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Witness:	Russell W. Trippensee
Type of Exhibit:	Cross-Surrebuttal
Sponsoring Party:	Public Counsel
Case No.:	EC-2002-1
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CROSS-SURREBUTTAL TESTIMONY

OF

RUSSELL W. TRIPPENSEE

Submitted on Behalf of
the Office of the Public Counsel

UNION ELECTRIC COMPANY

Case No. EC-2002-1

June 24, 2002

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

STAFF OF THE MISSOURI)
PUBLIC SERVICE COMMISSION,)
Complainant,)
vs.)
UNION ELECTRIC COMPANY,)
d/b/a AmerenUE,)
Respondent.)

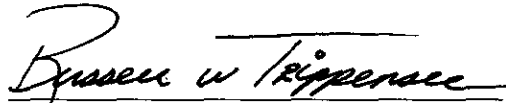
Case No. EC-2002-1

AFFIDAVIT OF RUSSELL W. TRIPPENSEE

STATE OF MISSOURI)
COUNTY OF COLE) ss

Russell W. Trippensee, of lawful age and being first duly sworn, deposes and states:

1. My name is Russell W. Trippensee. I am the Chief Public Utility Accountant for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my cross-surrebuttal testimony consisting of pages 1 through 39 and Schedule RWT-1 through RWT-3.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.


Russell W. Trippensee

Subscribed and sworn to me this 24th day of June 2002.


Bonnie S. Howard
Notary Public

My commission expires May 3, 2005

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CROSS-SURREBUTTAL TESTIMONY

OF

RUSSELL W. TRIPPENSEE

UNION ELECTRIC COMPANY

d/b/a

AMEREN UE

CASE NO. EC-2002-001

1 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

2 A. Russell W. Trippensee. I reside at 1020 Satinwood Court, Jefferson City, Missouri 65109, and my
3 business address is P.O. Box 7800, Jefferson City, Missouri 65102.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am the Chief Utility Accountant for the Missouri Office of the Public Counsel (OPC or Public
6 Counsel).

7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

8 A. I attended the University of Missouri at Columbia, from which I received a BSBA degree, major in
9 Accounting, in December 1977. I attended the 1981 NARUC Annual Regulatory Studies Program
10 at Michigan State University.

11 **Q. HAVE YOU PASSED THE UNIFORM CPA EXAM?**

12 A. Yes, I hold certificate number 14255 in the State of Missouri. I have not met the two-year
13 experience requirement necessary to hold a license to practice as a CPA.

14 **Q. PLEASE DESCRIBE YOUR WORK EXPERIENCE.**

15 A. From May through August, 1977, I was employed as an Accounting Intern by the Missouri Public
16 Service Commission (MPSC or Commission). In January 1978 I was employed by the MPSC as a

1 Public Utility Accountant I. I left the MPSC staff in June 1984 as a Public Utility Accountant III
2 and assumed my present position.

3 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL AFFILIATIONS.**

4 A. I served as the chairman of the Accounting and Tax Committee for the National Association of State
5 Utility Consumer Advocates from 1990-1992 and am currently a member of the committee. I am a
6 member of the Missouri Society of Certified Public Accountants.

7 **Q. PLEASE DESCRIBE YOUR WORK WHILE YOU WERE EMPLOYED BY THE MPSC**
8 **STAFF.**

9 A. Under the direction of the Chief Accountant, I supervised and assisted with audits and examinations
10 of the books and records of public utility companies operating within the State of Missouri with
11 regard to proposed rate increases.

12 **Q. WHAT IS THE NATURE OF YOUR CURRENT DUTIES WITH THE OFFICE OF**
13 **THE PUBLIC COUNSEL?**

14 A. I am responsible for the Accounting and Financial Analysis sections of the Office of the Public
15 Counsel and coordinating their activities with the rest of our office and other parties in rate
16 proceedings. I am also responsible for performing audits and examinations of public utilities and
17 presenting the findings to the MPSC on behalf of the public of the State of Missouri.

18 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE THE MPSC?**

19 A. Yes. I filed testimony in the cases listed on Schedule RWT-1 of my testimony on behalf of the
20 Missouri Office of the Public Counsel or MPSC Staff.

1 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

2 A. I will respond to the position of Union Electric Company d/b/a AmerenUE (AmerenUE or
3 Company) regarding Depreciation expense for regulatory purposes under 4 CSR 240-10.020 and
4 the proposed New Alternative Regulatory Plan (ARP). Specifically, I will respond to the rebuttal
5 testimonies of Company witnesses Warner Baxter, Gary Weiss, and Suede Kelly with respect to
6 their testimony on the appropriate application of 4 CSR 240-100.020 to depreciation expense in the
7 setting of rates. I will also address the rebuttal testimony of Company witness Baxter on the ARP
8 along with providing an overview of Public Counsel's view as to the appropriate ratemaking
9 method for AmerenUE.

10 **DEPRECIATION UNDER 4 CSR 240-10.020**

11 **Q. PLEASE EXPLAIN THIS ISSUE, AS YOU UNDERSTAND THE COMPANY**
12 **POSITION.**

13 A. The Company asserts in the testimony of Ms. Kelly that 4 CSR 240-10.020 requires the
14 Commission to set rates in a manner such that ratepayers provide the Company with one rate of
15 return on plant-in-service included in rate base while at the same time allow give the ratepayers a
16 credit for a different rate of return on investment for which the ratepayer has already paid for (i.e.
17 return of) via depreciation expense. Ms. Kelly asserts that the ratepayer can only receive a 3.00%
18 rate of return on the portion of a utilities investment for which the ratepayer has already provided a
19 "return of" (Kelly Rebuttal, page 26, line 14 – page 27, line 5). Gary Weiss provides rebuttal
20 testimony and schedules, which quantifies the Company interpretation of how the Commission

1 should apply 4 CSR 240-10.020 (Weiss rebuttal, page 29, line 9 – page 30, line 17 and Schedule
2 20).

3 **Q. WHAT IS PUBLIC COUNSEL'S POSITION ON THE COMPANY'S**
4 **INTERPRETATION OF THE COMMISSION RULE 4 CSR 240-10.020?**

5 A: Public Counsel believes AmerenUE's unique and unprecedented position results in inequitable
6 treatment of ratepayer supplied monies supporting rate base as compared to those funds provided by
7 the stockholder. OPC also asserts that the Company has failed to properly interpret the rule and in
8 fact ignores sections of the rule providing for Commission discretion. Finally, Public Counsel
9 asserts that AmerenUE's interpretation of the rule does not reflect sound regulatory principles, does
10 not reflect its own operations and actions, and would result in the inefficient use of the resources
11 devoted to public utility service.

12 **Q. PLEASE EXPLAIN WHY PUBLIC COUNSEL ASSERTS THAT COMPANY'S**
13 **POSITION IS UNIQUE AND UNPRECEDENTED.**

14 A. Company witness Weiss acknowledges that the Commission has not followed this rule (as
15 interpreted by the Company) in recent years (Weiss rebuttal, page 29, lines 20 – 24). Mr. Weiss's
16 use of the term "recent years" should not be construed to mean that the Commission has changed
17 application methods within the time frame bounded by the experience of anyone participating in this
18 case. I personally have been directly involved in the rate setting process in Missouri since 1978. To
19 my knowledge, this Commission has never interpreted this rule as AmerenUE is suggesting. Public
20 Counsel research has yet to reveal a Commission report and order that would applies the rule based
21 on AmerenUE's interpretation.

1 Q. WOULD THE COMPANY'S INTERPRETATION OF 4 CSR 240-10.020 RESULT
2 IN EQUITABLE TREATMENT OF RATEPAYERS AS COMPARED TO
3 STOCKHOLDERS?

4 A. No. Ratepayers and stockholders are both sources of funds used to support rate base necessary to
5 provide safe and adequate utility service. AmerenUE's proposal would result in a different
6 compensation rate for ratepayer supplied monies as compared to the rate for stockholder supplied
7 funds.

8 Q. HAS THE COMPANY PROVIDED ANY JUSTIFICATION FOR DIFFERENT
9 COMPENSATION RATES?

10 A. No. Public Counsel believes that providing different compensation rates would result in inequitable
11 treatment of ratepayers. Such an inequity could also provide perverse incentives with respect to the
12 management of the sources of funds available to a utility.

13 Q. HAS THE COMMISSION'S "RECENT" REGULATORY TREATMENT OF
14 RATEPAYER AND STOCKHOLDER SUPPLIED FUNDS RESULTED IN
15 EQUITABLE TREATMENT OF RATEPAYER AND STOCKHOLDER SUPPLIED
16 FUNDS USED TO SUPPORT RATE BASE?

17 A. Yes.

18 Q. YOU HAVE USED THE TERMS "RATE BASE" AND "RETURN OF", ALONG
19 WITH A GENERAL DISCUSSION OF 4CSR 240-10.020. PLEASE EXPLAIN

**THE RELATIONSHIP OF THESE TERMS AND HOW THEY INTERACT WITH
THE REFERENCED COMMISSION RULE.**

A. The foundation of Rate of Return regulation is essentially the same as what an investor looks at when deciding how to invest. Both the regulator and the investor look at the return on equity that can be expected to be achieved on a particular investment. Regulation has developed specific terms to identify the components of the investments necessary to provide public utility service. Rate Base is the most critical factor as it represents the value of the plant in service and other "permanent like invested resources" necessary to provide service. I use the term "permanent like invested resources" to refer to items that are not on-going expenses in the current period; however neither are these items static in nature like a power plant. Examples would include material and supplies inventory, cash working capital, and prepaid insurance. The specific items including in these investment categories change from period to period; however, a minimum or average level of investment in these categories is necessary at all times.

The funds necessary to acquire the resources referred to by regulators as "rate base" are supplied by the stockholder and the ratepayer. The regulatory process is designed to allow the stockholders the opportunity to receive a "return on" the funds they provided. In the mathematical formula, as traditionally applied by the MPSC, the term "rate base" represents the netting of the ratepayer-supplied funds against the total value of the investment resources necessary to provide service. The rate base therefore represents the total funds that the stockholder must supply through either the investment of their own monies (equity investment) or the incurrence of debt. The MPSC then multiplies the level of earnings rate plus the cost of debt, it finds appropriate, times the rate base. The result, after exclusion of debt cost, is commonly referred to as the "return on" rate base.

1 **Q. WHAT IS THE REVENUE REQUIREMENT FORMULA?**

2 A. Revenue Requirement = Earnings + expenses.

3 The term "Earnings" as used in the above formula is set equal to rate base times the overall rate of
4 return. The overall rate of return would include interest expense along with return on equity. The
5 term expenses includes applicable taxes along with all other operating and maintenance expenses
6 plus depreciation expense.

7 **Q. WHAT IS DEPRECIATION EXPENSE AND HOW DOES IT RELATE TO THE**
8 **ISSUE AT HAND?**

9 A. Most tangible assets, such as electric generating facilities or distribution facilities, do not hold their
10 value over time due to use and aging. Depreciation is the measurement of the decline in value not
11 restored by normal maintenance procedures during a specified period, or put another way, the
12 consumption of an asset used to produce a service during a specified period. Depreciation expense
13 also represents the recovery of the initial capital investment included in rate base. The Uniform
14 System of Accounts provides for the accumulation of depreciation expense associated with utility
15 property in USOA Account 107, for accounting purposes.

16 Since depreciation expense is a cost paid for by ratepayers, the accumulated reserve represents the
17 cost of investment of current plant in service (recorded in USOA Account 101) which has been paid
18 for the ratepayer. The question AmerenUE raises is whether or not it is appropriate under 4 CSR
19 240-10.020 that the ratepayer should continue to compensate the stockholder for an investment for
20 which the ratepayer has already paid. Public Counsel believes that basic fairness and equity would
21 clearly indicate the answer is **NO**.

1 **Q. DOES 4 CSR 240-10.020 REQUIRE THAT THE COMMISSION USE A**
2 **DIFFERENT RATE (SUCH AS 3%) IN REGARD TO ACCUMULATED RESERVE**
3 **FOR DEPRECIATION AS THE RATE APPLIED TO THE BALANCE OF RATE**
4 **BASE, AS IS THE POSITION ESPOUSED BY AMERENUE?**

5 **A.** No. I have been advised by counsel that the rule provides the Commission with the discretion to
6 modify the rate contained in 4 CSR 240-10.020 upon a showing that the 3% "rate is not reasonably
7 or equitably applicable to it", as explained in paragraph (4) of the rule. Public Counsel believes the
8 evidence in this case regarding the appropriate rate of return on equity and the cost of debt incurred
9 by the Company clearly indicates that a 3% rate is not currently applicable to AmerenUE
10 investments. The recommended Return on Equity rates in this case range from the Staff proposal of
11 8.91% (Bible direct, page 29, line 15) to AmerenUE recommended rate of 12.50% (Weiss Rebuttal,
12 Schedule 20, line 1). The cost of debt, as determined by OPC witness Burdette, is approximately
13 6.82% (Burdette rebuttal, Schedule MB-7).

14 Paragraphs (4) and (6) of 4 CSR 240-10.020 clearly contains language providing the Commission
15 with the necessary discretion to equitably treat ratepayers and stockholders during the rate setting
16 process. Paragraph 6 specifically states:

17 The commission shall retain jurisdiction in this matter for the purpose of making
18 any changes(s) in the interest rate prescribed in section (2) that may be warranted.

19 **Q. DOES PUBLIC COUNSEL BELIEVE THE 3% RATE WAS ORIGINALLY**
20 **DETERMINED BASED ON AN ACTUAL COST BASIS?**

1 A. Yes. The report and order from MPSC Case No. 10,723 includes extensive discussion about the
2 cost of debt for various utilities prior to determining that a 3% rate was appropriate with regard to
3 the accumulated reserve for depreciation. Almost 3 pages out of a 15-page report and order are
4 devoted to various testimony regarding the actual cost of monies for utilities. Public Counsel has
5 been unable to find any other discussion of a interest rate applicable to depreciation funds.

6 Q. DID THE REPORT AND ORDER IN CASE NO. 10,723 ALSO ADDRESS THE
7 POSSIBLE NEED TO ADJUST THE 3%?

8 A. Yes, the following paragraph addresses that point.

9 Upon consideration of all of the evidence in this matter, and based upon our
10 intimate knowledge of the operations and finances of the utilities under our
11 jurisdiction, and taking into consideration the fact that the utilities at times, varying
12 with economic conditions, are not able to invest depreciation reserve funds for use
13 in determining the income from the investment of moneys in depreciation funds to
14 be applied in the rate making process in reduction of the utilities allowable return is
15 3% per annum. We are also of the opinion, since the circumstances surrounding
16 the use of depreciation funds are generally the same as to all utilities, that such rate
17 should be applied in the case of all of the gas, electric, water, telegraph, telephone,
18 and heating utilities under our jurisdiction. However, if it should appear to the
19 Commission or if any utility shall prove that due to unusual or extraordinary
20 circumstances, such rate is not fairly and equitably applicable to it, such rate may
21 be modified according to the circumstances of the particular case.

22 Ibid., p. 14

23 Public Counsel would point out that Union Electric Company of Missouri was a party to the case.

24 Q. DOES THE CURRENT COMMISSION PRACTICE EFFECTIVELY LOOK AT THE
25 CURRENT CIRCUMSTANCES CONFRONTING EACH UTILITY AT THE TIME OF
26 THE RATE CASE MODIFY THE RATE ACCORDINGLY?

1 A. Yes. From a mathematical standpoint, the application of the overall rate of return times a rate base
2 that has been reduced by the accumulated reserve for depreciation results in exactly the same
3 revenue requirement if the appropriate rate is taken times the reserve in a separate calculation and
4 then used to reduce the necessary earnings included in the revenue requirement.

5 **Q. WOULD THE USE OF AN INTERST RATE ON DEPRECIATION FUNDS THAT**
6 **WAS DIFFERENT THAN THE OVERALL RATE OF RETURN CREATE PERVERSE**
7 **INCENTIVES WITH REGARD TO THE UTILITIES INVESTMENTS**
8 **DECISIONS?**

9 A. Yes most definitely. Such a practice would encourage unnecessary rate base investment due to the
10 fact that these investments could be funded with low cost depreciation dollars, while the utility
11 would earn a higher return. It creates the perfect scenario of being able to borrow at a cost lower
12 than you can earn on an investment funded by the borrowing. Application of 4 CSR 240-10.020 as
13 advocated by AmerenUE would clearly result in the Commission providing an incentive for this
14 monopoly to over-invest. While after the fact prudence review of investment policies might be able
15 to identify certain discreet imprudent investments, the Commission should not pursue regulatory
16 policies that encourage such a situation.

17 **Q. PLEASE DISCUSS THE VIEW THAT DEPRECIATION FUNDS IN A**
18 **REGULATED ENVIRONMENT ARE FOR THE REPLACEMENT OF UTILITY**
19 **PROPERTY.**

20 A. Long lived assets such as those used in provision of utility service have lives often in excess of 30
21 years. The accumulated funds related to depreciation during these long lives are not held in some

1 sort of sinking fund for the replacement of the specific asset to which the depreciation relates.
2 Depreciation expense results in cash flows in the current period and are used to fund the necessary
3 investments in new plant in service in the period. The use of depreciation funds in this matter is
4 commonly referred to as internally generated funds. In this current case the Company has informed
5 the Commission of a minimum of three billion dollars of new investment necessary over the next
6 five years. This situation is completely different than the situation discussed in Case No. 10,723
7 where the utilities were unable to spend the cash flow resulting from depreciation expense. The
8 shortage of materials due to World War II and economic conditions did not allow the utilities to
9 spend monies on new property at the time Case No. 10,723 was issued.

10 **Q. PLEASE SUMMARIZE PUBLIC COUNSEL'S POSITION OF AMERENUE'S**
11 **POSITION THAT 4 CSR 240-10.020.**

12 **A.** Public Counsel believes that AmerenUE's flawed interpretation of 4 CSR 240-10.020 would result
13 in inequitable treatment of ratepayer supplied funds as compared to stockholder supplied funds.
14 Application of AmerenUE's position would create a regulatory environment that provided
15 incentives to the Company to make unnecessary investments. Public Counsel would strongly
16 recommend this Commission reject AmerenUE's unique and unprecedented interpretation of 4 CSR
17 240-10.020.

ALTERNATIVE REGULATION PLAN

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY REGARDING THE ALTERNATIVE REGULATION PLAN PROPOSED BY THE COMPANY IN ITS REBUTTAL TESTIMONY?

A. I will discuss why Public Counsel does not believe it is appropriate for this Commission to regulate AmerenUE under an alternative regulatory plan (ARP) until 1) the Commission resolves outstanding allegations regarding the resolution of the experimental alternative regulatory plans, and 2) not until AmerenUE's rates are "re-based" in accordance with its cost of service. I will address the ARP proposal as outlined in the rebuttal testimony of AmerenUE witness Warner Baxter and supported by the testimony of various other AmerenUE witnesses. Finally, I will outline the conceptual components that Public Counsel believes should be part of a properly structured ARP in the event the Commission requests the parties agree to adopt an ARP for AmerenUE.

Q. WHAT IS THE HISTORY OF ALTERNATIVE REGULATORY PLANS WITH RESPECT TO AMERENUE?

A. AmerenUE has operated under two separate Experimental Alternative Regulatory Plans often referred to as EARP I and EARP II. EARP I was approved by the Commission in Case No. ER-95-411 (issued July 21, 1995) and was in effect for a three year period from July 1, 1995 through June 30, 1998. EARP II was approved by the Commission in EO-96-149 (issued February 21, 1997) and was in effect for a three-year period from July 1, 1998 through June 30, 2001.

Each EARP was made up of three one-year periods with the potential sharing of earnings in excess on 12.61% between ratepayers and stockholders on a predetermined ratio. As earnings rose above the threshold, stockholders retained less of the earnings. EARP I had a hard cap on earnings retention by stockholders. All earnings in excess of 14.00% (before any sharing) were credited to ratepayers. EARP I had a single earnings sharing band in which both ratepayers and stockholders received monies. EARP II instituted a similar hard cap on earnings above 16.00% (before sharing) with two earnings sharing bands.

Q. PLEASE EXPLAIN WHY PUBLIC COUNSEL BELIEVES THAT THE COMMISSION SHOULD NOT APPROVE AN ALTERNATIVE REGULATORY PLAN AT THIS TIME.

A. The answer is quite simple. Neither of the experimental plans, EARP I or EARP II, is complete and therefore a final analysis of how all stakeholders have either benefited or suffered harm cannot be ultimately resolved.

The results of the third year of EARP I is still in litigation due to AmerenUE's appeal of the Report and Order of the MPSC in Case No. EO-96-14, dated December 23, 1999. Public Counsel did not envision a delay of well over three years being required to terminate EARP I, nor the delay in getting an initial MPSC order regarding the appropriate level of sharing for the third year of EARP I. The MPSC report and order was issued on December 23, 1999, almost a full eighteen months after the end of EARP I, year 3. This delay created a real loss of money for customers associated with the time value of monies ultimately due them, which were held during the intervening period by AmerenUE. It is also inevitable that some customers who should have received monies based on

1 year 3 results, in fact never received any monies due to relocations, death, other events which
2 precluded them from receiving credits. This case is still on appeal in the Missouri court system.

3 The same scenario is again taking place with regard to year 3 of EARP II. EARP II ended on June
4 30, 2001 and the Commission has yet to hold hearings on the issues raised by various parties
5 regarding the appropriate level of earnings to be shared. Hearing in that case have recently been
6 scheduled to begin October 21, 2002. It will be difficult for the Commission to issue a Report and
7 Order any quicker than 18 months after the end of the 3rd year of EARP II.

8 Public Counsel does not believe delays of these lengths are in the public interest. The Commission
9 does need adequate time to address issues arising during the periods covered by an EARP, however
10 the delays are a significant detriment to ratepayers.

11 **Q. HAVE SIGNIFICANT QUESTIONS REGARDING HOW AMERENUE OPERATES**
12 **BEEN RAISED IN REGARD TO YEAR 3 OF EARP II?**

13 A. Yes. Public Counsel witness Ryan Kind has filed testimony in EM-96-149, dated May 7, 2002,
14 which raises significant issues regarding the propriety of certain transactions between AmerenUE
15 and affiliated companies and the alleged manipulation of earnings. The Commission's findings on
16 this issue will have a significant impact on the amount of ratepayer credits resulting from year 3 of
17 EARP II. The Commission's finding will also have a significant impact on how Public Counsel and
18 ultimately the Commission views the success or shortcomings of the EARP II.

19 **Q. THE COMPANY TOUTS SIGNIFICANT FINANCIAL BENEFITS TO**
20 **RATEPAYERS AS A RESULT OF THE TWO EARPS. DOES PUBLIC COUNSEL**

1 AGREE WITH THE COMPANY'S VALUATION IN RATEPAYER BENEFITS ON
2 THE ORDER OF \$425 MILLION?

3 A. No. Public Counsel does not believe that \$425 Million is representative of the appropriate amount
4 of value to the ratepayer of the two EARPs. In addition, Public Counsel would assert that the
5 Commission should also look at the significant earnings retained by the Company to get an accurate
6 reflection of the fairness of EARP I & II.

7 **Q. WHY DOES PUBLIC COUNSEL NOT BELIEVE THE \$425 MILLION IS AN**
8 **ACCURATE REFLECTION OF THE VALUE OF THE EARPS TO RATEPAYERS?**

9 A. There are several concerns regarding this asserted savings amount. The Company provided a
10 delineation of the amounts in response to OPC Data Request No. 1033, which is attached to my
11 testimony as Schedule RWT-2. \$195 Million of the alleged customer benefit results from a
12 permanent rate decrease that went into effect August 1, 1995, the same day that the Commission
13 Report and Order in Case No. ER-95-411 and EO-96-14 approving the stipulation and agreement
14 became effective. This rate reduction was not related to the Company's performance under the
15 EARP in any manner. Similarly, a customer credit of \$30 Million dollars was a component of the
16 same stipulation and was not related to the Company's performance under the EARP since the
17 EARP had not yet been approved. Public Counsel would also take issue with the Company
18 claiming \$54 Million dollars of rate reductions following the end of EARP I as being solely the
19 result of EARP I. AmerenUE has had four major rate decreases between 1987 and 1995, an
20 average of one every two years. There were several reasons to expect this trend to continue.
21 Therefore Public Counsel does not believe it is accurate to claim the EARPs were solely responsible

1 for the \$54 Million. Public Counsel would assert that the \$146 Million of credits paid to ratepayers
2 are the only direct financial benefit of the EARPs to ratepayers. (please note that year 3 of each
3 EARP is still in dispute and that the numbers herein reflect AmerenUE positions)

4 **Q. DOES PUBLIC COUNSEL BELIEVE THAT THE STOCKHOLDERS HAVE**
5 **RECEIVED THE LION'S SHARE OF EARNINGS UNDER THE EARPS?**

6 A. Yes.

7 **Q. HAS PUBLIC COUNSEL QUANTIFIED THE EXCESS EARNINGS RETAINED BY**
8 **AMERENUE DURING THE SIX YEARS OF THE TWO EARPS?**

9 A. Yes. Public Counsel believes that the Company has retained \$328 Million during the six years.
10 This amounts to the Company receiving a benefit under the EARPs equal to 2.25 times the
11 customers' benefit. (See Schedule RWT-3 attached)

12 **Q. THE COMPANY'S ALTERNATIVE REGULATORY PLAN PROPOSAL IS**
13 **SUMMARIZED BEGINNING ON PAGE 72, LINE 21 OF WARNER BAXTER'S**
14 **REBUTTAL TESTIMONY. RECOGNIZING THAT PUBLIC COUNSEL DOES NOT**
15 **BELIEVE THE COMMISSION SHOULD APPROVE AN ARP UNTIL EARP I AND**
16 **EARP II ARE COMPLETE, WOULD YOU TO ADDRESS EACH COMPONENT OF**
17 **THE COMPANY'S PROPOSAL.**

18 A. Okay.

1 **Q. THE COMPANY PROPOSES A THREE-YEAR TERM FOR AN ARP (BAXTER**
2 **REBUTTAL, PAGE 72, LINE 21). PLEASE COMMENT.**

3 A. Public Counsel does not believe that an ARP should last longer than three years without a
4 Commission review of the overall cost of service where all interested parties can present evidence.
5 Public Counsel believes that a three-year period provides a reasonable balance between the time
6 necessary to implement the findings of a complaint investigation and the utility's desire to retain
7 increased earnings resulting from efficiency gains. It is understandable that a utility would wish to
8 retain such increased earnings indefinitely. Only in an unregulated monopoly business
9 environment, could a firm expect to retain earnings for an indefinite period. Such a retention period
10 would require a lack of corrective action by the regulator. In a competitive environment, prices
11 move toward cost and the ability to retain excess earnings indefinitely is not an option.

12 **Q. PLEASE DEFINE THE TERM "COST".**

13 A. I use the term "cost" to refer to each component of the total revenue requirement of the utility. Cost
14 includes all expenses along with the earnings and interest expense associated with the rate base.
15 The total revenue requirement is also called the overall cost of service.

16 **Q. CAN YOU PROVIDE AN EXAMPLE OF HOW THE COST OF SERVICE IS USED**
17 **IN THE DETERMINATION OF RATES?**

18 A. Yes. The Commission has traditionally determined what is commonly referred to as the revenue
19 requirement. The revenue requirement formula is simply stated below:

20 Revenue Requirement = Operating Expenses + Taxes + Interest Expense + Return on Equity

1 The right side of the equation is commonly referred to as the overall cost of service. Revenues are a
2 result of a cost of service, not a component thereof. The following example will provide an
3 example of how the Return on Equity is calculated in total dollars (not as a percentage):

4
$$\text{Return on Equity} = \text{Revenue} - (\text{Operating Expenses} + \text{Taxes} + \text{Interest Expense})$$

5 This equation is the same as the revenue requirement formula used to set rates; simply restructured
6 to solve for the Return on Equity (in dollars or commonly referred to as Earnings) realized from the
7 actual operations of the Company.

8 **Q. IS ONE COMPONENT OF THE OVERALL COST OF SERVICE FORMULA,**
9 **PREVIOUSLY DISCUSSED, UNIQUE?**

10 **A.** Yes. As previously discussed, four basic components make up the overall cost of service which in
11 turn is equal to the revenue requirement. Three of the four components of the overall cost of service
12 are expenses that are recorded on the income statement of the utility. In other words, these
13 components result from or require an expenditure of monies by the utility. The fourth component,
14 return on equity, is equal to the Commission approved authorized rate of return multiplied times the
15 regulatory rate base. This fourth component does not represent an expense to the utility or an
16 expenditure of monies by the utility. This component is the amount of profit a utility has the
17 opportunity to earn if actual results, during the period after new tariffed rates are set, are the same as
18 those expectations used in the determination of the overall cost of service and rate structure.

19 **Q. AMERENUE PROPOSES THAT A PERMANENT RATE REDUCTION OF \$15**
20 **MILLION BE IMPLEMENTED WITH AN EFFECTIVE DATE OF APRIL 1,**

1 **2002 (BAXTER REBUTTAL, PAGE 72, LINE 24). WHAT IS PUBLIC**
2 **COUNSEL'S POSITION REGARDING THE APPROPRIATE RATE ADJUSTMENT**
3 **PRIOR TO COMMENCEMENT OF AN ARP?**

4 A. Public Counsel believes that in a general rate proceeding such as this case, rates should be set at a
5 level that reflects the current cost of service for providing electricity to Missouri ratepayers. An
6 ARP purports to provide greater incentives for efficiency in return for the opportunity to retain some
7 of the resulting earnings for a defined period without having the risk of the regulator adjusting rates
8 to flow all of the efficiency savings through to ratepayers prior to the end of that period. Absent
9 such a re-basing of rates, current rates would have excess profits built into rates that would be
10 retained by the utility without the need or incentive to improve efficiency.

11 **Q. WHAT DO YOU MEAN BY EXCESS PROFITS?**

12 A. I am referring to the level of earnings in excess of the return on equity (included in the revenue
13 requirement formula previously discussed) found appropriate by the Commission as being
14 representative of the market required return for investors to invest.

15 **Q. THE COMPANY ALLEGES THAT THE STAFF RATE PROPOSAL WOULD BE**
16 **"PUNITIVE" BECAUSE SETTING RATES ON A TRADITIONAL COST OF**
17 **SERVICE WOULD TAKE AWAY THE EFFICIENCY GAINS THE COMPANY**
18 **ALLEGES IT HAS ACHIEVED DURING EARP 1 AND 2 (BAXTER REBUTTAL,**
19 **PAGE 39 - 43). DOES PUBLIC COUNSEL AGREE THAT TRADITIONAL**
20 **REGULATION IS PUNITIVE?**

1 A. No. The traditional regulatory model looks at the **cost of service** to provide electricity to Missouri
2 ratepayers. The purpose of the regulation of public utilities is serve as a surrogate for a competitive
3 market. A basic principle in a competitive market is that over time, the price of a good moves
4 toward the total service long run incremental cost (TSLRIC) of providing the service. In a perfectly
5 competitive market, the price would equal the total long run incremental cost. A firm's ability to
6 obtain earnings in excess of the underlying cost of capital required by the capital markets (i.e. rate of
7 return on equity) is dependent on the firm's ability to become more efficient. However those
8 increased earnings are only temporary as the firm's competitors will respond by lowering their cost
9 and ultimately the price charged customers. If regulation is to be a surrogate for competition, the
10 Commission should respond in a similar manner. This response period is referred to as regulatory
11 lag during which time excess earnings can be retained prior to the adjustment in prices.

12 **Q. HOW DOES THE PHRASE "TOTAL SERVICE LONG RUN INCREMENTAL COST"**
13 **YOU JUST USED RELATE TO THE TERM "COST" TO DEFINED EARLIER?**

14 A. TSLRIC refers to a period of a firm's operation that is of sufficient length that all costs incurred by
15 the firm are variable. Traditional regulatory models have used cost of service studies which looks at
16 all costs incurred to serve current customers. In both instances the total cost of the firm is reviewed.
17 TSLRIC can never be reached in reality because firms such as utilities have long lived fixed assets
18 on which financial obligations exist. Therefore this Commission has utilized actual costs resulting
19 from current operations to determine the appropriate level of cost necessary to develop a revenue
20 requirement.

1 **Q. HAVE OTHERS RECOGNIZED REGULATORY LAG AND ITS VALUE TO THE**
2 **TRADITIONAL REGULATORY PROCESS?**

3 A. Yes. The following question and answer appeared in prefiled rebuttal testimony of Southwestern
4 Bell Telephone Company witness William Avera:

5 Q. WHAT INCENTIVES DO REGULATED UTILITIES HAVE TO IMPROVE
6 EFFICIENCY?

7 A. The incentives for regulated entities to achieve efficiencies are virtually the same as
8 for firms in the unregulated sectors. For utilities, once service rates have been set,
9 realized earnings will depend upon actual revenues and costs going forward. To
10 the extent the utility can improve its efficiency and reduce costs, it will enjoy a
11 return greater than that authorized, other things remaining constant. When another
12 rate case occurs, tariffs are revised to conform to the utility's new cost structure.
13 Any economic rents are eliminated, and the benefits of improved efficiency are
14 passed on to customers in the prices charged for utility service.

15 This outcome of the regulatory process is no different than markets provide under
16 perfect competition. Just as the competitive firm introducing efficiencies enjoys
17 greater returns during the transition period when competing firms are attempting to
18 achieve the same improvements, regulated utilities have the incentive to increase
19 the efficiency of their usage of all resources -- labor, capital, and technology -- in
20 order to earn transitory profits above the authorized rate of return between rate
21 cases.

22 (Case No. TC-89-14, Rebuttal Testimony of William Avera, page 62 - 63)

23 **Q. IS THE COMPANY'S PROPOSAL TO REDUCE EARNINGS BY \$15 MILLION**
24 **BASED ON A COST OF SERVICE STUDY?**

25 A. No.

26 **Q. DOES PUBLIC COUNSEL BELIEVE THIS AMOUNT IS ADEQUATE?**

27 A. Public Counsel believes that its rebuttal testimony along with our support of the Staff's direct filing
28 clearly indicates that \$15 Million is not an adequate re-basing of rates. Public Counsel urges this

1 Commission to make the proper determination that the going forward level of rates are determined
2 using an appropriate cost of service study and not a proposal which will ensure that AmerenUE
3 continues to earn returns well in excess of current market requirements.

4 **Q. THE THIRD COMPONENT OF THE COMPANY'S ARP PROPOSAL IS A ONE-**
5 **TIME CREDIT TO CUSTOMERS OF \$15 MILLION. (BAXTER REBUTTAL,**
6 **PAGE 73, LINE 1) WHAT IS PUBLIC COUNSEL'S RESPONSE TO THIS**
7 **COMPONENT.**

8 A. Customer credits have been voluntarily given by utilities as part of a stipulation and agreement in
9 the past. However those agreements have been reached as part of a negotiated package between all
10 parties to a proceeding before the Commission. Public Counsel is not averse to discussing such a
11 component as part of a settlement in this case, however discussions to date have not produced such
12 a settlement.

13 **Q. AMERENUE HAS PROPOSED WHAT IT TERMS " SIGNIFICANT NEW**
14 **INFRASTRUCTURE INVESTMENTS" AS PART OF A ALTERNATIVE**
15 **REGULATORY PROGRAM. (BAXTER REBUTTAL, PAGE 73, LINE 3) DOES**
16 **PUBLIC COUNSEL BELIEVE FUTURE GENERATION REQUIREMENTS AND**
17 **OTHER PLANNED PLANT-IN-SERVICE ADDITIONS SHOULD BE AN**
18 **INTEGRAL PART OF THE RATEMAKING PROCESS?**

19 A. No. The citizens of this state clearly indicated that the construction of electric generation facilities
20 were not to be considered when setting rates until such time that those facilities were in-service and

1 providing electricity. *Section. 393.135 RSMo. 2000* was passed by Missouri voters. "Proposition
2 No. 1" was adopted by initiative on November 2, 1976.

3 Public Counsel recognizes that rates should be set at a level that is sufficient to allow the utility to
4 attract the capital necessary to make the investments required for the provision of safe and adequate
5 service. The Company is allowed the opportunity to capitalize the cost associated with financing of
6 direct construction via the Allowance for Funds Used during Construction (AFUDC) in
7 conformance with the Uniform System of Accounts approved by this Commission. Use of AFUDC
8 maintains the earnings of the utility during the construction period. Once placed in service, these
9 financing costs along with the direct construction costs are paid for by the customers who are
10 actually using the service. Public Counsel does not believe it is appropriate to require current
11 customers to pay for facilities that are not currently used and useful in the provision of service.
12 Public Counsel believes this "wise" regulatory policy that has been in effect for over two decades
13 has greatly benefited customers, utilities, and the State's economy as a whole.

14 **Q. DOES THE PROPOSED INVESTMENT IN ELECTIC GENERATING FACILITIES**
15 **CONSTITUTE A SIGNIFICANT PORTION OF THE INFRASTRUCTURE**
16 **INVESTMENT REQUIREMENTS?**

17 A. Yes. AmerenUE assets that an average of \$600 Million must be invested per year over the next five
18 years. (Stout rebuttal, page 24, lines 9 – 11) An analysis of Schedule 7 attached to Mr. Stout's
19 rebuttal clearly indicates that well over 50% of the budgeted capital expenditures are for generating
20 facilities. OPC witness Ryan Kind's cross-surrebuttal testimony addresses the need for new

1 generating facilities and the Company's actions that contributed to the current situation regarding
2 generation requirements.

3 **Q. THE COMPANY HAS PROPOSED A LOW INCOME CUSTOMER ASSISTANCE**
4 **PROGRAM AND AN ECONOMIC DEVELOPMENT PROGRAM. (BAXTER**
5 **REBUTTAL, PAGE 73, LINE 7 - 16) DOES PUBLIC COUNSEL BELIEVE**
6 **THESE PROGRAMS ARE INTEGRAL COMPONENTS OF THE TRADITIONAL**
7 **REGULATORY MODEL?**

8 A. No. While the purported goals of these two programs, outlined by AmerenUE, may be deemed
9 worthy, the funding of these programs with the use of excess earnings for the sole purpose of
10 avoiding a permanent rate decrease should not be ordered by this Commission. Moreover,
11 AmerenUE is proposing that current period payments to these programs be amortized to expense in
12 future periods and thus reduce earnings during those periods.

13 **Q. DOES PUBLIC COUNSEL OPPOSE THE INCLUSION OF THESE PROGRAMS IN**
14 **THE COST OF SERVICE UNDER ANY CIRCUMSTANCES?**

15 A. No. The question of whether or not these programs should be included in the cost of service should
16 be determined on the merits of the program. That is whether or not the programs are in the public
17 interest. The focus of my testimony is that these programs are not an integral component of an
18 ARP. These programs should not be dependent on whether or not this Commission adopts the
19 Company's proposed ARP.

1 **Q. MR. BAXTER OUTLINES THE PROPOSED SHARING GRID FOR EARNINGS IN**
2 **SEVERAL BULLET POINTS BEGINNING ON PAGE 73, LINE 18 AND**
3 **CONTINUING THROUGH PAGE 74, LINE 22. PLEASE EXPLAIN YOUR**
4 **UNDERSTANDING OF THE GRID.**

5 A. The sharing grid proposed by AmerenUE provides for sharing credits to be given customers when
6 earnings reported by the Company exceed 10.5%. The sharing portion of the grid is made up of
7 four distinct blocks; 10.5% - 12.5%, 12.51% - 15.0%, 15.01% - 16.0%, and greater than 16.0%.
8 Within the first block, a fixed amount (\$17 Million) would be credited to ratepayers if reported
9 earnings were anywhere within that block. For incremental reported earnings within the next two
10 block, 55% and 90% respectively would be credited to customers in addition to any credits related
11 to the lower blocks. Within the final block, 100% of earnings above 16.0% would be credited to
12 customers.

13 If earnings levels are within the first block, the Company also proposes to provide an additional \$2
14 Million grant to the low-income assistance program and the economic development program in
15 total. For incremental earnings in the second block, the Company proposes to provide a grant of 5%
16 of such incremental earnings in total to the two programs.

17 **Q. DOES PUBLIC COUNSEL SUPPORT THE CONCEPT OF A FLAT CREDIT**
18 **AMOUNT REGARDLESS OF THE LEVEL OF EARNINGS WITHIN THE FIRST**
19 **SHARING GRID?**

20 A. No. Public Counsel believes such a proposal provides perverse incentives for AmerenUE to
21 manipulate its earnings. Public Counsel would point out that all earnings up to \$14.9 Million dollars

1 above the 10.5% would cost the Company \$15.0 Million. AmerenUE could literally spend \$1 at
2 11:59 p.m. on June 30 to avoid the payment of a \$15 Million credit to customers.

3 **Q. DOES THE GENERAL STRUCTURE OF THE COMPANY PROPOSE GRID ALSO**
4 **CREATE PERVERSE INCENTIVES?**

5 A. Yes. The grid, similar in structure to that used in EARP I & II, creates the situation where as
6 earnings rise, the Company's retention percentage decreases. This creates a distinct incentive for
7 the Company to make large one-time expenditures of monies that are either expensed or capitalized
8 (increased rate base) in order to avoid the risk of having to give those funds to the customers in the
9 form of credits.

10 Expenditures that are capitalized as plant-in-service not only reduce current year earnings, but also
11 reduce future year earnings, all things else being equal. Therefore a grid structure as Company has
12 proposed provides an incentive to invest in uneconomic or unnecessary facilities. Likewise the
13 incentive would be strong to incur unnecessary expenses or accelerate expenditures to the current
14 period in order to decrease earnings thereby reducing or avoiding paying customer credits by a like
15 amount. People are often critical of year-end spending practices of government when funds will
16 lapse back to general funds if the appropriated levels are not spent. Public Counsel would submit
17 this Commission should not use a regulatory system that provides an analogous incentive

18 Public Counsel would submit that a grid structure such as AmerenUE has proposed and also as
19 contained in EARP I & II, are not in the public interest.

1 **Q. ARE THERE OTHER CONSIDERATIONS REGARDING THE GRID AS PROPOSED**
2 **BY AMERENUE?**

3 A. Yes. The first block of the grid (in which sharing occurs) proposed by AmerenUE is 200 earnings
4 basis points (12.5% - 10.5%). To put this into perspective, 1 basis point (0.01%) is equal to
5 approximately \$395,235 in revenue requirement and 100 basis points is equal to \$39,523,500.
6 (based on Staff Accounting Schedule 1). Therefore, this grid block contains almost \$80 Million
7 dollars. The Company's proposal would return only 19% of any earnings to customers from this
8 block in contrast to the 50% return provided customers from the first sharing block of the grids used
9 in EARP I & II.

10 A second consideration is that the AmerenUE ARP proposal is not based on having rates initially set
11 based upon a cost of service. Current rates are producing earnings, which exceed 12.61% for the
12 last year of EARP II even under Company's reporting. Absent a proper re-basing of rates, this
13 block would effectively lock in excess revenue requirement of \$65 Million (\$80 Million less \$15
14 Million). These excessive over-earnings would be charged to ratepayers on an annual basis.

15 **Q. THE COMPANY SETS OUT A PLAN FOR THE PAYMENT OF CREDITS TO**
16 **CUSTOMERS WHEREIN THE CUSTOMER WOULD RECEIVE ALL UNDISPUTED**
17 **AMOUNTS BEGINNING APPROXIMATELY SEPTEMBER 1ST FOLLOWING THE**
18 **END OF THE ARP PERIOD. FURTHER, AMERENUE PROPOSES THAT ANY**
19 **DISPUTED AMOUNTS, WHEN FINALLY PAID, WOULD BE PAID WITH**
20 **INTEREST. DOES PUBLIC COUNSEL BELIEVE THIS WOULD BE AN**
21 **ENHANCEMENT AS COMPARED TO THE PREVIOUS EARP I & II?**

1 A. Yes. This would remove some of the incentive (related to the time value of money) AmerenUE has
2 had to delay the investigation necessary with each EARP period and the resolution of disputed
3 credit amounts with respect to each period. Public Counsel would point out that neither EARP I or
4 EARP II is complete and that Public Counsel has experienced significant discovery problems during
5 the each of the previous EARPs.

6 **Q. MR. BAXTER TOUTS THE PROPOSED ARP AS CONTAINING " ADDED**
7 **SPECIFICITY AND CLARIFIED LANGUAGE" . PLEASE COMMENT ON THE**
8 **DISCOVERY AND DISPUTE PROCEDURES AS REFERRED TO ON PAGE 75,**
9 **LINE 12 - 15 OF HIS REBUTTAL TESTIMONY AND CONTAINED IN**
10 **DETAIL IN SCHEDULE 1 ATTACHED THERE TO.**

11 A. The clarifying language contained in ARP as set out in Schedule 1 effectively eliminates the
12 Commissions ability to regulate AmerenUE for a period of three years. The alleged clarifying
13 language provides only for a limited mathematical review to be performed by Staff and excludes the
14 OPC from the process. The specificity language also restrains the Commission from considering a
15 complaint by OPC or other effected parties. OPC will address the legality or complete lack thereof
16 of these recommendations in the briefs to be filed after the hearing.

17 **Q. DOES PUBLIC COUNSEL HAVE SPECIFIC EXAMPLES OF THE ELIMINATION**
18 **OF COMMISSION OVERSIGHT THAT WOULD OCCUR UNDER THE ARP AS**
19 **PROPOSED BY THE COMPANY?**

20 A. Yes. AmerenUE's proposal precludes the OPC and Staff from requesting any information not
21 specifically listed on Schedule 1-15. This provision would preclude the Commission from receiving

1 evidence regarding imprudent expenditures as it relates to new investments or expenses not
2 necessary in the provision of utility service. This exclusion provides the Company with virtually
3 unlimited ability to manage its earnings within the ARP periods.

4 A second example deals with the requirement found on Schedule 1-10 that deals with financial
5 records being prepared in a manner consistent with Generally Accepted Accounting Practices
6 (GAAP). While GAAP is intended to provide a consistent presentation of financial reports to the
7 investment community of publicly traded companies, GAAP prepared financial reports are not
8 always appropriate for regulatory purposes. In fact, the basic premise of Financial Accounting
9 Standard Board opinion No. 71 is that regulators may require a utility's financial records to reflect
10 an item in a manner that otherwise would not be in conformance with GAAP. Public Counsel
11 witness Ted Robertson has filed surrebuttal testimony in this case that addresses the relationship
12 between GAAP and regulation. Mr. Robertson's comments outlining OPC's position on this
13 relationship can be found on pages 2 – 9 of his surrebuttal testimony. Public Counsel will address
14 legal precedent regarding the concerns addressed by Mr. Robertson in OPC's briefs to be filed in
15 this case.

16 GAAP has a specific purpose as explained by Mr. Robertson. However, GAAP was not intended to
17 nor does it meet the needs of regulators whom must set just and reasonable utility rates. GAAP
18 does **not** recognize basic regulatory principles and processes such as annualization adjustments,
19 normalization adjustments, imprudence of expenditures, known and measurable, or used and useful
20 criteria with respect to plant investments.

1 **Q. DOES THE COMPANY PROPOSE TO USE ACCOUNTING STANDARDS THAT ARE**
2 **NOT IN CONFORMANCE WITH THE COMMISSION APPROVED USOA?**

3 A. Yes. The MPSC has adopted the USOA as prescribed by the FERC and published at 18 CFR part
4 101 (1992). The Company proposes to use the FERC approved USOA as of May 10, 2002, which
5 is a later version of the USOA that has not been approved for use by this Commission. Public
6 Counsel would also respectfully remind the Commission that rules for financial reporting such as
7 USOA are not always appropriate for ratemaking for the same reasons just discussed in regard to
8 GAAP.

9 **Q. DOES THE COMPANY ALSO PROPOSE TO UTILIZE OTHER STANDARDS AS**
10 **OF MAY 10, 2002?**

11 A. Yes.

12 **Q. HOW WOULD THE USE OF STANDARDS AS OF MAY 10, 2002 ELIMINATE**
13 **COMMISSION OVERSIGHT?**

14 A. The accounting practices of the Company as of May 10, 2002 have not been audited by OPC, the
15 Staff, or any intervenor. The test year in this proceeding ended June 30, 2001. AmerenUE is asking
16 this Commission to adopt an accounting system without specific knowledge of how that system
17 works.

18 **Q. DO YOU HAVE ANY FINAL COMMENTS ON AMERENUE'S ALTERNATIVE**
19 **REGULATORY PLAN PROPOSAL WHICH ELIMINATES COMMISSION**
20 **OVERSIGHT?**

1 A. Yes. The financial reporting policies to be followed are required to be in compliance with
2 procedures and standards that follow those used in the Company's rebuttal testimony in this case.
3 Public Counsel believes that the financial reporting for an ARP should be in compliance with the
4 procedures and standards found appropriate by the Commission in determining the appropriate cost
5 of service on which to set rates. Those procedures and standards will become known when the
6 Commission determines the Company's cost of service in this case.

7 **Q. THE SECOND TO LAST BULLET POINT SET OUT IN MR. BAXTER'S**
8 **REBUTTAL TESTIMONY REGARDING THE ARP ADDRESSES THE INCLUSION**
9 **OF PERFORMANCE MONITORING. (BAXTER REBUTTAL, PAGE 75, LINES**
10 **16 - 18) DOES PUBLIC COUNSEL BELIEVE IT IS APPROPRIATE TO**
11 **INCLUDE PERFORMANCE MONITORING IN AN ARP PLAN?**

12 A. Yes. Specific performance standards are set out beginning on Schedule 1-15, line 22 and ending on
13 Schedule 1-16, line 5.

14 **Q. DOES PUBLIC COUNSEL AGREE THAT THE PERFORMANCE STANDARDS**
15 **SHOWN ARE APPROPRIATE AND ADEQUATE?**

16 A. No. Public Counsel believes that customer surveys are of limited value as compared to the more
17 objective and quantifiable nature of the other measures set out in Schedule 1-15 & 1-16. Public
18 Counsel does not believe this Commission has the authority to order the type of ARP proposed by
19 AmerenUE, absent agreement of the parties, and therefore has not attempted to recommend specific
20 performance measures to the Commission. However, any performance measures should address
21 issues including but not be limited to; generation measures to ensure efficient operation of and

1 maintenance of generation facilities, employee productivity and safety, interruptions of customer
2 service, and maintenance measures to ensure facilities are kept at peak operating conditions.

3 **Q. IS PUBLIC COUNSEL RECOMMENDING THAT THE COMMISSION ORDER AN**
4 **ALTERNATIVE REGULATORY PLAN WITHOUT THE AGREEMENT OF THE**
5 **PARTIES IN THIS PROCEEDING?**

6 A. No. Public Counsel does not believe that a new ARP should be considered at this time nor that the
7 Commission has that authority to adopt the type of ARP proposed by AmerenUE absent agreement
8 of the parties, as will be addressed in the briefs to be filed in this case.

9 **Q. DOES PUBLIC COUNSEL HAVE GENERAL CONCEPTS THAT SHOULD BE**
10 **INCLUDED IN A ALTERNATIVE REGULATORY PLAN?**

11 A. Yes. Public Counsel has not developed a specific plan because as discussed previously, EARP I &
12 II are not complete and therefore the success or failure of those experimental plans cannot be
13 determined at this time.

14 **Q. COULD YOU PLEASE OUTLINE THOSE GENERAL CONCEPTS THAT AN ARP**
15 **SHOULD ADDRESS?**

16 A. Yes.

17 * Tariffed rates should be re-based using traditional regulatory procedures
18 prior to the initiation of any ARP.

19 * The sharing grid should be based on the authorized return on equity used
20 in the re-basing of rates.

- * The sharing grid should include a "dead band" around the authorized return on equity.
- * The sharing grid should provide for an "inverted" sharing of excess earnings between ratepayers and stockholders.
- * The ARP should be in effect for a period not to exceed three years and should include provisions for reviewing and/or adjusting the base rates at the conclusion of the ARP period.
- * The ARP should provide for objective measures of utility performance in the areas of customer service, generation, delivery, and maintenance.
- * The ARP should provide for earnings calculations in conformance with past Commission regulatory practices and precedent.
- * The ARP should ensure that the discovery rights of the various parties are not infringed.
- * The ARP should ensure the ability of parties to bring issues to the Commission that are alleged to be in conflict with past regulatory practices, have not been addressed previously by the Commission, represent a change or significant variation from previous utility operations, or result in earnings levels not being calculated appropriately.
- * Appropriate rules or code of conduct requirements should be in place (including appropriate reporting requirements) to ensure that ratepayers are protected from adverse impacts of transactions between the regulated utility and affiliated companies.
- * The ARP should provide the opportunity for the Commission to adjust rates in the event earnings fall to levels that threatened the provision of safe and adequate service.

Q. PLEASE EXPLAIN WHY PUBLIC COUNSEL BELIEVES A RE-BASING OF RATES IS NECESSARY PRIOR TO STARTING AN ARP.

A. I previously discussed the problem that would arise absent setting rates on a cost of service basis prior to entering into an ARP in response to the Company's proposal to implement a \$15 Million rate decrease as part of its ARP proposal. Suffice it to say, rates should be adjusted to avoid excess profits being built into rates. The resulting excess profits (profits above the appropriate return)

1 would be retained by the utility without the need or incentive to improve efficiency during the
2 period of the ARP.

3 **Q. WHY DOES PUBLIC COUNSEL ADVOCATE BASING THE SHARING GRID ON**
4 **AN AUTHORIZED RATE OF RETURN AND A "DEAD BAND" AROUND SUCH**
5 **RETURN?**

6 A. Public Counsel concurs with the Missouri Energy Policy Task Force Final Report to Governor Bob
7 Holden, dated October 16, 2001, which stated:

8 The State of Missouri should encourage the Commission to use either the
9 traditional regulatory model or alternative regulation that **focuses on earnings**
10 (emphasis added)

11 (page 46)

12 Public Counsel firmly believes that investors focus on earnings. The primary purpose of GAAP as
13 discussed by OPC witness Robertson is assurance that financial reporting to the investment
14 community is presented consistently and in a comparable format.

15 Public Counsel believes regulation should focus on the earnings of the utilities in order to achieve
16 results similar to those, which would occur if a full and robust competitive market existed.
17 Therefore an ARP should likewise focus on earnings. The use of a Commission authorized rate of
18 return is the first step in this process.

19 **Q. PLEASE EXPLAIN THE PURPOSE OF A "DEAD BAND".**

20 A. The main thrust of the dead band is a simulation of traditional regulation in that rarely are there any
21 ratemaking actions if earnings are relatively close to the authorized rate of return in the short term.

1 Electric utility earnings are also subject to weather. The dead band allows for these weather-related
2 fluctuations without triggering the need for rate activity. If earnings fall short of the dead band, rate
3 changes should be allowed. If earnings exceed the dead band, sharing should occur.

4 **Q. HOW LARGE SHOULD THE "DEAD BAND" BE?**

5 A. Public Counsel would recommend that the dead band be plus or minus 100 basis points from the
6 authorized rate of return.

7 In EARP I, the dead band was 261 basis points which were not distributed evenly around the
8 underlying market based return. 100 basis points equates to approximately \$40 Million in revenue
9 requirement or 1.85% of AmerenUE jurisdictional revenue as found on Staff's Accounting
10 Schedule 9. Public Counsel believes that a dead band that allows for earnings fluctuations based on
11 revenue changes totaling \$80 Million dollars provides for an adequate cushion to allow for weather
12 effects and small increases or decreases in earnings without triggering rate activity.

13 **Q. PUBLIC COUNSEL IS RECOMMENDING AN "INVERTED GRID", PLEASE**
14 **EXPLAIN WHAT IS MEANT BY THE TERM.**

15 A. An inverted grid refers to a sharing grid in which the shareholder retention percentage increases as
16 earnings grow, whereas prior sharing grids in Missouri featured a decline in shareholder retention as
17 earnings rose. For example, an inverted grid might provide for shareholder retention of 30% in the
18 1st sharing band, 50% within the 2nd sharing band, and 70% for all earnings in excess of the 2nd
19 earnings band.

1 In contrast, EARP I & II had higher shareholder retention in the initial sharing band and ultimately a
2 cap on earnings after which all excess earnings were credited to the ratepayer. Public Counsel
3 believes this creates a perverse incentive to the Company.

4 **Q. PLEASE EXPLAIN.**

5 A. ARPs are touted by some as regulatory models, which provide greater incentives to utilities to
6 become more efficient. The purported incentive is the opportunity to earn more money via the
7 retention of earnings resulting from pro-active actions of management and employees to cut costs,
8 increase sales, make better economic investments or risk reduction decisions, and other actions to
9 enhance earnings. Public Counsel believes that a grid that allows the utility to retain a larger
10 percentage of earnings as earnings grow, is more in line with the concept of providing the utility the
11 proper incentives to manage its operations efficiently and pursue new innovative strategies. An
12 inverted grid would provide management with a powerful incentive to grow earnings. Public
13 Counsel is at a complete loss to understand how a grid that returns all earnings growth after certain
14 earning levels are reached provides any incentive to become more efficient.

15 **Q. DOESN'T AN INVERTED GRID ALLOW AN UNLIMITED LEVEL OF EARNINGS**
16 **FOR THE UTILITY?**

17 A. Yes within the period of time that the ARP is in effect. However, the same opportunity exists today
18 for AmerenUE or any other utility in Missouri absent action by the Commission, Staff, OPC or
19 other intervenor to file a complaint asking for a rate reduction.

20 **Q. IS THE THREE-YEAR TIME FRAME RECOMMENDED BY PUBLIC COUNSEL**
21 **INFLUENCED BY THE INVERTED GRID?**

1 A. Yes. Public Counsel believes that the three year time frame allows the Company adequate time to
2 retain earnings from its actions prior to an adjustment in rates. As previously discussed, in
3 competitive industries, competitors or new entrants into the market will ultimately bring customer
4 prices back down to cost. Likewise regulation should react to re-establish the relationship between
5 rates and cost. The three-year period is slightly longer than the time frame OPC believes is
6 necessary to process a complaint proceeding, excluding the time necessary for judicial review.

7 Another consideration is that as time passes, capital market requirements are subject to change.
8 Therefore, the market-required return on equity, which was appropriate at the inception of the ARP,
9 has less chance of being valid, the more time passes. The resulting erosion in confidence in the
10 appropriateness of the sharing grid by parties (whose viewpoint will be effected by which way the
11 market moves) will inevitably decrease the plan's value to those who are harmed by the market
12 movement. This increases the potential for conflicts to arise in the operation of the plan, as parties
13 will seek to protect their interests.

14 **Q. WHY DOES PUBLIC COUNSEL INCLUDE THE RECOMMENDATION THAT AN**
15 **ALTERNATIVE REGULATORY PLAN HAVE A STATED PROVISION TO REVIEW**
16 **OR ADJUST RATES AT THE CONCLUSION OF THE PLAN?**

17 A. Public Counsel believes that such a provision recognizes the need to re-establish the relationship
18 between rates and costs. Public Counsel believes that this provision would give the Commission
19 and the parties the opportunity to evaluate the utility's performance under the ARP and make any
20 necessary adjustments in base rates and formulate a new plan, if found to be appropriate. Public
21 Counsel would point out that the stipulation and agreements that established both EARP I and II

1 contemplated the termination of the plans. EARP I was amended to provide for a base rate
2 adjustment prior to EARP II.

3 **Q. WHY DOES PUBLIC COUNSEL INCLUDE PERFORMANCE MEASURES IN ITS**
4 **CONCEPTUAL RECOMMENDATIONS FOR AN ARP?**

5 A. The Commission is charged with ensuring Missourians receive safe and adequate service.
6 Performance measures included in an ARP should be designed to look at objective measures so that
7 the Company is not given the incentive to increase earnings at the expense of safe and adequate
8 service.

9 Management decisions to decrease maintenance activities, close call centers, reduce outside service
10 personnel, or not make needed investments would result in increased earnings in the short-run. As a
11 monopoly provider of electric service, customers would have no alternative provider from which to
12 choose. Therefore, the Commission should ensure that measurement tools are in place to ensure
13 safe and adequate service is maintained.

14 **Q. WHY HAS PUBLIC COUNSEL INCLUDED THE RECOMMENDATION REGARDING**
15 **RULES OR CODE OF CONDUCT REGARDING TRANSACTIONS WITH**
16 **AFFILIATED COMPANIES?**

17 A. OPC witness Ryan Kind will discuss the need for this recommendation in greater detail in his
18 surrebuttal testimony. Suffice it to say, however, that an ARP plan decreases the scrutiny of the
19 utility by the Commission and others during the period of the ARP. As such, the opportunity to
20 abuse the relationship between affiliates to the detriment of ratepayers is increased, as are the

1 financial rewards from doing so. Proper rules or utility specific code of conduct policies along with
2 adequate reporting are necessary to provide the Commission the assurance that ratepayers are not
3 being adversely effected by affiliated transactions. The adverse effect on ratepayers would result
4 from a firm's ability to shift cost responsibility from an affiliated company to the regulated utility,
5 thereby reducing the earnings of the regulated utility an avoiding paying credits. The net effect of
6 such action would be to increase the overall earnings of the parent company of the affiliate and the
7 regulated utility. Thus the incentive to engage in such activities is readily apparent.

8 **Q. PLEASE SUMMARIZE PUBLIC COUNSEL'S POSITION ON AN ALTERNATIVE**
9 **REGULATORY PLAN FOR AMERENUE AT THIS TIME.**

10 A. Public Counsel does not believe that the Commission should approve an ARP as proposed by
11 AmerenUE. The proposal as presented is flawed and is detrimental to the ratepayers served by
12 AmerenUE. The proposal creates perverse incentives to over invest, incur unnecessary expenses,
13 and engage in affiliate transaction abuse. EARP 1 & 2 are not yet complete and serious questions
14 have been raised regarding certain detrimental aspects of those plans which require Commission
15 decisions before a complete analysis of the performance of the EARPs can be made.

16 Moreover, the Commission should also re-base AmerenUE's rates based upon its cost of service
17 before any new ARP is considered.

18 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

19 A. Yes.

Missouri Power & Light Company, Steam Dept., Case No. HR-82-179
Missouri Power & Light Company, Electric Dept., Case No. ER-82-180
Missouri Edison Company, Electric Dept., Case No. ER-79-120
Southwestern Bell Telephone Company, Case No. TR-79-213
Doniphan Telephone Company, Case No. TR-80-15
Empire District Electric Company, Case No. ER-83-43
Missouri Power & Light Company, Gas Dept., Case No. GR-82-181
Missouri Public Service Company, Electric Dept., Case No. ER-81-85
Missouri Water Company, Case No. WR-81-363
Osage Natural Gas Company, Case No. GR-82-127
Missouri Utilities Company, Electric Dept., Case No. ER-82-246
Missouri Utilities Company, Gas Dept., Case No. GR-82-247
Missouri Utilitites Company, Water Dept., Case No. WR-82-248
Laclede Gas Company, Case No. GR-83-233
Great River Gas Company, Case No. GR-85-136 (OPC)
Northeast Missouri Rural Telephone Company, Case No. TR-85-23 (OPC)
United Telephone Company, Case No. TR-85-179 (OPC)
Kansas City Power & Light Company, Case No. ER-85-128 (OPC)
Arkansas Power & Light Company, Case No. ER-85-265 (OPC)
KPL/Gas Service Company, GR-86-76 (OPC)
Missouri Cities Water Company, Case Nos. WR-86-111, SR-86-112 (OPC)
Union Electric Company, Case No. EC-87-115 (OPC)
Union Electric Company, Case No. GR-87-62 (OPC)
St. Joseph Light and Power Company, Case Nos. GR-88-115, HR-88-116 (OPC)
St. Louis County Water Company, Case No. WR-88-5 (OPC)
West Elm Place Corporation, Case No. SO-88-140 (OPC)
United Telephone Long Distance Company, Case No. TA-88-260 (OPC)
Southwestern Bell Telephone Company, Case No. TC-89-14, et al. (OPC)
Osage Utilities, Inc., Case No. WM-89-93 (OPC)
GTE North Incorporated, Case Nos. TR-89-182, TR-89-238, TC-90-75 (OPC)
Contel of Missouri, Inc., Case No. TR-89-196 (OPC)
The Kansas Power and Light Company, Case No. GR-90-50 (OPC)
Southwestern Bell Telephone Company, Case No. TO-89-56 (OPC)
Capital City Water Company, Case No. WR-90-118 (OPC)

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Trippensee
Cross-Surrebuttal
EC-2002-1

AmerenUE's Response to
OPC Data Request
Case No. EC-2002-1
Excess Earnings Complaint
Staff of the MPSC v. Union Electric Company d/b/a AmerenUE

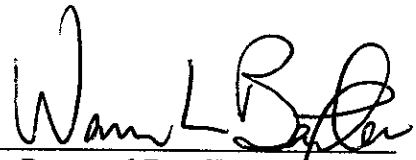
No. 1033:

Re Baxter Rebuttal testimony, page 4, lines 3-4. For each of the four rate reductions discussed, please list the case numbers and effective dates of said orders. Please provide a copy of the calculation including sufficient detail and source of data used in the development of the alleged \$1 billion in rate reduction benefits.

Response:

See attached workpaper.

Signed By:



Prepared By: Warner Baxter

Title: Senior Vice President, Finance

Schedule RWT-2.1

JUN 17 2002

Trippensee
Cross-Surrebuttal
EC-2002-1

AmerenUE
Total Missouri Electric Revenue Reduction
Due to Rate Decreases and Rate Credits
1990 - 2001

\$30 million rate decrease 11/26/90	(91 - 01)	\$330,000,000
\$40 million rate decrease 1/1/93	(93 - 01)	360,000,000
\$30 million rate decrease 8/1/95	(95 - 01)	195,000,000
\$30,000,000 revenue credit 7/95		30,000,000
\$43,662,000 revenue credit 1/97		43,662,000
\$17,897,000 revenue credit 8/98		17,897,000
\$26,085,000 revenue credit 4/00		26,085,000
\$26,487,000 revenue credit for 9/98 - 4/00 Retro Rate Decrease		26,487,000
\$16 million rate decrease 5/00	(00 - 01)	28,000,000
\$20,214,000 revenue credit 12/00		20,214,000
\$28,000,000 revenue credit 5/01		28,000,000
\$9,683,000 revenue credit (last sharing period) (1)		9,683,000
Total		<u>\$1,115,028,000</u>
Total for the Revenue Sharing Plans To Date		<u>\$425,028,000</u>

(1) Per Final Earnings Report Filed by the Company.

Schedule RWT-2.2

JUN 17 2002

AmerenUE Share Of EARP Earnings Analysis

For Year Ending	Earned Return On Common Equity
1996	14.629%
1997	13.710%
1998	14.121%
1999	13.690%
2000	13.588%
2001	13.099%

	Year:	1996	1997	1998	1999	2000	2001	Total
		(000)	(000)	(000)	(000)	(000)	(000)	(000)
Missouri Rate Base		\$3,809,833	\$3,896,708	\$3,900,496	\$3,867,987	\$3,905,537	\$3,922,217	
Common Equity Percent		53.344%	54.225%	54.847%	56.676%	59.494%	62.210%	
100% Sharing for Earned Return > 11.61% but < 12.61%		20,323	21,130	21,393	21,922	23,236	24,400	\$132,404
50% Sharing for Earned Return > 12.61% but < 14%		14,125	11,621	14,868	11,838	11,362	5,966	69,780
Subtotal Sharing to AmerenUE		\$34,448	\$32,751	\$36,261	\$33,760	\$34,598	\$30,366	\$202,184
Tax Rate		1.6231	1.6231	1.6231	1.6231	1.6231	1.6231	1.6231
Total Sharing to AmerenUE Including Income Taxes		\$55,912	\$53,159	\$58,856	\$54,796	\$56,156	\$49,287	\$328,165
Total Sharing to Ratepayers Including Income Taxes		\$43,674	\$17,897	\$26,085	\$20,214	\$28,000	\$9,683	\$145,553
Difference		\$12,238	\$35,262	\$32,771	\$34,582	\$28,156	\$39,604	\$182,612

- Sources:
- 1996 Order Approving Sharing Credit, Case No. EO-96-14, December 20, 1996.
 - 1997 Staff Suggestions In Support Of Stipulation And Agreement, Case No. EO-96-14, June 19, 1998.
 - 1998 UE's Response To The Commission Request For An Amended Final Earnings Report And Third Year Credit Sharing Report, Case No. EO-96-14, January 18, 2000.
 - Order Directing Credit Sharing, Case No. EO-96-14, February 29, 2000.
 - 1999 Order Approving First Year Sharing Credit Of The Second Experimental Alternative Regulation Plan And Order Approving Stipulation And Agreement, Case No. EM-96-149, October 31, 2000.
 - 2000 Order Approving Second Year Sharing Credit Of The Second Experimental Alternative Regulation Plan And Order Approving Stipulation And Agreement, Case No. EM-96-149, May 27, 2001.
 - Company's Final Earnings Report Filing For The Second Sharing Period Of The Second Experimental Alternative Regulation Plan, Case No. EM-96-149, October 13, 2000.
 - 2001 Company's Final Earnings Report Filing For The Third Sharing Period Of The Second Experimental Alternative Regulation Plan, Case No. EM-96-149, October 17, 2001.

- Footnotes:
- 1998 Order, Case No. 00CV323273 stayed \$2,290,000 of the \$28,375,000 credit ordered by the MPSC.
 - 2000 Case resolved on a "dollar settlement" amount. All other numbers shown are based on the Company's filed position.
 - 2001 Case is ongoing and in dispute. All numbers shown are based on the Company's filed position. Public Counsel and the MPSC Staff believe that the credit should be much higher.