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

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

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

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

Q Is it as sizeable as return on equity?

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

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

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

(Off the record.)

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

Commissioner Clayton, do you have questions?

BY COMMISSIONER CLAYTON:

Q Good afternoon, Mr. Baxter.

A Good afternoon, Commissioner.

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

A Sure.

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

A Commissioner, I think there are

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

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

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

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

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

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

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

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

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

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

JUDGE DIPPELL: Yes.

THE WITNESS: Thank you. It is Exhibit WMS-1. And on that exhibit, Your Honor, it -- it shows how retirements do indeed fluctuate rather significantly between years, and it also shows, frankly, that there are increasing levels of retirements which are taking place now into the future. So there is some level of volatility on the actual cash outflows for retirements.

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

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

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

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

costs of recent retirements?

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

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

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

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

A No. No. The safeguard which is in

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

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

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

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

A Yes. In these depreciation studies, all the groups of accounts would be evaluated, and the true-up mechanisms would be there. And certainly to the extent that we did collect moneys, say, for instance, in this case years one through five that ultimately were corrected, the other safeguard is in place is the offset to rate base. And so, therefore, customers are earning a return on moneys that we in effect borrow from them in advance.

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

A Absolutely.

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

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

But putting that aside, those moneys are part of the overall rates we collect from customers, and so, therefore, they come as part of the general funds of the company that are utilized for the utility to do any number of things, including reinvesting in infrastructure, including taking care of existing retirements, among other things.

Q Including paying regular expenses associated with the account?

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

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

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

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

A Yes. Essentially that's really --

Q Okay.

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

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

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

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

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

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

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

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

Q Page 5, line 17 through 21.

JUDGE DIPPELL: That's of the supplemental rebuttal?

COMMISSIONER CLAYTON: Supplemental rebuttal testimony.

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

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

A Please.

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

A Not that I'm aware of.

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

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

And I was wondering if you could address that statement?

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

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

So just because every order which is issued by this Commission or any commissions around the country don't say, you must use the standard approach wouldn't suggest to me that that is indeed not something that's appropriate.

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

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

A I have her testimony in front of me.

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

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

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

served to handle that.
Q (BY COMMISSIONER CLAYTON) That's fine. That's fine. Your -- I'm sure you supervise accounting, but I'm not sure if that's your role necessarily in the company to do accounting work. I think I asked Mr. Cooper the same question. I mean, your role is generally more of a financial market overview, is it not?
A That is true. Certainly the accounting function and financial reporting function does report to me, but on the day-to-day activities, people like Marty Lyons, who is one of our witnesses, would be closer to those types of things, as well as Mr. Stout from more of a policy perspective would be appropriate.
Q Let me conclude by asking you this question. With regard to the increased cash flows that this type of the accrual accounting method in this instance would -- it would increase your cash flows, would it be appropriate that -- that those amounts should be tied to some sort of capital investment or infrastructure investment or removal? Is that even an appropriate step to take?
A Well, Commissioner, it -- my sense

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

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

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

And it gets a little bit to what Mr. Oligschlaeger had recommended as his sort of setting these moneys aside. I think one is that certainly we would put these moneys in, say, a trust account that would earn some rate of return, but my sense is that the Commission would want us to invest those in very safe funds, and that would have a low rate of return.

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

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

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

A I think clearly the Commission has that discretion. If they have concerns over a particular utility, I think they could indeed impose that if they felt that was appropriate.

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

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

Q Sure you are.

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

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

Certainly we could say, okay, we'll

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

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

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

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

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

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

A Um --

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

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

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

reporting method at that time?

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

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

COMMISSIONER CLAYTON: Okay. Thank you.

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

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

BY COMMISSIONER MURRAY:

Q Good afternoon, Mr. Baxter.

A Good afternoon, Commissioner Murray.

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

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

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

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

Q The money itself would earn significantly less?

A That's correct.

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

JUDGE DIPPELL: Thank you.

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

COMMISSIONER DAVIS: Not at this time.

JUDGE DIPPELL: Commissioner Appling?

COMMISSIONER APPLING: No questions.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

A I agree 100 percent with that statement.

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

A I think that's a fair assessment and I think you're exactly right. It would be the children and the grandchildren and the great grandchildren, all those would pay significant costs. There would be a detrimental effect not only to them, but potentially to the overall economy of the State and issues with infrastructure and the like. I agree 100 percent with that.

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

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

A I'm sorry, page 13?

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

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

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

A That's exactly right.

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

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

COMMISSIONER MURRAY: Thank you.

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

MR. PENDERGAST: Just a few, Your Honor.

CROSS EXAMINATION BY MR. PENDERGAST:

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

A I do recall that.

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

A That's correct.

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

A I do.

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

A Sure. The Staff imposes a safeguard

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

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

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

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

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

A That is correct.

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

A That's correct.

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

A That is clearly an additional protection.

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

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

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

MR. PENDERGAST: Okay. Thank you very much.

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

MS. O'NEILL: Maybe just a few.

CROSS EXAMINATION BY MS. O'NEILL:

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

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

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

A That's correct.

Q And the net salvage is not --

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

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

Q Right.

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

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

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

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

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

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

A That's correct.

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

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

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

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

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

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

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

A Yes, they do.

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

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

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

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

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

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

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

We would not seek the additional principal amount, if you would, for that $8,000 that we've collected over the life. We would not double collect.

Q How about the interest?

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

And, in fact --

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

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

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

A That's correct.

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

A Sure. They could be. Indeed.

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

A No. I disagree.

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

THE WITNESS: Thank you.

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

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

RECROSS EXAMINATION BY MR. SCHWARZ:

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

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

correct?

A Yes.

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

A That is correct.

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

A Yes.

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

A That would be correct.

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

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

Q When did Union Electric file a rate case last?

A I think the actual last rate case that we filed versus when the Staff filed a rate proceeding against us, which was 2002, but the last rate case, and this is my recollection, may be 1987, 1988? I believe it could be that far, although I can't say definitively.

Q Perhaps 1984, when Callaway --

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

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

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

Q The gap between internally generated funds and construction needs. Infrastructure needs.

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

funds could be at any particular point in time.
So if you're asking me about the gap between the retirement costs and the accrual basis over time, then that, I believe, if you look at Mr. Stout's schedule, that that gap continues to increase over time, if I'm understanding you correctly.
MR. SCHWARZ: Thank you.
JUDGE DIPPELL: Is there redirect from Ameren?
MR. BYRNE: Yes, Your Honor, there is.
REDIRECT EXAMINATION BY MR. BYRNE:
Q Mr. Baxter, you were asked some questions earlier about when -- by both the Commissioners and I think Mr. Schwarz about when the figures cross over and they start to accrue less in net salvage than we have to pay; do you remember that line of questioning?
A I do, yes.
Q And I guess the suggestion may have been that UE might have difficulty finding money to retire its -- or pay its retirement costs, do you recall that?
A I do recall.

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

A To the best of my knowledge, no.

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

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

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

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

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

Do you recall that line of questioning?
A I do.
Q In your opinion, would it ever be appropriate for Ameren UE or Laclede to double collect retirement costs from its customers?
A No.
Q Does the Commission have the authority, in your opinion, to prevent a utility from double collecting those costs?
A Absolutely, and I would suggest, too, that the safeguards inherent in the standard method prevent that as well.
Q Mr. Schwarz asked you if you could name any customers who failed to locate in Missouri because of utility problems. Do you remember that line of questioning?
A I do.
Q And would it be fair to say that at least historically and even currently for Ameren UE, the standard approach is used for net salvage currently?
A It is.
Q And so to the extent that there hasn't been a problem, could it be due in part to the fact that the standard approach is used?

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

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

A I do recall that.

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

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

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

A Sure. It's a fairly lengthy process. It is one where models are developed by the company that reflects basically their expectations of cash flows based upon existing regulatory framework, based upon a variety of assumptions including low growth, including capital expenditures, including operating expenditures and the like, as well as the needs to do whatever borrowings may be necessary to fund their operations.

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

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

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

A I think it's obvious they would view it negatively as reflected in the negative comments the agencies have had in both the Laclede and Empire case, and I'm certain that would be the case here.

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

A I do recall that.

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

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

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

A Certainly.

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

recall those questions?

A I do recall those questions.

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

A That's correct.

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

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

And when I talk about transaction costs, it includes really administrative costs associated with the administrating of.

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

A Absolutely.

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

A I would expect, yes.

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

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

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

A I'm not aware of any.

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

A That's correct.

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

recovering it from rate payers?

A That's correct.

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

A I do. I do.

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

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

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

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

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

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

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

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

A I believe, Mr. Byrne, if I consider that, we -- as part of the rate proceedings which have taken place during those times, information has been updated in terms of the determination of rates going forward, which would include rate base. So potentially as part of those settlements, it's hard for me to distinguish part of those settlements than to have some of that reflected potentially.

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

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

THE WITNESS: Thank you, Your Honor.

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

(Off the record.)

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

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

(Witness sworn.)

WILLIAM STOUT, testified as follows:

DIRECT EXAMINATION BY MR. ZUCKER:

Q Good afternoon, Mr. Stout.

A Good afternoon.

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

A Thank you.

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

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

Q And who are you employed by?

A I am employed by Gannett Fleming.

Q And what is your position with Gannett Fleming?

A I am President of the valuation and rate division.

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

A I am.

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

A I am.

Q And do you have any changes to these testimonies?

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

Q Mr. Stout, would you do that again?

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

Q Thank you. Would you read the number again?

A The correct number is 0.128042.

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

A No.

Q How about your supplemental rebuttal?

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

Q And that is still negative; is that correct?

A Yes. And at line 22, the negative

66 percent should be negative 95 percent. Finally, continuing on Exhibit 137 at page 24, at line 18, the reference to page 49 should be to page 38.

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

A Yes, they are correct.

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

THE WITNESS: The location of the error?

JUDGE DIPPELL: Yes.

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

JUDGE DIPPELL: All right.

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

A I do not.

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

A Yes, they would.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

JUDGE DIPPELL: I think what I'm going to do is treat this with those and let -- because, otherwise, I need to have the chance to look at each exhibit and analyze it. So I think I will allow you to make these objections in writing as well.

MS. O'NEILL: All right.

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

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

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

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

JUDGE DIPPELL: Yes.

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

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

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

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

MR. ZUCKER: Tender the witness for cross.

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

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

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

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

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

Public Counsel?

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

CROSS EXAMINATION BY MS. O'NEILL:

Q Good afternoon, Mr. Stout.

A Good afternoon.

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

A Yes, it is.

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

A No.

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

A No.

MS. O'NEILL: No further questions.

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

CROSS EXAMINATION BY MR. SCHWARZ:

Q Good afternoon.

A Good afternoon.

Q With respect to your direct

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

A I do.

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

A Yes.

MR. SCHWARZ: May I approach the witness?

JUDGE DIPPELL: Yes.

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

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

Q Why did you omit that particular passage?

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

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

A I don't understand your comment.

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

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

Q What's a Handy-Whitman index?

A The Handy-Whitman index is a cost index prepared by the firm of Whitman Requardt in Baltimore, Maryland that -- based on information it obtains each year related to the cost of constructing various types of utility plants in different parts of the United States.

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

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

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

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

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

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

Q I would ask you to turn to Schedule

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

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

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

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

Q And how did you estimate the retirements?

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

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

A Yes, it is.

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

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

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

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

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

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

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

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

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

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

A Probably not.

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

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

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

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

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

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

A Same answer.

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

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

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

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

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

A Yes, it does.

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

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

Q Unless the company has an ISRS?

A Which does not cover all plant, I believe.

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

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

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

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

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

A They are nominal dollars. I believe

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

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

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

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

A I don't believe so.

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

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

Q And -- so could you have different

generations of customers for different plant accounts?

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

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

When would you start a generation of rate payers?

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

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

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

COMMISSIONER MURRAY: Thank you.

BY COMMISSIONER MURRAY:

Q Good afternoon.

A Good afternoon, Commissioner.

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

making treatment for specific items?

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

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

A Yes.

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

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

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

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

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

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

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

Q What would only be applied?

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

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

be discontinued?

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

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

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

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

A Yes. It would be in place of first deducting the accumulated depreciation from gross plant to arrive at a rate base to which the current cost of capital is applied.

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

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

A That's my understanding.

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

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

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

A Yes. They then went on to state that if the standard approach were abandoned in favor of the cash approach, that there were amounts accumulated in the depreciation reserve in excess of what would be required on a cash basis.

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

A Yes, it did.

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

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

A I think I can posit a situation that would fit that. If, through good maintenance practices, the lives of the plant in service were becoming longer than it had been before and the current estimates of service life were longer than the basis for prior accruals to the accumulated depreciation account, that also would contribute to an accumulated depreciation amount greater than what is currently required, and I think that that in part could then be attributed to good management.

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

A Yes, I did say that several times.

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

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

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

JUDGE DIPPELL: State which one that is again?

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

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

A Certainly.

Q And it's Schedule 1?

A Yes. Page 3.

Q Okay. I do have it. I apologize. Go ahead.

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

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

However, as this illustrates, 20, 25 years later, the amount is about twice what the level was in the early to mid 1970s. And that's what I'm talking about when I say that estimates of net salvage based on analyses of net salvage as a percent of original cost have tended to understate the future levels of net salvage as a percent of original cost.

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

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

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

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

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

A Yes, that is correct.

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

JUDGE DIPPELL: Thank you.

Commissioner Clayton, do you have questions?

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

JUDGE DIPPELL: You have ten

minutes.

COMMISSIONER CLAYTON: Ten minutes. I'll talk fast.

BY COMMISSIONER CLAYTON:

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

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

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

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

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

A I believe by the year 2000 with the

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

Q Fifty million dollars?

A Yes, sir.

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

A Not in the year 2000.

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

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

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

A It crosses over in the year 2020.

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

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

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

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

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

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

So the net salvage cost that we're going to realize currently is coming from plant that was there to serve hundred or 200,000 customers, whereas the plant that we have today is there to serve over 600,000 customers.

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

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

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

Q Sooner than 2020?

A Yes.

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

A It would be difficult to tell. It

may have already occurred in this particular instance.

Q Could be this year?

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

Q Okay, up here, yes.

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

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

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

A Yes, I have.

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

A May I take a moment to --

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

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

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

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

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

In reality, that's not the case.

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

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

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

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

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

A Yes. And --

Q So are the facts in the hypothetical

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

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

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

A What I'm suggesting is this. That

--

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

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

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

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

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

My response to that is that we need to do the very same thing, though, with respect to forecasting the future net salvage, because today's plant that was installed 10 or 20 or 30 years ago will be removed in another 30, 40, 50, 60 years and there will have been a change in price level between the time it was installed and the time it is retired also.

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

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

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

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

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

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

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

A No. The designation of the standard approach, which is to accrue net salvage during the life of the plant to which it relates, does not dictate, therefore, what that net salvage percentage will be. It is subject to evidence by various parties as to their view of what that is, just as various parties opine about what the average service life of the account is.

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

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

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

A Yes. There's actually two. First off, if indeed what you described took place and that no costs were incurred at the end of the asset's life as compared to the amount that was accrued, then obviously a revision in estimate would be called for, the amount that had been accrued would continue to earn a return for the customer, and would then be returning back to the customer after an appropriate period of time through a reduction in depreciation expense.

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

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

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

A Absolutely.

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

We will begin again tomorrow at 8:30 and will continue with Commissioner Clayton's questions if he has more in the morning, and the rest of the Commissioners' questions and then do recross examination of Mr. Stout and redirect.

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

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

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

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

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

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

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

MS. O'NEILL: Oh, yes.

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

(Off the record.)

I N D E X

WITNESSES

EXHIBITS

134 Supplemental direct testimony of Barry C. Cooper	
For Identification	1252
Received	1253
135 Supplemental direct testimony of Warner Baxter	
For Identification	1321
136 Supplemental direct testimony of William Stout	
For Identification	1396
137 Supplemental rebuttal testimony of William Stout	
For Identification	1396
Received	1403
144 Chart showing data from WMS-3-2	
Identified	1207
145 Safeguards in the Standard Approach	
For Identification	1208
146 Example made by Barry Cooper	
For Identification	1292

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