

Exhibit No.:  
Issue: Policy  
Witness: Warner L. Baxter  
Type of Exhibit: Direct Testimony  
Sponsoring Party: Union Electric Company  
Case No.:  
Date Testimony Prepared: May 23, 2003

**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO. \_\_\_\_\_**

**DIRECT TESTIMONY**

**OF**

**WARNER L. BAXTER**

**ON BEHALF OF**

**UNION ELECTRIC COMPANY,  
d/b/a AmerenUE**

**St. Louis, Missouri  
May 2003**

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

In the Matter of Union Electric Company,  
d/b/a AmerenUE, for Authority to File  
Tariffs Increasing Rates for Gas Service  
Provided to Customers in the Company's  
Missouri Service Area.

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Case No. \_\_\_\_\_

**AFFIDAVIT OF WARNER L. BAXTER**

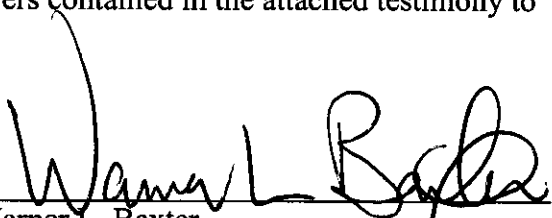
**STATE OF MISSOURI**     )  
                                      ) ss.  
**CITY OF ST. LOUIS**     )

Warner L. Baxter, being first duly sworn on his oath, states:

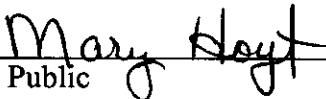
1.     My name is Warner L. Baxter. I work in the City of St. Louis, Missouri, and I am employed by Ameren Corporation as Senior Vice President and Chief Financial Officer.

2.     Attached hereto and made a part hereof for all purposes is my Direct Testimony on behalf of Union Electric Company, d/b/a AmerenUE, consisting of 11 pages, which has been prepared in written form for introduction into evidence in the above-referenced docket.

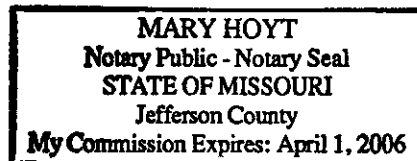
3.     I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.

  
\_\_\_\_\_  
Warner L. Baxter

Subscribed and sworn to before me this 22<sup>nd</sup> day of May, 2003.

  
\_\_\_\_\_  
Notary Public

My commission expires: 4-1-2006



**DIRECT TESTIMONY**

**OF**

**WARNER L. BAXTER**

**CASE NO. \_\_\_\_\_**

**Q. Please state your name and business address.**

A. My name is Warner L. Baxter. My business address is One Ameren Plaza,  
1901 Chouteau Avenue, St. Louis, Missouri.

**Q. By whom are you employed and in what capacity?**

A. I am employed by Ameren Corporation (“Ameren”) as Senior Vice  
President of Finance and Chief Financial Officer for Ameren, Union Electric Company  
d/b/a AmerenUE (“AmerenUE” or “Company”), and several other Ameren subsidiaries.

**Q. Please describe your educational background and work experience.**

A. I graduated from the University of Missouri–St. Louis in 1983 with a  
Bachelor of Science degree with a major in Accounting. I am a licensed Certified Public  
Accountant in the state of Missouri and a member of the American Institute of Certified  
Public Accountants and the Missouri Society of Certified Public Accountants.

In September 2001, I was promoted to my current position and named  
Senior Vice President, Finance, and Chief Financial Officer. I have been with Ameren  
since 1995. First as the Assistant Controller at AmerenUE, then in 1996 as the Controller  
of AmerenUE, and as Vice President and Controller of Ameren starting in May 1998.  
Since I joined Ameren in 1995, I have played a major role in the development of  
operational, regulatory and financial strategies.

1                   Prior to my employment at Ameren, I was employed by Price Waterhouse  
2   LLP (now PriceWaterhouseCoopers LLP) as Senior Manager in the company's St. Louis  
3   and New York City offices. My principal responsibilities at Price Waterhouse included  
4   supervising audit and consulting services to clients in the public utility industry  
5   (including AmerenUE) and manufacturing industries, among others. I also developed  
6   Price Waterhouse's financial statement disclosure and content guide for public utilities  
7   and authored various sections of Price Waterhouse's annual Survey of Financial  
8   Reporting and Industry Developments for the public utility industry. I was a member of  
9   Price Waterhouse's National Public Utilities Industry Services Group and their  
10   Accounting and SEC Services Department.

11                  In March 2003, I was appointed to the Missouri Energy Policy Council by  
12   Governor Bob Holden. The Council serves in an advisory capacity to the Governor on  
13   matters of local, state and national energy policy. I am also a former Chairman of the  
14   executive committee of the chief accounting officers of Edison Electric Institute member  
15   companies and currently serve as Vice President of the Chancellor's Council and a  
16   member of the Dean's Advisory Board of the University of Missouri-St. Louis.

17               **Q.     Please describe your duties in your current position.**

18               A.     My responsibilities include the oversight of the financial, accounting and  
19   regulatory functions of Ameren, as well as the treasury, tax, risk management, internal  
20   audit and budget and corporate modeling functions of the company. In this role, I also  
21   act as Ameren's primary spokesperson in communications with the financial community,  
22   including financial analysts and credit rating agency analysts.

1           **Q.     What is the purpose of your direct testimony in this proceeding?**

2           A.     The purpose of my direct testimony is to introduce the other witnesses  
3 providing direct testimony in this case, to provide an overview of AmerenUE's need for  
4 the rate increase it is proposing in this proceeding, and to provide a summary of the  
5 measures AmerenUE is proposing to mitigate the impact of this rate increase on the  
6 customers and communities that it serves.

7           **Q.     Who are the other Company witnesses providing direct testimony in**  
8 **this proceeding, and what are their areas of responsibility?**

9           A.     The other Company witnesses and their areas of responsibility in this case  
10 are indicated below:

11	G. Rainwater	Policy
12	R. Mark	Low-Income Assistance
13	J. Davis	System Operations/Improvements
14	M. O'Bryan	Overall Rate of Return
15	K. McShane	Rate of Return on Equity
16	G. Weiss	Cost of Service/Accounting Schedules
17	M. Adams	Cash Working Capital
18	J. Pozzo	Weather Normalization
19	W. Warwick	Allocated Class Cost of Service
20	W. Cooper	Rate Design

21           **Q.     Please summarize AmerenUE's gas rate increase request.**

22           A.     The revised tariffs filed by AmerenUE in this case are designed to make  
23 up an annual deficiency in the Company's natural gas operating revenues of

1 approximately \$26.7 million, exclusive of applicable revenue related taxes. The  
2 requested change in rates is expected to result in an overall increase of approximately  
3 18% in customers' annual bills for gas service. A detailed breakdown of the impact of  
4 this increase by customer class is shown on Schedule WLC-2 in the direct testimony of  
5 Company witness Wilbon L. Cooper.

6 **Q How long has it been since AmerenUE last increased its gas base**  
7 **rates?**

8 A. The Company last increased its gas base rates effective November 2000 as  
9 a result of the Commission's Order in Case No. GR-2000-512. In that case, the  
10 Commission authorized an increase of approximately \$4.2 million in annual revenues,  
11 which increased customers' annual gas bills by approximately 4.9%. This was only the  
12 second increase approved for AmerenUE's gas rates since 1987.

13 **Q. Why does AmerenUE need the rate increase that it has proposed in**  
14 **this case?**

15 A. There are several reasons. First, the Company has made substantial  
16 investments in its energy infrastructure in the gas business to improve the overall  
17 reliability and safety of its gas distribution system.

18 **Q. Please summarize the capital investments in the Company's gas utility**  
19 **since the previous rate case that are included in the Company's cost of service in**  
20 **this filing.**

21 A. This filing includes over \$50 million of investment in gas system  
22 improvements, including significant replacement of cast iron mains and unprotected steel  
23 services to comply with state regulations, and various technological and operational

1 improvement projects completed since the last rate case. The Company is working  
2 toward the complete elimination of cast iron mains and unprotected steel services.  
3 Company witness Jimmy L. Davis provides additional testimony explaining these  
4 investments in greater detail.

5 **Q. What other factors have contributed to the Company's need for a gas**  
6 **rate increase?**

7 A. Simply put, the Company's costs of serving its customers have  
8 significantly increased since its last gas rate case. Although inflation has been relatively  
9 modest since the end of the test year for the Company's last gas rate case (June 30, 1999),  
10 the Consumer Price Index has increased approximately 8% from that time until  
11 December 31, 2002, the end of the test year in this case. These general inflationary  
12 pressures affect all aspects of our gas business. Moreover, the Company has experienced  
13 cost increases in some areas that far exceed the rate of inflation. Employee benefit costs  
14 and medical expenses are two examples of such rapidly escalating costs that affect all  
15 businesses, including utilities.

16 In addition, the Company has made a number of improvements to its  
17 natural gas system since its last rate case. For example, the Company has implemented  
18 enhancements to its metering, gas flow monitoring and customer billing systems, which  
19 have increased expenses, but permitted the Company to provide improved service to its  
20 customers. Finally, additional safety-related activities, including increased costs incurred  
21 in locating natural gas facilities under Missouri's One Call Program, have added to the  
22 Company's costs.

1           **Q.     Are any of the increases in the Company's capital investment and**  
2           **annual operating expenses associated with the cost of gas supply?**

3           A.     Gas supply costs are recovered dollar for dollar through the application of  
4     AmerenUE's Purchased Gas Adjustment Clause. Consequently, gas supply costs are not  
5     included in the revenue requirement for this case. However, as explained more fully in  
6     the direct testimony of Company witness Michael J. Adams, the cash working capital  
7     adjustment proposed by the Company is impacted by a revenue lag and an expense lead  
8     associated with gas purchases and sales.

9           **Q.     Have the cost increases you addressed above had an impact on**  
10          **AmerenUE's ability to earn a reasonable return on its gas delivery business in**  
11          **Missouri?**

12          A.     Yes, they have. As explained in the direct testimony of Company witness  
13     Gary S. Weiss, the Company's rate of return on rate base for its gas business has  
14     deteriorated to negative 0.416% for the Pro Forma twelve months ending December 31,  
15     2002. This compares to the requested rate of return of 9.577% as set forth in the direct  
16     testimony of Company witness Michael G. O'Bryan.

17          **Q.     Have other local distribution companies in the state requested regular**  
18          **rate increases to recover costs such as these?**

19          A.     Yes, in recent years Missouri's larger local gas distribution companies  
20     have filed for rate increases to reflect gas energy infrastructure investments and cost  
21     increases with some regularity. Laclede Gas Company, for example, has found it  
22     necessary to file rate increase requests with the Commission six times in the last 10 years.  
23     In contrast, AmerenUE has increased its natural gas rates only three times in the last



1 20 years. Moreover, AmerenUE has incurred some types of costs that the other larger  
2 local distribution companies in the state have not faced. One reason for this is that  
3 AmerenUE's customer base is less dense than the customer bases in the St. Louis and  
4 Kansas City metropolitan areas, resulting in increased levels of cost per customer for  
5 pipeline facilities and operation and maintenance expenses.

6           Although the cost of gas is not being considered in this proceeding, it is  
7 worth noting that AmerenUE has also been among the more successful gas utilities in  
8 managing its gas supply costs on behalf of its customers. AmerenUE began developing  
9 and implementing hedging strategies in the late 1990's with an experimental hedging  
10 program created in coordination with the Commission Staff in Docket Nos. GO-97-405  
11 and GO-98-486. Using the experience and lessons learned from this experimental  
12 program, AmerenUE developed more sophisticated hedging strategies and implemented  
13 these strategies without pursuing pre-approval from the Commission or seeking special  
14 customer surcharges to pay for hedging instruments. The benefits of this strategy were  
15 apparent with the gas price spikes and volatility experienced during the winter of  
16 2000/2001 when AmerenUE was able to maintain a stable PGA rate during this critical  
17 period in the gas industry. This experience was repeated again during the winter of  
18 2002/2003 when natural gas prices rocketed to over \$10 per MMBtu. AmerenUE has  
19 played a leading role in implementing hedging strategies in Missouri to reduce price  
20 volatility for its customers without seeking any added financial incentives from the  
21 Commission.

22           **Q. Why is it important for the Commission to increase the Company's**  
23 **rates to a level sufficient to permit it to recover its costs?**

1           A.     It is critical to all of the Company's stakeholders that its gas operations  
2     remain financially viable, so that the Company has the resources necessary to continue to  
3     provide safe, reliable, high-quality gas service and to make energy infrastructure  
4     investments on a timely basis. In order for the Company's gas operations to remain  
5     viable, the Commission must permit the Company to charge rates at a level sufficient to  
6     recover the costs it incurs and provide the Company a fair return on its investment.

7           **Q.     Can't AmerenUE's Missouri gas operations simply be subsidized by**  
8     **its much larger electric operations?**

9           A.     No. It is a fundamental principle of regulatory law and policy in Missouri  
10    that rates for each utility have to be set to recover the legitimate costs incurred by that  
11    utility to provide service. AmerenUE's electric rates were established without  
12    consideration of the Company's gas operations, and rates for the Company's gas  
13    operations must be set without consideration of its electric operations. Rates for each  
14    segment of AmerenUE's business must be set to permit each segment to pull its own  
15    weight. Any other result would be unfair to customers who would ultimately be required  
16    to provide subsidies, and shareholders who would, at least in the short run, be denied an  
17    opportunity to earn a reasonable return on their investment in the Company.

18          **Q.     Is ensuring adequate cost recovery for the Company the only issue**  
19    **that the Commission should consider when it sets rates?**

20          A.     No. The Commission should also balance the impact of any rate increase  
21    on the Company's customers—especially low-income customers—and the communities  
22    in which they live. This is an important consideration, particularly in a case such as this,  
23    where proper recovery of the Company's costs will require an increase to customer gas

1 bills of approximately 18%. (See the direct testimony of Wilbon L. Cooper, Schedule  
2 WLC-2.)

3 **Q. Do you have any proposals to mitigate the impact of the Company's**  
4 **proposed rate increase on customers and their communities?**

5 A. Yes. The Company has developed a proposal which would mitigate the  
6 impact of the requested rate increase on customers and their communities. This proposal  
7 has three major components, provided that the Commission grants AmerenUE its entire  
8 rate increase request, and that new rates take effect on or before December 1, 2003 in  
9 accordance with our proposal.

10 The first component of the Company's proposal is that the proposed rate  
11 increase be phased in over two years. If 50% of the proposed increase is collected  
12 through tariffs which take effect on or before December 1, 2003, the Company is willing  
13 to defer the implementation of the remaining 50% of the increase until November 1,  
14 2004. This phase-in will mitigate the impact of the rate increase on gas consumers, while  
15 eventually permitting the Company to charge rates that fully reflect its costs. Although  
16 the phase-in will require the Company to continue to under-recover its costs until  
17 November 1, 2004, it will reduce the burden on customers that would result if the entire  
18 rate increase was put into effect at once.

19 Second, the Company proposes a moratorium for any additional changes  
20 to its gas base rates (excluding PGA matters and any special provisions for the recovery  
21 of infrastructure replacement costs that may be provided by law) until an effective date of  
22 November 1, 2006. Given the reality of steadily rising gas distribution costs and limited  
23 growth in gas demand in AmerenUE's service territory, this proposal will almost

1 certainly provide customers with lower rates than those they would be charged in the  
2 absence of a moratorium. Perhaps just as important, this moratorium will provide  
3 customers with certainty concerning their base gas rates over the next three heating  
4 seasons.

5 Third, if the Company's proposed rate increase is approved as set forth  
6 above, the Company will provide an incremental contribution of \$1 million to the Dollar  
7 More program on December 1, 2003, and additional incremental contributions to Dollar  
8 More of \$250,000 on or before November 1 in each of the next three years. These funds  
9 will be used to assist low-income customers in AmerenUE's Missouri gas service area to  
10 pay their energy bills. These contributions will be taken from shareholder funds and they  
11 will not be included in the Company's cost of service for ratemaking purposes. The  
12 direct testimony of Richard J. Mark explains how the Dollar More Program works in  
13 greater detail, and the benefits that will result from the Company's proposed  
14 contributions.

15 **Q. What are the benefits of the Company's proposal?**

16 A. The primary benefit of the Company's proposal is that it effectively  
17 balances the interests of all stakeholders in this case. For customers, it mitigates the  
18 impact of the rate increase by phasing it in over two years. For the period December 1,  
19 2003 through November 1, 2004, customers' base rates will only rise about 9% in the  
20 aggregate, and on November 1, 2004, they will rise an additional 9%. Moreover, the  
21 phase-in of natural gas rates, when coupled with the settlement in Case No. EC-2002-1,  
22 would provide AmerenUE customers regulatory certainty through 2006 with regard to  
23 both their electric and gas rates.

1                   In addition, this proposal recognizes that we are currently operating in  
2     difficult economic times and that rate increases can be a heavy burden for certain of our  
3     customers. We have addressed this issue through both the phasing in of our rates, and  
4     through a proposed additional \$1.75 million in contributions to the Dollar More Program  
5     to assist our low-income customers in paying their bills. When coupled with our  
6     contribution commitments from the settlement in Case No. EC-2002-1 last year,  
7     AmerenUE will have contributed \$10.75 million to the Dollar More Program to address  
8     low-income customers' needs.

9                   Finally, the Company's proposal ensures that AmerenUE will recover its  
10    costs and earn an adequate return on its energy infrastructure investments in a timely  
11    manner. In addition, this proposal will provide incentives for the Company to continue to  
12    conduct its gas operations in an efficient manner during the rate moratorium.

13                  In summary, I believe the Company's proposal is an example of another  
14    creative ratemaking proposal that balances the interests of all stakeholders, and creates a  
15    win-win situation for all parties.

16               **Q.     Does this conclude your direct testimony?**

17               A.     Yes, it does.