14 Schad's testimony, her supplemental rebuttal,
15 which I believe is what you just were referencing
16 earlier, Schedule 8-1, she attached in there a
17 rather lengthy letter from John Ferguson to the
18 membership of the Society of Depreciation
19 Professionals. Are you familiar with that Society
20 of Depreciation Professionals?

21 A I am aware of the society that it
22 suggests. To say that I know absolutely anything
23 that that society does would be an overstatement.

24 Q Look at the fifth paragraph down on
25 the first page of that letter.

1 A Commissioner, I'm sorry, it is
2 Schedule 8-1?

3 Q Yes. And it's a memo dated June 10?

4 A Okay. Thank you. And where were
5 you referring to again, please?

6 Q It's five paragraphs down, and I'll
7 read it out loud. It's the near term revenue
8 requirement impact, and talking about the standard
9 basis for salvage treatments, I understand,
10 anyway.

11 The near term revenue requirement
12 impact makes such cash treatment and other forms
13 of salvage and cost of removal deferral attractive
14 to regulators. The proceedings discussed here
15 demonstrate that this attraction is strong enough
16 to prompt some regulators to dictate cash
17 treatment even though in conflict with uniform
18 systems of accounts that specify accrual
19 accounting and, and this is the part that I want
20 to emphasize here because it goes on to say, and
21 unfortunate for customers and the economy of the
22 service territory.

23 I don't know if you've read that or
24 if -- if your interpretation of that would be the
25 same as mine, which would be that he's saying that

1 a result orient approach to look at short-term
2 rates and apply that on the cash basis even though
3 it's in conflict with the uniform system of
4 accounts and even though it's unfortunate for
5 customers and for the economy of the service
6 territory. Is that a reasonable interpretation of
7 that, in your opinion?

8 A Well, Commissioner, I think that
9 that is -- that is a reasonable interpretation. I
10 think what he could be referring to as well,
11 although I disagree, is that the accrual
12 accounting is, in his view, unfortunate for
13 customers and the accounting of the service
14 territory. I'm not sure how to interpret that.

15 Q Well, actually, when I started out,
16 I think I started out incorrectly here, I think
17 what he's saying, the near term revenue
18 requirement impact makes cash treatment attractive
19 to regulators --

20 A Which is the short-term gain, which
21 is the short-term gain that regulators find
22 attractive for customers. Yet, as we state in our
23 testimony, customers pay clearly in the long term
24 in a variety of ways by moving to the cash method
25 versus the accrual method. Ultimately resulting

1 in higher rates to customers.

2 Q And it seems to me that if we
3 develop a policy or use a methodology that results
4 in basically looking good right now to customers
5 for the short term at the cost of future
6 customers, maybe after we're gone, that that's a
7 very inappropriate type of manipulation that might
8 make regulators look good temporarily, but really
9 would have a -- an unfair and unfortunate effect
10 on rate payers over the long term.

11 A I agree 100 percent with that
12 statement.

13 Q And if -- if we were to save
14 customers in the short term some amount based on
15 adopting Staff's -- going forward with Staff's
16 methodology, but the current customers' children
17 and grandchildren end up paying more because of
18 that, I wonder if the current customers would even
19 be happy about that, if they understood that that
20 would be the result.

21 A I think that's a fair assessment and
22 I think you're exactly right. It would be the
23 children and the grandchildren and the great
24 grandchildren, all those would pay significant
25 costs. There would be a detrimental effect not

1 only to them, but potentially to the overall
2 economy of the State and issues with
3 infrastructure and the like. I agree 100 percent
4 with that.

5 And I think existing customers, if
6 they understand that it is a short-term gain with
7 a significant long-term loss, I think they would
8 express the same view.

9 Q And I believe your testimony is the
10 one -- actually, I see it here on page 13, you are
11 the witness who pointed out that -- line 17 and
12 following -- that --

13 A I'm sorry, page 13?

14 Q Yes. You are talking about why
15 Staff's approach of removing that salvage prime
16 depreciation constitutes poor rate making policy
17 because it improperly defers net salvage cost to
18 future customers forcing them to subsidize current
19 customers, but then Staff makes that already poor
20 policy even worse with amortization of net salvage
21 accruals collected from past customers to further
22 subsidize current customers.

23 And as I read that, I read that to
24 mean that the net salvage accruals that have
25 already been collected, that Staff's approach is

1 to repay the current customers for that, those
2 amounts that were collected from past customers,
3 and also at the same time not charge the current
4 customers for any accrual for removal or
5 retirement of the assets that they're currently
6 using. Is that what you're saying? It's kind of
7 like a double subsidy to the current customers?

8 A That's exactly right.

9 Q And the result at some point in time
10 could be rate shock to -- to customers if there
11 were significant removal costs and the Commission
12 were to apply those costs as an expense whenever
13 it were incurred?

14 A I would be stronger, I wouldn't say
15 "could," I would say it is very likely that that
16 would happen. Absolutely.

17 COMMISSIONER MURRAY: Thank you.

18 JUDGE DIPPELL: Are there any
19 additional questions from the Commissioners? All
20 right, then. You can go ahead with further cross
21 examination based on questions from the bench.
22 Laclede?

23 MR. PENDERGAST: Just a few, Your
24 Honor.

25 CROSS EXAMINATION BY MR. PENDERGAST:

1 Q Mr. Baxter, in response to a
2 question or two that you received regarding the
3 ability to pay back these amounts in the future
4 and where the sources of cash would come from to
5 do that, I think you talked about various
6 safeguards, and I think you also mentioned
7 safeguards that have recently been imposed when it
8 comes to Ameren UE borrowing funds from third
9 parties through financing. Do you recall that?

10 A I do recall that.

11 Q And I believe you answered that --
12 that certain conditions had been imposed on Ameren
13 UE to ensure that this money that is being
14 borrowed ostensibly for utility related purposes
15 will be there to pay for the obligations that it's
16 being borrowed; is that correct?

17 A That's correct.

18 Q And one in particular that you
19 mentioned is a condition that says that the total
20 borrowings that Ameren UE has will not exceed its
21 regulated rate base. Do you recall that?

22 A I do.

23 Q Okay. Can you explain a little bit
24 about that particular condition and how it works?

25 A Sure. The Staff imposes a safeguard

1 when it comes time for UE and other utilities, to
2 my understanding, to come to borrow, that they
3 don't over leverage, meaning they don't borrow
4 moneys really in excess of the assets they have.

5 So, as we've discussed, rate base
6 includes not only original cost of plant, but also
7 reserve for depreciation, is net of that, which
8 would include net salvage. So by ensuring that
9 companies can't borrow anything in excess of their
10 rate base, that means they have the ability to go
11 to the capital markets for borrowings based on
12 assets which have not had borrowings against it
13 already.

14 So when you have rate base less net
15 salvage, that means you really don't have the
16 ability to borrow more than you're capable of to
17 ensure that you have the funds, at least should
18 you choose to borrow it, to go to the capital
19 markets to have the funds available to meet your
20 obligations, whether they be from net salvage or
21 certainly for infrastructure.

22 Q And based on the discussion we've
23 had about the interplay between net salvage and
24 its influence on the depreciation reserve, and the
25 depreciation reserve being deducted from rate

1 base, would it generally be true that as you
2 accrue more net salvage, in other words, customers
3 prepay more, that that deduction from rate base
4 becomes larger?

5 A That is correct.

6 Q And therefore, the limitation
7 becomes stricter that's in those financing
8 conditions from the standpoint that you've got a
9 smaller rate base that your borrowings can't
10 exceed?

11 A That's correct.

12 Q Do you view that as an additional
13 protection for the concern that if these
14 prepayments are made through net salvage
15 adjustments, that the company will have the
16 economic wherewithal and the financial wherewithal
17 to meet those obligations in the future?

18 A That is clearly an additional
19 protection.

20 Q And do you know if those protections
21 were imposed after an impartial response to some
22 of the unfortunate developments we had with
23 respect to perhaps certain utilities and certainly
24 the Enron-like developments that we had?

25 A Mr. Pendergast, I must say I'm not

1 sure exactly in terms of the timing when those
2 particular restrictions were imposed so I can't
3 answer it completely.

4 MR. PENDERGAST: Okay. Thank you
5 very much.

6 JUDGE WOODRUFF: Is there further
7 cross based on questions from the bench from
8 Public Counsel?

9 MS. O'NEILL: Maybe just a few.

10 CROSS EXAMINATION BY MS. O'NEILL:

11 Q Mr. Baxter, when we're talking about
12 net salvage, we're talking about the cost of
13 removal of an item for service, not the original
14 cost to purchase and install that item. Correct?

15 A It is the cost to remove an item
16 from service less any scrap potentially that you
17 can sell that for. That would be a negative net
18 salvage.

19 Q And that would -- so that's a number
20 that's in addition to the cost to purchase that
21 plant item and install it? That's -- that's also
22 depreciated, but that's separate than this net
23 salvage number?

24 A That's correct.

25 Q And the net salvage is not --

1 doesn't go into a particular account that's only
2 used for cost of removal, correct?

3 A Is your question whether those
4 moneys are specifically segregated in the accounts
5 of the company?

6 Q Right.

7 A I would ask you to ask Mr. Lyons
8 that specific question.

9 Q Okay. So also I -- so if I wanted
10 to talk about in this example that's on the board,
11 this \$8,000 cost of removal, or net salvage
12 number, by way of example, you can't tell me
13 whether or not that's designated to actually
14 remove that item or plant?

15 A Miss O'Neill, what do you mean by
16 "designated"?

17 Q That \$8,000 gets used to remove that
18 plant.

19 A No, we do not have a separate,
20 segregated fund of cash that would specifically
21 pay for net salvage. That is correct.

22 Q And, in fact, you don't have a
23 specific requirement that that \$8,000 that's
24 collected from the customers actually be used for
25 cost of removal at all, correct?

1 A That's correct.

2 Q So if a company collects the \$8,000,
3 but spends it on something not related to cost of
4 removal of plant and then has to remove that
5 plant, where does the \$8,000 come from?

6 A Well, as I said before -- I believe
7 Mr. Schwarz asked that question before. I think
8 it comes from a variety of sources. It could come
9 from the operating funds of the company, the
10 general funds of the company, or those funds could
11 be obtained by us going to the capital markets and
12 issuing either new common stock or issuing new
13 debt to pay for that obligation.

14 Q Where do the general funds of the
15 company come from?

16 A They are the funds that are on hand
17 at any given time in the possession of the
18 company.

19 Q Do they come from the customers when
20 they pay their bills?

21 A Well, in part. They also could come
22 from return on investments that the company has.
23 So in general, in large part, I would say they
24 come from rate payers, but certainly there are
25 other sources of funds as well.

1 Q When you go out into the capital
2 markets and you issue more equity, do your
3 investors then expect a return on that equity?

4 A Yes, they do.

5 Q And does that return on equity come
6 from payments made by your customers?

7 A As part of the rate making
8 framework, there's certainly a return on equity
9 which is reflected in the overall regulatory
10 framework. So they in part come certainly from
11 rate payers to pay for that.

12 Q And if you go out and you get debt
13 and you have debt issued and you have to pay that
14 debt back, is the cost of that debt also part of
15 that rate making framework where you get money
16 from your customers through rates to pay for that
17 debt?

18 A Part of the overall cost of capital
19 which goes into the overall regulatory framework.
20 But keep in mind if we do indeed have to do
21 borrowings at the end of a particular life of an
22 asset and because we've used some of those funds
23 that we receive in advance from customers, what we
24 have -- likely have done and what we have done is
25 reduced borrowings at the front end of a

1 particular asset's life.

2 And so, therefore -- so, therefore,
3 customers are still better off in terms of our
4 ability to access, even though we accessed the
5 capital markets at the end and it's reflected in
6 the cost of capital, that is mitigated, not offset
7 entirely by the fact that we haven't had
8 borrowings earlier on in that asset's life because
9 we used internally generated funds.

10 Q So although your customers have paid
11 the \$8,000, if you spent the \$8,000 somewhere
12 else, you may be asking customers to pay at least
13 a significant portion of the \$8,000 to remove that
14 item at the time that you incur those removal
15 costs?

16 A That's not correct under the
17 standard method. We are not going to double
18 collect from customers. What customers may
19 ultimately have to pay for is simply potential
20 borrowings, but the borrowing itself is not
21 collected from customers. That has been collected
22 as part of the standard approach throughout the
23 life of that asset.

24 We would not seek the additional
25 principal amount, if you would, for that \$8,000

1 that we've collected over the life. We would not
2 double collect.

3 Q How about the interest?

4 A Well, the interest costs don't go
5 directly into the regulatory framework. It is
6 simply a part of the cost of capital. What I am
7 saying is that we have less interest costs in the
8 front of that asset's life if indeed -- if we have
9 to indeed do some borrowings at the end, because
10 we've been able to use those internally generated
11 funds at the front end and, therefore, mitigated
12 the overall cost to customers.

13 And, in fact --

14 Q That was internally generated funds,
15 they're funds that you get as a result of being in
16 business; is that correct? If you weren't in
17 business, you wouldn't get any funds. It's not a
18 trick question.

19 A Well, sure, I guess you're not in
20 business, you don't get funds. You don't get
21 money for no reason.

22 Q You're in business providing
23 regulated utility service for your customers, your
24 customers provide you with funds in exchange for
25 providing that service; is that correct?

1 A That's correct.

2 Q Those funds may be -- those funds --
3 in addition to the net salvage component of those
4 funds, other funds you're saying may also be used
5 for this cost of removal?

6 A Sure. They could be. Indeed.

7 Q So the customers could give you more
8 than \$8,000 related to this cost of removal?

9 A No. I disagree.

10 MS. O'NEILL: I guess we disagree.
11 I have no further questions.

12 THE WITNESS: Thank you.

13 JUDGE DIPPELL: Is there further
14 cross examination based on questions from the
15 bench from Staff?

16 MR. SCHWARZ: Yes, I'm afraid so.

17 RE-CROSS EXAMINATION BY MR. SCHWARZ:

18 Q Commissioner Clayton I think had a
19 series of questions where he was talking about
20 safeguards and evaluations, and I -- I'm not sure
21 that I was clear on parts of it, so I'm asking
22 these mostly to be clear.

23 Depreciation expense is charged each
24 month and it goes to the reserve for depreciation,
25 that's where it's eventually closed to. Is that

1 correct?

2 A Yes.

3 Q And that's used as an offset to rate
4 base. Is that correct?

5 A That is correct.

6 Q And that, therefore, is a benefit to
7 rate payers. Correct? Having it as an offset to
8 rate base benefits rate payers?

9 A Yes.

10 Q But it doesn't really benefit rate
11 payers until it's reflected in customer rates; is
12 that correct?

13 A That would be correct.

14 Q Can you tell me when Union Electric
15 filed its last rate case?

16 A Is the question when we filed our
17 last rate case or when we were in a rate
18 proceeding that affected the company?

19 Q When did Union Electric file a rate
20 case last?

21 A I think the actual last rate case
22 that we filed versus when the Staff filed a rate
23 proceeding against us, which was 2002, but the
24 last rate case, and this is my recollection, may
25 be 1987, 1988? I believe it could be that far,

1 although I can't say definitively.

2 **Q Perhaps 1984, when Callaway --**

3 A I get confused because I know there
4 was a proceeding in '84; and then in '87, there
5 was some subsequent, so I'm not sure if you would
6 consider that a rate proceeding or not.

7 **Q Um, if currently your internally**
8 **generated funds are not sufficient to cover your**
9 **construction costs, at the time when net salvage**
10 **reverses and is no longer sufficient to cover your**
11 **expenditures for cost of removal, your -- that gap**
12 **will be even greater, will it not?**

13 A I'm not sure I understand the gap
14 that you're referring to.

15 **Q The gap between internally generated**
16 **funds and construction needs. Infrastructure**
17 **needs.**

18 A Well, I think we're talking about a
19 couple of different things. There's the accrual,
20 which you get through rates, which I believe we
21 talked about in Mr. Stout's exhibit. And then
22 there's the retirements that you get that you have
23 made a cash outflow for. And then you have
24 internally generated funds which aren't
25 necessarily -- who knows what those particular

1 funds could be at any particular point in time.

2 So if you're asking me about the gap
3 between the retirement costs and the accrual basis
4 over time, then that, I believe, if you look at
5 Mr. Stout's schedule, that that gap continues to
6 increase over time, if I'm understanding you
7 correctly.

8 MR. SCHWARZ: Thank you.

9 JUDGE DIPPELL: Is there redirect
10 from Ameren?

11 MR. BYRNE: Yes, Your Honor, there
12 is.

13 REDIRECT EXAMINATION BY MR. BYRNE:

14 Q Mr. Baxter, you were asked some
15 questions earlier about when -- by both the
16 Commissioners and I think Mr. Schwarz about when
17 the figures cross over and they start to accrue
18 less in net salvage than we have to pay; do you
19 remember that line of questioning?

20 A I do, yes.

21 Q And I guess the suggestion may have
22 been that UE might have difficulty finding money
23 to retire its -- or pay its retirement costs, do
24 you recall that?

25 A I do recall.

1 Q Has Ameren UE ever had any
2 difficulty in its hundred year history finding the
3 funds to meet its retirement obligations?

4 A To the best of my knowledge, no.

5 Q Do you anticipate any problems
6 meeting retirement obligations in the future?

7 A No, especially if -- if we continue
8 to use the standard method of depreciation, I feel
9 very confident we'll be able to meet those
10 obligations in the future.

11 Q And what does Ameren UE do with
12 funds it collects from depreciation rates through
13 net salvage?

14 A It does a variety of things, but
15 certainly it can utilize those funds to invest in
16 the infrastructure of the company. As I explained
17 to Commissioner Clayton, we don't have the ability
18 to reflect the construction in progress funds that
19 are in that -- and construction work in progress
20 in rates, and so, therefore, we up front fund a
21 lot of these infrastructure improvements. So in
22 part those moneys can be utilized for that.

23 Q Okay. There were some questions
24 from Ms. O'Neill about -- concerning the issue of
25 possibly double collecting money from customers.

1 Do you recall that line of questioning?

2 A I do.

3 Q In your opinion, would it ever be
4 appropriate for Ameren UE or Laclede to double
5 collect retirement costs from its customers?

6 A No.

7 Q Does the Commission have the
8 authority, in your opinion, to prevent a utility
9 from double collecting those costs?

10 A Absolutely, and I would suggest,
11 too, that the safeguards inherent in the standard
12 method prevent that as well.

13 Q Mr. Schwarz asked you if you could
14 name any customers who failed to locate in
15 Missouri because of utility problems. Do you
16 remember that line of questioning?

17 A I do.

18 Q And would it be fair to say that at
19 least historically and even currently for Ameren
20 UE, the standard approach is used for net salvage
21 currently?

22 A It is.

23 Q And so to the extent that there
24 hasn't been a problem, could it be due in part to
25 the fact that the standard approach is used?

1 A If you're referring to a problem
2 with customers being concerned with locating to
3 the State of Missouri, I think absolutely right.
4 That standard method can certainly give them that
5 comfort.

6 Q Do you recall Mr. Schwarz -- I guess
7 he handed you a piece of paper and asked you to
8 read a sentence off of it, and I think it was a
9 Standard & Poor's credit report on Ameren and
10 Ameren UE?

11 A I do recall that.

12 Q And did -- did that report from
13 Standard & Poor's lead to a credit rating change
14 for Ameren or Ameren UE?

15 A It did not. It just reflected the
16 negative outlook. It did not reflect a specific
17 credit rating change.

18 Q Can you explain to me what process a
19 credit rating agency such as Standard & Poor's
20 goes through when they issue a report on a company
21 like Ameren or Ameren UE?

22 A Sure. It's a fairly lengthy
23 process. It is one where models are developed by
24 the company that reflects basically their
25 expectations of cash flows based upon existing

1 regulatory framework, based upon a variety of
2 assumptions including low growth, including
3 capital expenditures, including operating
4 expenditures and the like, as well as the needs to
5 do whatever borrowings may be necessary to fund
6 their operations.

7 So they look at that, and they also
8 look at other things. They look at the overall
9 regulatory climate of a particular jurisdiction,
10 they look at the future outlook at the economy of
11 a state, and a host of other things. It's a very
12 detailed look.

13 So when they put all those things
14 together, one of the things they clearly focus on
15 in terms of all those things are cash flows, as
16 certainly my discussion. That is clearly one of
17 the main focal points they utilize in terms of
18 looking at cash flows of all the entities of
19 Ameren, including Ameren UE.

20 **Q And how would a credit rating agency**
21 **view a departure by a commission from the standard**
22 **approach to net salvage?**

23 **A I think it's obvious they would view**
24 **it negatively as reflected in the negative**
25 **comments the agencies have had in both the Laclede**

1 and Empire case, and I'm certain that would be the
2 case here.

3 Q You had a question from Commissioner
4 Clayton, and I think paraphrasing, he asked you
5 why we wanted to use the standard method, what
6 were some of the reasons, and I think you talked
7 about cash flows and intergenerational equity. Do
8 you recall that question and answer?

9 A I do recall that.

10 Q Is another reason we want to use the
11 standard approach is because it properly allocates
12 the cost of an asset to customers that use the
13 asset?

14 A Absolutely. And I probably didn't
15 explain my view of intergenerational equity
16 appropriately, because that really kind of goes
17 part and parcel. It's ensuring current customers
18 pay for the current use of the assets used to
19 serve them.

20 Q Is another reason we want to retain
21 the standard approach is because it is required by
22 the uniform system of accounts?

23 A Certainly.

24 Q Commissioner Murray asked you some
25 questions about having a separate fund. Do you

1 recall those questions?

2 A I do recall those questions.

3 Q And I think one of your answers, you
4 mentioned transaction costs being an issue in a
5 separate fund. Do you recall that?

6 A That's correct.

7 Q And I'd like to ask you a couple
8 questions about that. I mean, would you
9 anticipate, if you had a separate fund for
10 retirement and net salvage expenses, that there
11 would be a lot of transactions in that fund? As
12 pieces of property are taken out of service every
13 year?

14 A Well, I think that there would
15 certainly be numerous transactions because there
16 would be -- as we don't just do all our
17 retirements at once, certainly there would be
18 several sources of cash outlays that would have to
19 be made during the course of a year.

20 And when I talk about transaction
21 costs, it includes really administrative costs
22 associated with the administering of.

23 Q So like paying a fund supervisor or
24 a fund trustee, that kind of a cost?

25 A Absolutely.

1 Q And then might there also not be
2 transaction costs for each individual transaction?

3 A I would expect, yes.

4 Q Okay. And if you compare that to,
5 say, a nuclear decommissioning fund, how would you
6 think the number of transactions would compare
7 with the number of transactions in a nuclear
8 decommissioning fund?

9 A Certainly today they would be
10 significantly more for net salvage versus nuclear
11 decommissioning fund.

12 Q In your experience, has the
13 Commission required separate funds in other areas
14 where it's not required, say, by federal law like
15 in the case of a nuclear decommissioning fund?

16 A I'm not aware of any.

17 Q So, for example, if a company has a
18 cash flow difference between deferred taxes that
19 are included in rates and when those deferred
20 taxes actually get paid, the Commission hasn't set
21 up a separate fund for that?

22 A That's correct.

23 Q Okay. And I guess it works the
24 other way? There's no separate fund that protects
25 a utility when it has to pay costs in advance of

1 recovering it from rate payers?

2 A That's correct.

3 Q Okay. Mr. Schwarz I believe asked
4 you when the last time the company filed a rate
5 case, a rate increase case, and I think you said
6 around 1988. Do you recall that question and
7 answer?

8 A I do. I do.

9 Q Do you think it's a bad thing that
10 the company hasn't asked for a rate increase since
11 1988?

12 A No, absolutely not. I think it's a
13 great thing. We've had several rate proceedings
14 during that time, and several rate decreases since
15 that time.

16 Q And to the extent since 1988 the
17 company has been investing in infrastructure --
18 well, let me ask you this. Has the company made
19 considerable investments in infrastructure since
20 1988?

21 A Oh, absolutely. I think potentially
22 Mr. -- some of the analyses and things that I
23 think you showed in your overall opening statement
24 shows the level of increase in overall plant
25 balances.

1 But certainly in our last rate case
2 -- excuse me, rate proceeding, I'm not sure if
3 rate case is the appropriate terminology, in 2002,
4 Ameren UE made a commitment in over \$2 billion in
5 infrastructure investments over I believe four,
6 four and a half years to make sure that the
7 overall reliability of the -- of our system was
8 maintained.

9 Q And do we have a rate moratorium
10 during that period?

11 A Well, rate moratorium is kind of
12 interesting. We had several rate decreases during
13 that period. Decreases totalling over 110
14 million. As we stand today, rates are frozen
15 through June of 2006.

16 Q So since they have not increased
17 from 1988 until, I guess, 2006 when the rate
18 moratorium expires, isn't it true that we can't
19 reflect increased investment in infrastructure
20 that occurred during that period? We've not had
21 an opportunity to change the rate base to reflect
22 increased infrastructure investments?

23 A I believe, Mr. Byrne, if I consider
24 that, we -- as part of the rate proceedings which
25 have taken place during those times, information

1 has been updated in terms of the determination of
2 rates going forward, which would include rate
3 base. So potentially as part of those
4 settlements, it's hard for me to distinguish part
5 of those settlements than to have some of that
6 reflected potentially.

7 MR. BYRNE: That's all I have.
8 Thank you, Mr. Baxter.

9 JUDGE DIPPELL: Thank you. I
10 believe, then, that's all the questions for you,
11 Mr. Baxter, and you may be excused.

12 THE WITNESS: Thank you, Your Honor.

13 JUDGE DIPPELL: We're going to go
14 ahead and take another ten minute break, slightly
15 less, come back at 5 till, and then we'll go until
16 5 o'clock and then we will end for the day. Thank
17 you. Go off the record.

18 (Off the record.)

19 JUDGE DIPPELL: Okay, let's go ahead
20 and go on. Let's go back on the record.

21 I believe we're ready, then, to
22 begin with Mr. Stout. He's already taken the
23 witness stand when I wasn't looking.

24 (Witness sworn.)

25 WILLIAM STOUT, testified as follows:

1 DIRECT EXAMINATION BY MR. ZUCKER:

2 Q Good afternoon, Mr. Stout.

3 A Good afternoon.

4 Q I'm Rick Zucker, I'm an attorney for
5 Laclede Gas Company. Welcome to Missouri.

6 A Thank you.

7 Q Can you please state your full name
8 and business address for the record?

9 A William M. Stout, my business
10 address is 207 Senate Avenue, Camp Hill,
11 Pennsylvania.

12 Q And who are you employed by?

13 A I am employed by Gannett Fleming.

14 Q And what is your position with
15 Gannett Fleming?

16 A I am President of the valuation and
17 rate division.

18 Q And are you the same William M.
19 Stout who filed supplemental direct testimony on
20 August 20th, 2004, which has been marked as
21 Exhibit -- yeah, Exhibit 136?

22 A I am.

23 Q And are you the same William Stout
24 who filed supplemental rebuttal testimony in this
25 docket which has been marked as Exhibit 137?

1 A I am.

2 Q And do you have any changes to these
3 testimonies?

4 A Yes, I have several minor
5 corrections to some numerical values. In Exhibit
6 No. 136, my supplemental direct testimony, on page
7 18 at line 19, the numerical value shown there of
8 0.131524 should be 0.128042.

9 Q Mr. Stout, would you do that again?

10 A Certainly. Exhibit No. 136, my
11 supplemental direct, page 18 at line 19.

12 Q Thank you. Would you read the
13 number again?

14 A The correct number is 0.128042.

15 Q Okay. Any other changes to your
16 supplemental direct testimony?

17 A No.

18 Q How about your supplemental
19 rebuttal?

20 A Yes. On page 7 of Exhibit No. 137
21 at line 18, the amount 118 percent should be 115
22 percent.

23 Q And that is still negative; is that
24 correct?

25 A Yes. And at line 22, the negative

1 66 percent should be negative 95 percent.

2 Finally, continuing on Exhibit 137 at page 24, at
3 line 18, the reference to page 49 should be to
4 page 38.

5 Q And the line numbers are the same,
6 lines 11 through 19?

7 A Yes, they are correct.

8 JUDGE DIPPELL: And, I'm sorry, what
9 was the page and line number on that last one?

10 THE WITNESS: The location of the
11 error?

12 JUDGE DIPPELL: Yes.

13 THE WITNESS: Is on page 24 of
14 Exhibit 137, line 18, before the quote. The
15 reference to page 49 should refer to page 38.

16 JUDGE DIPPELL: All right.

17 Q (BY MR. ZUCKER) Do you have any
18 other changes?

19 A I do not.

20 Q Okay. So with those changes, if you
21 were asked the same questions that were posed in
22 the supplemental direct and rebuttal testimonies,
23 Exhibits 136 and 137 today, would your answers to
24 them be the same?

25 A Yes, they would.

1 MR. ZUCKER: Your Honor, I request
2 that Exhibits 136 and 137 be admitted into
3 evidence.

4 JUDGE DIPPELL: Will there be any
5 objection to Exhibit No. 136?

6 MS. O'NEILL: Your Honor, I have not
7 -- I have an objection not to the testimonial
8 portion of the exhibit, but to some of the
9 schedules. I would object to Schedule WMS-1,
10 WMS-3-2, WMS-4-2, WMS-5-2, and WMS-6-2, and the
11 reason for that objection is that I believe that
12 those exhibits are not relevant to the Laclede Gas
13 Company rate case proceeding.

14 All but the last one of those
15 specifically deals with Ameren UE. The final
16 schedule to which I am objecting, 6-2, is an
17 exhibit that deals with electric utilities.
18 Laclede does not have -- is not an electric
19 utility.

20 JUDGE DIPPELL: Mr. Zucker, would
21 you like to respond?

22 MR. ZUCKER: First, I'm not sure I
23 caught all the exhibit numbers. What was the one
24 after WMS-1?

25 MS. O'NEILL: WMS-3-2, WMS-4-2,

1 WMS-5-2, WMS-6-2.

2 MR. ZUCKER: Okay. Thank you. My
3 response would be very similar to the discussion
4 we had earlier today where Mr. Byrne responded to
5 this issue. The -- these schedules are shown for
6 illustrative purposes to illustrate a point having
7 to do with net salvage methodology.

8 Neither Mr. Stout nor Ameren is
9 asking for any relief for Ameren in this docket,
10 so these aren't meant to prove anything for
11 Ameren, only to illustrate issues having to do
12 with net salvage which is relevant to this case.

13 MR. LOWERY: Your Honor, and if I
14 might, since the objection seems to be to
15 relevance and seems to be directed toward the fact
16 that Ameren data is discussed in these schedules,
17 I won't repeat, I'll just refer to the record that
18 Mr. Byrne already made in the untimeliness of
19 Public Counsel's objection.

20 We believe in those types of issues,
21 but I'd like to expand just a minute on what Mr.
22 Zucker had to say. Ameren UE has a gas utility
23 and has a gas distribution plant and also electric
24 transmission and distribution assets, and those
25 are mass property assets.

1 Those assets, for purposes of how
2 the standard approach applies, the principles, the
3 safeguards, all the things that we've been talking
4 about, the policies that at least some of the
5 Commissioners I know have expressed may or may not
6 ultimately be things that they consider in this
7 case, those things are perfectly analogous.

8 There's almost no difference
9 whatsoever, and so clearly I think that's relevant
10 and material evidence to illuminate the points and
11 to illustrate the points using real data, which is
12 all Mr. Stout is doing. How the standard approach
13 applies and through contrasts with Staff's
14 approach, and we are entitled as a party to this
15 case to put on that relevant, material evidence.

16 JUDGE DIPPELL: Okay. Ms. O'Neill,
17 these objections are very similar to some of the
18 objections that you had to the previous exhibits;
19 is that correct?

20 MS. O'NEILL: To the extent that my
21 objection is relevance, that would be correct.

22 JUDGE DIPPELL: I think what I'm
23 going to do is treat this with those and let --
24 because, otherwise, I need to have the chance to
25 look at each exhibit and analyze it. So I think I

1 will allow you to make these objections in writing
2 as well.

3 MS. O'NEILL: All right.

4 JUDGE DIPPELL: And I will -- if the
5 objection just goes to those specific schedules --

6 MS. O'NEILL: It does. The rest of
7 the testimony in that exhibit, I don't have an
8 objection to.

9 JUDGE DIPPELL: Let's just leave it
10 pending right now and, again, we'll treat it as if
11 it were an offer of proof and we'll let the
12 witness testify as to any cross examining as to
13 what he would have said if the exhibit were
14 admitted. And I will let Ms. O'Neill put those
15 specifically in writing and give the other parties
16 a chance to respond so they can take it under
17 advisement.

18 MR. ZUCKER: Thank you, Your Honor.
19 So we'll treat 136 the same way that we treated
20 Mr. Baxter's testimony?

21 JUDGE DIPPELL: Yes.

22 MR. ZUCKER: Okay. I also move for
23 the admission of Exhibit 137.

24 JUDGE DIPPELL: And is there an
25 objection to Exhibit No. 137?

1 MS. O'NEILL: Not from Public
2 Counsel, no.

3 JUDGE DIPPELL: Is there any other
4 objection? All right then, I will admit Exhibit
5 No. 137.

6 MR. ZUCKER: Tender the witness for
7 cross.

8 JUDGE DIPPELL: Thank you. Is there
9 cross examination from Public Counsel? I'm
10 assuming that there's -- this witness is actually
11 sort of co-sponsored, according to the witness
12 list; is that correct?

13 MR. ZUCKER: That's correct, Your
14 Honor.

15 JUDGE DIPPELL: All right. So I'm
16 assuming, then, that there is no cross examination
17 from Ameren?

18 MR. LOWERY: The joint schedule that
19 we provided to the Commission provided that Ameren
20 and Laclede would just have redirect with this
21 witness, and what we had intended to do is have
22 Laclede have the last redirect since it is their
23 case.

24 JUDGE DIPPELL: All right. Is there
25 -- I'm sorry, is there cross examination from the

1 Public Counsel?

2 MS. O'NEILL: Just briefly, Your
3 Honor.

4 CROSS EXAMINATION BY MS. O'NEILL:

5 Q Good afternoon, Mr. Stout.

6 A Good afternoon.

7 Q You've consulted for Missouri
8 regulated utilities in the past; is that correct?

9 A Yes, it is.

10 Q Are you currently consulting with
11 either Laclede or Ameren UE in any other cases
12 before this Commission?

13 A No.

14 Q Okay. Are you -- have you provided
15 any testimony for Ameren UE or Laclede for any
16 other cases currently pending before the
17 Commission?

18 A No.

19 MS. O'NEILL: No further questions.

20 JUDGE DIPPELL: Thank you. Is there
21 cross examination from Staff?

22 CROSS EXAMINATION BY MR. SCHWARZ:

23 Q Good afternoon.

24 A Good afternoon.

25 Q With respect to your direct

1 testimony on page 26, there is a quotation at the
2 bottom of the page, do you see that?

3 A I do.

4 Q And there is an ellipsis in there,
5 that indicates omitted material. Is that correct?

6 A Yes.

7 MR. SCHWARZ: May I approach the
8 witness?

9 JUDGE DIPPELL: Yes.

10 Q (BY MR. SCHWARZ) I've handed you a
11 copy of the material quoted, and I have
12 highlighted what I believe is the omitted
13 material. And I would ask you, after you have
14 confirmed that that's the omitted material, to
15 read the omitted material into the record for us.

16 A The Commission's conclusion about
17 the use of the whole life method should not be
18 taken as a final endorsement of it, nor as a
19 condemnation of Staff's approach. Both have merit
20 and the Commission will use the one that fits the
21 particular circumstances under investigation. The
22 Commission explicitly distinguishes its holding on
23 the net salvage issue here from its holding in
24 Laclede Gas Company's recent rate case, Case No.
25 GR-99-315.

1 **Q Why did you omit that particular**
2 **passage?**

3 A I was responding to the question as
4 to the key elements of the Commission's policy
5 regarding the treatment of net salvage, and I
6 included those portions that I thought described
7 the Commission's policy as to when it was
8 appropriate to use the standard method.

9 **Q And you didn't think a reference to**
10 **the -- this particular case was relevant in that**
11 **regard?**

12 A I don't understand your comment.

13 **Q You're filing testimony in the case**
14 **referenced in the omitted language. You didn't**
15 **think that was worthy of note?**

16 A I'm certainly not intending to hide
17 that passage from anyone, and certainly did not
18 succeed in hiding it from you if that had been my
19 intent.

20 **Q What's a Handy-Whitman index?**

21 A The Handy-Whitman index is a cost
22 index prepared by the firm of Whitman Requardt in
23 Baltimore, Maryland that -- based on information
24 it obtains each year related to the cost of
25 constructing various types of utility plants in

1 different parts of the United States.

2 Q So it would be my understanding that
3 there are separate indexes, say, for St. Louis and
4 Atlanta and Washington and Philadelphia and
5 Chicago?

6 A No, sir. They divide the country
7 into a number of regions, and St. Louis is part of
8 the North Central region. Atlanta would be part
9 of the Southeastern region, and --

10 Q How many regions are there? Let's
11 --

12 A I don't have the publication with
13 me. I think there are about seven.

14 Q Okay. So one size does not fit all
15 as far as the Handy-Whitman index is concerned?
16 That is, there are differences in costs for
17 different regions of the country?

18 A The indexes do not purport to show
19 absolute costs, but rather the change in price
20 levels from year to year in the different regions.
21 Given that all of those regions are part of the
22 United States economy, indexes for specific
23 accounts don't tend to vary a great deal from one
24 region to another.

25 Q I would ask you to turn to Schedule

1 4-1 to your supplemental direct testimony. With
2 respect to the column headed Net Salvage Accrual,
3 how did you compute the figures in that column?

4 A The net salvage accrual in that
5 column is determined by multiplying the balance in
6 column 2 by the portion of the accrual rate
7 related to net salvage.

8 Q And how did you compute the figures
9 in the column Estimated Net Salvage Costs?

10 A Those were computed by multiplying
11 the retirements in the first column, or second if
12 we count the column year, by the estimated net
13 salvage percent for the account.

14 Q And how did you estimate the
15 retirements?

16 A The retirements were estimated based
17 on the survivor curve estimate for the account and
18 the surviving original cost at December 31, 1998.

19 Q And just to make clear for the
20 Commission, this is based -- this is activity for
21 the plant as it existed at December 31, 1998, or
22 January 1, 1999?

23 A Yes, it is.

24 Q Have you ever done a study of
25 Laclede's depreciation history to confirm that the

1 actual cost to remove a vintage of a particular
2 plant account actually matches the amounts
3 collected in rates from customers for that
4 purpose?

5 A I have not and don't believe that
6 such a study is possible.

7 Q Have you ever done a study to
8 confirm that the actual cost to remove a vintage
9 of a particular plant account actually matches the
10 depreciation expensed, charged on the books of any
11 particular company?

12 A Again, I have not, and it cannot be
13 done.

14 Q On page 15 of your supplemental
15 direct testimony, you attribute the increase over
16 time in net salvage cost to growth in plant,
17 inflation, and increasing environmental
18 requirements. Do you expect each of those items
19 in the future to increase at the same rate that
20 they have over the past 25 years?

21 A I don't have an expectation with
22 respect to the continued growth in plant; however,
23 since I am only estimating net salvage related to
24 the current plant in service, the future plant has
25 no bearing on the issue.

1 My expectation with respect to
2 inflation is that the next 25 years will be
3 comparable to the past 25 years.

4 With respect to environmental
5 requirements, I would have an expectation of a
6 continued increase in that, probably at a rate
7 somewhat greater than the past 25 years. Many
8 environmental requirements came into place in the
9 1970s. There hasn't been as much in the last 25
10 years. I think there will probably be an uptake
11 in that going forward.

12 **Q Well, then, let me -- would you**
13 **expect that the increase in environmental**
14 **requirements will be as great, say, for the next**
15 **25 years as it was between 1970 and 1995?**

16 A Probably not.

17 **Q With respect to Schedule WMS-1, did**
18 **you investigate the reasons for the particular**
19 **spikes in net salvage costs that are depicted on**
20 **that graph?**

21 A I would say yes, I did. This is a
22 summation of the net salvage costs for all of
23 Ameren's plant. In conducting my study for Ameren
24 several years ago, I would have looked at it on an
25 account by account basis and investigated the

1 various reasons for the increases in net salvage
2 costs.

3 If those were strictly related to
4 increases in retirements, I probably would not
5 have looked as hard; but if the absolute net
6 salvage is a percent of original cost that
7 increased, that would have more likely resulted in
8 an investigation.

9 Q For instance, in -- there appears to
10 be a spike in 1985. Can you tell me what caused
11 that spike?

12 A I would have to go back and look at
13 the amounts by account in order to respond.

14 Q So for 19 -- well, it's a two year
15 spike, perhaps. In '94 and '95, same --

16 A Same answer.

17 Q So it's possible that there -- that
18 those be anomalies?

19 A I don't believe them to be
20 anomalies. I think that, in my experience, the
21 level of retirements and the related net salvage
22 do vary significantly during periods of time as
23 the company moves into perhaps replacement
24 programs and out of a mode of growth where capital
25 is being used to add new customers, causing

1 increased retirements, increased levels of net
2 salvage.

3 Of course, I've also observed, as
4 this chart demonstrates, that net salvage costs
5 have been increasing over time despite the ups and
6 downs, there is an overall upward trend.

7 So I don't find what's illustrated
8 here to be any different than what I've seen in
9 many other utilities, and, therefore, would not
10 describe it as anomalous, but rather typical of
11 what happens with retirement programs and net
12 salvage costs.

13 **Q With respect to Schedule WMS-2, this**
14 **schedule depicts benefits customers receive from a**
15 **declining rate base under the standard method,**
16 **does it not?**

17 **A Yes, it does.**

18 **Q Isn't it true that customers will**
19 **not receive the benefit of a declining rate base**
20 **unless a rate proceeding is filed to reflect the**
21 **lower rate base amount in revenue requirement?**

22 **A That is correct, but at the same**
23 **time, they won't bear the burden of the additional**
24 **plant added during that same period.**

25 **Q Unless the company has an ISRS?**

1 A Which does not cover all plant, I
2 believe.

3 Q No, but specifically covers
4 replacement property. In any event -- so
5 basically this schedule assumes the filing and
6 resolution of annual rate proceedings over a 20
7 year period?

8 A The schedule illustrates that within
9 the overall regulatory model, that as the -- under
10 the standard approach with the provision for net
11 salvage during the life of the plant to which it
12 relates, the impact on rate base results in a
13 lower revenue requirement than does the approach
14 proposed by Staff.

15 Q But the standard approach
16 methodology assumes a rate case every year, does
17 it not?

18 A This -- this illustration assumes a
19 rate case every year for both the standard
20 approach and the Staff approach in order to
21 illustrate and compare the two.

22 Q Thank you. And the comparison's in
23 nominal dollars; is that correct? There's no
24 present value taken into account?

25 A They are nominal dollars. I believe

1 the present value concept, or the flip side of it,
2 anyway, is recognized in the return on rate base.

3 Q What's your understanding of a
4 generation of rate payers?

5 A My interpretation of a generation of
6 rate payers is consistent with the use of the term
7 "generation" by a layman, meaning approximately a
8 20 or 30 year period that is the period in time
9 going from the age of a grandparent to a parent to
10 a child.

11 Q Would it also be possible to
12 consider, in the terms of utility regulation,
13 customers who share service under the same set of
14 prescribed rates for a utility?

15 A I don't believe so.

16 Q On Schedule WMS-4-1, can you
17 identify for me where -- how many generations are
18 on there? And where they begin and where they
19 end?

20 A No, I can't, because I'm not sure
21 where they started because this picks up partway
22 through the plant in service. But, again, I would
23 adhere to a generation being on the order of every
24 20 to 30 years.

25 Q And -- so could you have different

1 generations of customers for different plant
2 accounts?

3 A If the changes in plant accounts --
4 I mean, when would you start?

5 Q Let me -- strike that last question.
6 It was poor.

7 When would you start a generation of
8 rate payers?

9 A I think we could start with the
10 current generation that's paying rates today and
11 consider that over a period of 20 or 30 years,
12 there will be a substantial change in the large
13 majority of those rate payers to a new generation
14 of rate payers.

15 MR. SCHWARZ: So it has -- I don't
16 think I have anything further.

17 JUDGE DIPPELL: Thank you. Are
18 there questions from the bench? Commissioner
19 Murray?

20 COMMISSIONER MURRAY: Thank you.

21 BY COMMISSIONER MURRAY:

22 Q Good afternoon.

23 A Good afternoon, Commissioner.

24 Q Is it customary regulatory policy to
25 consider cash flow when you're looking at rate

1 making treatment for specific items?

2 A I believe it is a factor to be
3 considered in deciding between several
4 alternatives.

5 Q And would that include in
6 consideration of depreciation rates and
7 consideration of how to treat net salvage?

8 A Yes.

9 Q The Staff has an apparent concern
10 that the earnings that the rate payer -- that are
11 imputed to the rate payer by the accrual method
12 through reduction in rate base are only achieved
13 when a new rate case is filed. Is that your
14 understanding?

15 A That certainly seems to be one of
16 the concerns that was expressed in the questioning
17 by Mr. Schwarz.

18 Q And I haven't thought this through
19 and I just was thinking of it now and it may be
20 dangerous to even bring it up when you haven't
21 really thought something through, but I was
22 wondering why, and if you know, why Laclede has
23 not, and Ameren have not applied the 3 percent
24 rule and imputed just a straight 3 percent
25 earnings to the customers for the accrued amount.

1 And as I read the rule, that -- it's
2 to be considered a fund, whether or not it's --
3 let's see. Represented by a segregated fund
4 earmarked for that purpose. So do you know why
5 that rule is not in place? Or not being applied?

6 A I can't speak for why they haven't
7 used it. I only know based on discussions with
8 them that they have been tempted to propose that,
9 but have chosen not to.

10 Q And would that -- if that were
11 applied, is it your understanding that the accrued
12 amount would continue to be deducted from rate
13 base and the customers would then also receive
14 earnings based on that reduction in rate base
15 after a rate case? Or that it would simply be the
16 3 percent and the accrued amount would no longer
17 be deducted from rate base?

18 A It's been some time since I read the
19 regulation, but I believe that it would only be
20 applied during the course of a rate proceeding.

21 Q What would only be applied?

22 A The 3 percent would be applied to
23 the accrued depreciation balance.

24 Q Okay. But what about the reduction
25 in rate base? Would that continue? Or would that

1 **be discontinued?**

2 A It's an effective reduction in rate
3 base. The difference being that the current cost
4 of capital would be applied to the gross plant,
5 and the 3 percent would then be applied to the
6 accumulated depreciation, and the difference would
7 be the return to the utility. The practice is to
8 net the two numbers and simply apply the cost of
9 the capital to the net rate base.

10 Q **Go through that one more time, if**
11 **you would, please.**

12 A Certainly. The -- my understanding
13 of the regulation regarding 3 percent would be
14 that that percentage is the rate that would be
15 applied to the accumulated depreciation account in
16 the proceeding, and that the total return provided
17 to the utility would be the net of their gross
18 plant times their current cost of capital less 3
19 percent applied to the accumulated depreciation.

20 Q **And that would be in place of**
21 **deducting the full accumulated depreciation from**
22 **the rate base. Is that right?**

23 A Yes. It would be in place of first
24 deducting the accumulated depreciation from gross
25 plant to arrive at a rate base to which the

1 current cost of capital is applied.

2 In doing that, the effect is to
3 apply the current cost of capital to the
4 accumulated depreciation account, thereby
5 providing effectively to the customer a return at
6 the utility's cost of capital on amounts that have
7 been provided through rates towards depreciation.

8 Q But either method is only applied at
9 the time of a rate case. Is that correct?

10 A That's my understanding.

11 Q In the original '99 Laclede case
12 that started this whole thing, Staff was concerned
13 about there being excess depreciation reserves.
14 Is that your understanding as to one of the things
15 that Staff was concerned about?

16 A I think I'll try to express it
17 somewhat differently. My understanding of what
18 initiated Staff's concern was their observation
19 that the net salvage accruals under the standard
20 approach were greater than the current net salvage
21 costs being incurred.

22 Q Well, did they not express it as an
23 excess depreciation reserve?

24 A Yes. They then went on to state
25 that if the standard approach were abandoned in

1 favor of the cash approach, that there were
2 amounts accumulated in the depreciation reserve in
3 excess of what would be required on a cash basis.

4 Q All right. So just applying the new
5 method created an excess reserve.

6 A Yes, it did.

7 Q The Court of Appeals made some
8 statements about Laclede's reserves and the
9 findings that this Commission made, and the Court
10 made the statement that the Commission failed to
11 rule out other factors that could be the cause of
12 Laclede's reserves.

13 And it went on to say, for example,
14 the depreciation reserves could be the result of
15 good management on the part of Laclede. Is that
16 true, in your opinion?

17 A I think I can posit a situation that
18 would fit that. If, through good maintenance
19 practices, the lives of the plant in service were
20 becoming longer than it had been before and the
21 current estimates of service life were longer than
22 the basis for prior accruals to the accumulated
23 depreciation account, that also would contribute
24 to an accumulated depreciation amount greater than
25 what is currently required, and I think that that

1 in part could then be attributed to good
2 management.

3 Q Mr. Stout, I believe that it's in
4 your testimony, I'm not sure where, but I believe
5 you were one of the witnesses that said that the
6 standard approach is a conservative approach to
7 estimating net salvage costs, and that it
8 generally under recovers. Is that --

9 A Yes, I did say that several times.

10 Q All right. Do you have -- do one of
11 your attachments illustrate that? Or does one of
12 your attachments illustrate that?

13 A I think there are exhibits in the
14 record that illustrate that. Schedule 1, attached
15 to the surrebuttal testimony of Mr. Codaman from
16 the original proceeding? And I would refer to
17 page 3 in particular of that schedule shows that
18 the net salvage as a percent of original cost
19 retired for steel services --

20 Q Excuse me a second, I don't believe
21 my page 3 of the schedule is --

22 JUDGE DIPPELL: State which one that
23 is again?

24 THE WITNESS: Surrebuttal testimony
25 of Richard A. Codaman, Jr.

1 Q **(By COMMISSIONER MURRAY) I was**
2 **looking in the direct. Just give me a second.**

3 A Certainly.

4 Q **And it's Schedule 1?**

5 A Yes. Page 3.

6 Q **Okay. I do have it. I apologize.**
7 **Go ahead.**

8 A This shows that the net salvage as a
9 percent of the original cost retired has increased
10 from a level of approximately negative 60 percent
11 in the early 1970s to a level in excess of 120
12 percent in the late 1990s.

13 If one had conducted a study of net
14 salvage as a percent of original cost, which is
15 the typical statistical analysis used in making
16 estimates of future net salvage under the standard
17 approach, one might have concluded in the mid
18 1970s that negative 60 percent would be an
19 appropriate basis for forecasting the future net
20 salvage amounts.

21 However, as this illustrates, 20, 25
22 years later, the amount is about twice what the
23 level was in the early to mid 1970s. And that's
24 what I'm talking about when I say that estimates
25 of net salvage based on analyses of net salvage as

1 a percent of original cost have tended to
2 understate the future levels of net salvage as a
3 percent of original cost.

4 Q Okay. Your -- attached to your
5 testimony, your Schedule 4, what does your
6 Schedule 4 there demonstrate, or does it
7 demonstrate anything in relation to the estimated
8 costs and the actual -- now that I'm looking at
9 it, I'm not seeing the actual costs. Does that
10 show the -- it shows estimated -- okay.
11 Cumulative estimated net salary, but it -- this
12 schedule doesn't show anything about the costs; is
13 that correct?

14 A It does not show anything about the
15 historical costs of net salvage. The purpose of
16 the schedule is to demonstrate that for the plant
17 presently in service, although the net salvage
18 accrual for that plant today is greater than the
19 net salvage costs that are being incurred for that
20 plant, that over time as that plant balance
21 decreases, the net salvage accrual will decrease,
22 retirements will increase, as will the net salvage
23 related to such retirements. And that within a
24 period of about 20 years for this particular
25 account, the net salvage costs being incurred will

1 actually be greater than the net salvage accrual
2 for this plant.

3 The illustration is to show that
4 early in the life cycle of a group of plant, the
5 net salvage accrual will exceed the net salvage
6 cost, but in the latter part of a -- that life
7 cycle, the net salvage costs exceed the net
8 salvage accruals.

9 As shown on the schedule, on the
10 second page, the total of the net salvage costs
11 and the net salvage accruals shown in the last
12 column and the third to last column are the same.

13 **Q So that -- does that demonstrate**
14 **that this methodology over the full life of the**
15 **plant is -- tends to neither over accrue nor under**
16 **accrue?**

17 **A** Yes, that is correct.

18 COMMISSIONER MURRAY: That's all I
19 have right now anyway. Thank you.

20 JUDGE DIPPELL: Thank you.

21 Commissioner Clayton, do you have
22 questions?

23 COMMISSIONER CLAYTON: Where to
24 start. How much time do I have, Judge?

25 JUDGE DIPPELL: You have ten

1 minutes.

2 COMMISSIONER CLAYTON: Ten minutes.

3 I'll talk fast.

4 BY COMMISSIONER CLAYTON:

5 Q Mr. Stout, on your schedule WMS-1, I
6 was speaking with Mr. Baxter about this, I was
7 wondering if you could establish where the line
8 would be for the accrual method, or the standard
9 approach on this issue? Or if it would even fit
10 on this graph?

11 A It would fit on the beginning
12 portion of the graph back in the 1970s. It would
13 be a line that is at a higher level than the
14 amounts plotted there. As we've discussed during
15 the early growth cycle, which this period
16 encompasses, the net salvage accruals are greater
17 than the net salvage costs.

18 Q Okay. Where do you think it would
19 be in 1971? I'm going to try to draw a line here.
20 Do you know?

21 A I would say somewhere between 4 and
22 \$6 million.

23 Q Okay. And where would it -- where
24 would it be in, say, the year 2000? Do you know?

25 A I believe by the year 2000 with the

1 growth in plant, it -- approximately \$50 million.

2 Q Fifty million dollars?

3 A Yes, sir.

4 Q So it wouldn't fit on this -- it
5 wouldn't fit on this chart?

6 A Not in the year 2000.

7 Q Okay. So if we follow from 1971,
8 draw a line up to 50 million that goes way over
9 the chart on the year 2000, if we go into the
10 future past the year 2000, at what point -- or
11 would there ever be a point where the actual
12 retirements would actually approach that accrual
13 number?

14 A Yes, and that's what I've tried to
15 illustrate in 4-1 is that for the plant in
16 service, it will cross over, and it depends on the
17 life characteristics of the account as to when
18 that would occur.

19 Q Okay. Well, looking at your chart
20 WMS-4-1, when does it cross over? And forgive me
21 for not paying attention enough to know where this
22 is.

23 A It crosses over in the year 2020.

24 Q There's a significant difference
25 between the numbers on your graph and where those

1 lines would be, is there not, between the accrual
2 and the net salvage costs?

3 A I'm sorry, Commissioner, I didn't
4 understand your question.

5 Q There's a big difference between 50
6 million in the year 2000 and the average of costs,
7 I guess your dotted line, your average of ten
8 years salvage costs of roughly 8 million, we've
9 got a significant difference in between the 50
10 million and the 8 million, wouldn't you say?

11 A Yes, as a result of the tremendous
12 growth in plant as illustrated in Schedule WMS-3-1
13 and 3-2 that has occurred. There is a much larger
14 plant base on which we must be accruing net
15 salvage as compared to the plant from which the
16 current retirements are being made from.

17 That is, in the case of Laclede
18 where we now have a plant value of a billion
19 dollars on which we are accruing net salvage, or
20 propose to accrue net salvage, the retirements are
21 coming out of that much smaller base of 60 to \$90
22 million back in the 1950s, or perhaps from a
23 smaller base yet back in the '40s or '30s.

24 So the net salvage cost that we're
25 going to realize currently is coming from plant

1 that was there to serve hundred or 200,000
2 customers, whereas the plant that we have today is
3 there to serve over 600,000 customers.

4 So the -- trying to compare the two
5 and say they should be the same is not giving
6 appropriate consideration to the tremendous amount
7 of growth in plant that has occurred.

8 Q So until the year 2020, the rate
9 payers, under the accrual method, will be paying
10 or contributing more until the year 2020, and then
11 after that, the -- they would be getting -- that's
12 when the actual net salvage would increase above
13 the accrual, so then they'd be paying less than
14 the actual; is that correct?

15 A Yes and no. With respect to only
16 the depreciation expense portion of the revenue
17 requirement, that is correct. However, when you
18 consider the total revenue requirement and the
19 impact of those greater accruals on rate base, the
20 customer will actually be paying less much sooner.

21 Q Sooner than 2020?

22 A Yes.

23 Q What would be the sooner? What date
24 would be the sooner?

25 A It would be difficult to tell. It

1 may have already occurred in this particular
2 instance.

3 Q Could be this year?

4 A Well, if -- if you refer to Schedule
5 WMS-4-1, the cumulative net salvage in the
6 depreciation reserve is \$56 million as shown as
7 the first value in the far right-hand column.

8 Q Okay, up here, yes.

9 A So \$56 million is now being deducted
10 from rate base. Let's just assume that a 10
11 percent return is being applied to that value.
12 That would be a reduction in revenue requirement
13 of 5.6 million in return plus the tax effect on
14 that, which would make it even larger, as compared
15 to the difference in the net salvage accrual
16 compared to the net salvage costs, 4.9 million
17 versus 1.2 million, a difference of 3.7 million.

18 The reduction in return and taxes
19 due to the amount that's been accumulated to date
20 is greater than the difference between the net
21 salvage accrual and the current net salvage costs.
22 So in this particular account, the customer is
23 already paying less.

24 Q Have you reviewed the testimony of
25 Miss Schad with Staff?

1 A Yes, I have.

2 Q There is a hypothetical scenario set
3 out on page 9 and 10, maybe 9 through 11. Do you
4 recall that hypothetical and the concerns that are
5 listed by her in that hypothetical?

6 A May I take a moment to --

7 Q Sure. Certainly. Basically I want
8 you to critique the analysis in that hypothetical.
9 That'll take us up to 5. Mercifully.

10 A You would like me to review and
11 critique that now?

12 Q Well, the concerns that are listed
13 in her hypothetical, is that a correct analysis or
14 incorrect analysis?

15 A I believe it's incorrect. The
16 concern expressed is that in relating the net
17 salvage costs in today's dollars to the original
18 cost retired in the dollars from the year in which
19 plant was installed, that there is -- that the net
20 salvage percent that results from that is somehow
21 inflated beyond reason.

22 The suggestion is that the original
23 cost of the plant retired is being determined on a
24 first in/first out basis for the plant so that,
25 therefore, the very oldest plant is being retired.

1 In reality, that's not the case.

2 In reality, the actual year -- the
3 average costs of plant installed is determined
4 based on the actual year installed of the plant.
5 And that might be from the 1920s, or it might be
6 from the 1970s.

7 On average, as I've indicated in my
8 testimony for the Company's mains account,
9 retirements during the past 30 years have averaged
10 only 23 years of age.

11 And so the -- the issue here is how
12 much inflation has incurred between the time the
13 plant being retired today is coming out and when
14 it was first put into service, and is that measure
15 of inflation reasonable as a projection of the
16 inflation that will occur between the plant
17 presently in service and when it was installed and
18 when it will be retired.

19 As I have indicated in my testimony,
20 the historical retirements on average in the mains
21 account have come out at 23 years.

22 **Q As opposed to the 75 years listed in**
23 **this example?**

24 **A** Yes. And --

25 **Q So are the facts in the hypothetical**

1 far out of line of what would happen, or is it, I
2 guess, the concern that is suggested through this
3 hypothetical -- are you suggesting that the
4 elements used to set up this hypothetical are
5 simply unlikely or impossible, or -- tell me how
6 this is not a valid concern. Simple language.
7 Quickly.

8 A No pressure. If indeed the
9 hypothetical comported with reality and the
10 retirements we were making today were from plant
11 installed 75 years ago, then the 200 percent is
12 reflective of the change in price level that has
13 occurred during that 75 year period. And, in
14 fact, would be a reasonable number to use because
15 the plant that is now in service is likely to live
16 for 75 years or perhaps longer based on the
17 estimates.

18 Q Well, forgive me for asking this
19 clarifying question. Are you saying that the
20 amounts of the old retired plant would be adjusted
21 for inflation to get a more accurate percentage in
22 determining the average service -- to get to the
23 percentage to multiply it times the total plant
24 account balance? Is that what you're suggesting?

25 A What I'm suggesting is this. That

1 --

2 Q No would be the answer. You're not
3 suggesting that.

4 A I really couldn't give it a yes or
5 no.

6 Q Okay. If I'm wrong, I can handle
7 it.

8 A I understand. One of the issues
9 that's raised by proponents of the cash basis and
10 criticism of the statistical analyses done as a
11 basis for estimates of future net salvage is that
12 in those studies, we relate the net salvage, or
13 removal costs incurred in, for example, the year
14 1995 to the original cost of the plant that was
15 retired in that year.

16 But that plant was not installed in
17 1995, it was installed many years ago at a lower
18 price level. So their objection is that we're
19 relating one set of dollars to another set of
20 dollars.

21 My response to that is that we need
22 to do the very same thing, though, with respect to
23 forecasting the future net salvage, because
24 today's plant that was installed 10 or 20 or 30
25 years ago will be removed in another 30, 40, 50,

1 60 years and there will have been a change in
2 price level between the time it was installed and
3 the time it is retired also.

4 In fact, on average, in the case of
5 Laclede's steel mains, the historical retirements
6 analyzed and its study of net salvage occurred on
7 average at 23 years of age. In contrast, the
8 future retirements of the mains presently in
9 service will take place on average at in excess of
10 the 83 year life that Staff has estimated for that
11 account.

12 So that the period of time during
13 which inflation will act on the price level for
14 the plant presently in service will be, say, 90
15 years as compared to the 23 years that has
16 occurred in the data that has been analyzed.

17 This is another reason why, in my
18 view, the net salvage percents indicated by these
19 historical analyses that we conduct tend to
20 understate what that future net salvage will
21 actually be.

22 Q So would it be your testimony that
23 there would be protections in the traditional
24 method to protect us from scenarios that would be
25 this lopsided in this example?

1 A Oh, absolutely. If, for example,
2 this 75 -- first off, again, first in/first out is
3 -- does not comport with reality in the case of
4 Laclede Gas.

5 But just accepting that the age of
6 retirements coming out is 75 years and it's
7 indicating 200 percent negative net salvage, if
8 the life, all of a sudden, we now estimate is only
9 going to be 50 years instead of 75, then we would
10 need to reflect that in both an adjustment to the
11 service life, but also in an adjustment to the net
12 salvage percent, because now a plant's not going
13 to live as long, inflation won't have acted for as
14 long.

15 Q In a rate case, would each of these
16 elements, even if there was a designation of the
17 accrual or traditional, standard approach,
18 whatever it has been called, is there negotiating
19 in a rate case on each of these elements within
20 that method? Or by choosing the method, does that
21 identify -- does that set out the formula for how
22 things will be?

23 A No. The designation of the standard
24 approach, which is to accrue net salvage during
25 the life of the plant to which it relates, does

1 not dictate, therefore, what that net salvage
2 percentage will be. It is subject to evidence by
3 various parties as to their view of what that is,
4 just as various parties opine about what the
5 average service life of the account is.

6 Q Are there mechanisms within this
7 methodology that would account for situations
8 where perhaps plant is abandoned but not removed?

9 A Yes. The historical data actually
10 reflect the extent to which plant is abandoned in
11 place. But I think it's important --

12 Q What do you mean, "the historical
13 data"? I mean, if you have an accrual that's
14 being paid in by the rate payers, say, over a 25
15 year period, you reach year 25 and let's say the
16 plant is abandoned and it's just not removed, is
17 the amount that's been accrued -- do the rate
18 payers get credited back that amount if the cost
19 is zero or significantly less? Is there a
20 protection in for that type of circumstance?

21 A Yes. There's actually two. First
22 off, if indeed what you described took place and
23 that no costs were incurred at the end of the
24 asset's life as compared to the amount that was
25 accrued, then obviously a revision in estimate

1 would be called for, the amount that had been
2 accrued would continue to earn a return for the
3 customer, and would then be returning back to the
4 customer after an appropriate period of time
5 through a reduction in depreciation expense.

6 However, I think it's important to
7 understand that even when plant is abandoned,
8 costs of retiring are incurred.

9 Q I know. I try to use an extreme
10 example to kind of, you know, get excited about
11 the subject matter. You kind of have to use the
12 extremes to contrast the positions, and that's why
13 I used that.

14 I understand it's unlikely that
15 you'd have a zero dollar retirement, but if the
16 amount estimated in reality turned out to be
17 significantly less or more, there is a method for
18 truing up or accounting for that; is that your
19 testimony?

20 A Absolutely.

21 JUDGE DIPPELL: Commissioner, I'm
22 going to have to cut you off. We've got to wrap
23 it up for today.

24 We will begin again tomorrow at 8:30
25 and will continue with Commissioner Clayton's

1 questions if he has more in the morning, and the
2 rest of the Commissioners' questions and then do
3 recross examination of Mr. Stout and redirect.

4 I apologize that we did not get
5 finished with you today, Mr. Stout.

6 I -- we had -- there was some
7 discussion earlier about reproducing the exhibit,
8 which is 134, that the witness drew, and if it's
9 agreeable with the parties, I'll just ask Mr.
10 Pendergast to reproduce that perhaps in a
11 typewritten format instead of having to photocopy
12 it or something. Would there be any objection to
13 that?

14 MS. O'NEILL: That's fine, Your
15 Honor.

16 JUDGE DIPPELL: All right. You may
17 do that if you wish, Mr. Pendergast.

18 Miss O'Neill, when do you believe
19 that you could have your objections to the
20 Commission?

21 MS. O'NEILL: I will -- I will
22 finish them before I leave this evening, but I
23 don't really have the ability to file them on the
24 EVVA system, but I can bring them with me first
25 thing in the morning.

1 JUDGE DIPPELL: Okay. So you think
2 you can get them before the close of the hearing
3 at least?

4 MS. O'NEILL: Oh, yes.

5 JUDGE DIPPELL: All right. That
6 would be good. All right, then. We will
7 reconvene in the morning beginning at 8:30 by that
8 clock, which I won't reset while you're gone.
9 Thank you, we can go off the record.

10 (Off the record.)
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