Exhibit No.:
Issue: Alternative Regulation Plan and Agreements; Computer Software Maintenance; Other Computer Costs; Merger Costs; Injuries and Damages Expense; Advertising; Territorial Agreements; Decommissioning Trust Fund Deposits; Lobbying Expenses; Plant Held for Future Use; and Income Taxes
Witness: Warner L. Baxter
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Union Electric Company
Case No: EO-96-14
EM-96-149

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. EO-96-14
CASE NO. EM-96-149

REBUTTAL TESTIMONY

OF

Warner L. Baxter

ST. LOUIS, MISSOURI
April 1, 1999

MISSOURI PUBLIC SERVICE COMMISSION

STATE OF MISSOURI

In the Matter of the Investigation into the Class Cost of Service and Rate Design for Union Electric Company	)))	Case No. EO-96-14
In the Matter of the UE/CIPSCO Merger	)	Case No. EM-96-149

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 Vice President and Controller of Ameren Corporation.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony consisting of pages 1 through 54, all of which testimony has been prepared in written form for introduction into evidence in Missouri Public Service Commission Case No. EO-96-14 and Case No. EM-96-149 on behalf of Union Electric Company.

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

Affiant

Subscribed and sworn to before me this 1st day of April, 1999.

C. A. LANG
Notary Public — Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires: March 3, 2001

C. A. Lang

Notary Public

REBUTTAL TESTIMONY
OF
WARNER L. BAXTER

MISSOURI PUBLIC SERVICE COMMISSION
Case No. EO-96-14
Case No. EM-96-149

BACKGROUND

Q. Please state your name and business address.

A. My name is Warner L. Baxter and my business address is One Ameren Plaza, 1901 Chouteau Avenue, St. Louis, Missouri, 63103.

Q. By whom are you employed and in what position?

A. I am employed by Ameren Corporation (Ameren) as Vice President and Controller. I am also the Controller of Union Electric Company (UE) and Central Illinois Public Service Company (CIPS).

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 also 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 May 1998, I was named Vice President and Controller of Ameren Corporation. I was appointed to the Controller position at Union Electric in August 1996 and was subsequently named the Controller of Ameren Corporation. From August 1995 to August 1996, I was the Assistant Controller at Union Electric. Prior to that time, I was employed by Price Waterhouse LLP (now PricewaterhouseCoopers LLP). From 1983 to 1993, I worked in Price Waterhouse's St. Louis practice office in their Accounting and Auditing Services Department. I held a variety of positions including staff accountant, senior accountant, manager, and senior manager. My principal responsibilities included supervising audit and consulting services to clients in the public utility (including Union Electric) and manufacturing industries, among others. In addition, I was a member of Price Waterhouse's National Public Utilities Industry Services Group. In that capacity, I consulted on various accounting and regulatory matters, as well as assisted in the preparation of expert witness testimony in various rate cases. I also developed Price Waterhouse's financial statement disclosure and content guide for public utilities, and authored various sections of Price Waterhouse's annual Survey of Financial Reporting and Industry Developments for the public utility industry. From 1993 to 1995, I worked in Price Waterhouse's national office in New York in the Accounting and SEC Services Department. My responsibilities included researching and providing technical accounting, reporting and auditing guidance to Price Waterhouse partners and managers, as well as clients. In addition, I assisted in formulating firm-wide accounting positions, including those related to the public utilities industry. I was also responsible for monitoring the activities of various accounting standard setting bodies, including the Securities and Exchange Commission, Financial Accounting Standards Board, and Emerging Issues Task Force.

I also currently serve as Vice Chairman of the Accounting Executive Advisory Committee of Edison Electric Institute (EEI). As Vice Chairman, I work with other chief accounting officers in formulating industry-wide positions on various accounting matters, as well as meet with accounting standard setting bodies and various regulatory bodies to discuss accounting and other issues related to the electric utility industry.

Q. Please describe your duties and responsibilities in your current position.

A. As Vice President and Controller, I direct and manage the accounting, financial and regulatory reporting, budgeting and investor relations functions of Ameren Corporation (including UE and CIPS). In that regard, I have responsibility for assuring that transactions are accounted for in accordance with generally accepted accounting principles and regulatory requirements. In addition, I am responsible for financial and regulatory reporting requirements to the Securities and Exchange Commission (SEC), the Missouri Public Service Commission (MPSC), the Illinois Commerce Commission (ICC) and the Federal Energy Regulatory Commission (FERC).

PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address certain issues raised by the MPSC staff (Staff) and Office of Public Counsel staff (OPC Staff) in their direct testimonies filed on February 23, 1999 with the MPSC relating to the Company's Final Earnings Report filed in connection with the Stipulation and Agreement (Agreement) dated June 12, 1995 that established the experimental alternative rate plan (EARP or Plan). Specifically, I will address issues raised in the direct testimonies of Messrs.

Rackers and Gruner and Ms. Westerfield of the Staff and Mr. Robertson of the OPC Staff. In my rebuttal testimony, I will present evidence indicating that nearly all of the issues raised by the Staff and OPC Staff, and the related proposed adjustments to the Company's Final Earnings Report for the third sharing period (July 1, 1997 – June 30, 1998) are inconsistent with the terms of the Agreement and are at odds with the binding, contractual obligations created by the Agreement. Accordingly, if these proposed adjustments are adopted by the Commission, they would constitute a breach of contract and impair the contractual obligations established by the Agreement; they would effect an uncompensated taking of the Company's property rights; and they would deny the Company's right to due process of law. At the very least, such an action by the Commission would repudiate the representations of the Commission upon which the Company reasonably relied and destroy the investment-backed expectations of the Company created by those representations. In addition, despite the fact that nearly all of the Staff's and OPC Staff's proposed adjustments to the Final Earnings Report are contrary to the terms of the Agreement between the Company and the Parties to the Agreement, I will point out other flaws with their proposed adjustments.

Q. You just stated that many of the Staff's and OPC Staff's proposed adjustments to the Final Earnings Report are totally inappropriate under the terms of the Agreement. Under what circumstances can the Parties to the Agreement propose adjustments to the Company's Final Earnings Report that can give rise to

proceedings before the Commission and ultimately a Commission order commanding such adjustments to be made?

A. As discussed in Mr. Donald E. Brandt's rebuttal testimony, the Parties to the Agreement are afforded the opportunity to monitor UE's compliance with the specific terms of the Agreement, so all the Parties have information concerning that compliance. Informally, of course, the Parties are free to discuss with UE any questions they might have concerning UE's calculation of its earnings and suggest adjustments to those figures. However, as more fully explained by Mr. Brandt, the Agreement is designed to limit the disputes that can be brought to the Commission and resolved by it. The terms of the Agreement describing the operation and implementation of the EARP with respect to the calculation of earnings mandate both the methodologies for that calculation and the kinds of disputes over those calculations that can be brought to the Commission for resolution.

With respect to the earnings calculations, a dispute over a proposed adjustment to the Company's Final Earnings Report can only be brought before the Commission in two situations:

1. If the proposed adjustment arises out of the failure of UE to accurately follow the accounting methodologies for calculating earnings set out in the Reconciliation Procedure of the Agreement, whether as a simple mistake, or intentionally in a deliberate act of manipulation to reduce amounts to be shared with customers or to misrepresent actual earnings or expenses; or

2. If the proposed adjustment arises from a new category of costs that has not been previously included in any ratemaking proceedings.

Q. Please describe what you consider to be a failure to apply the accounting methodologies under the Agreement either through an inadvertent error or through a deliberate manipulation of earnings under the terms of the Agreement.

A. An example of a failure to apply the accounting methodologies under the Agreement would be the failure to reflect a specific adjustment in the Company's Final Earnings report, as noted in Attachment C to the Agreement. For instance, the failure to eliminate $250,000 of goodwill advertising from the Final Earnings Report would be a failure to apply the accounting methodologies under the Agreement. Another example would be an inadvertent error in the preparation of the Final Earnings Report resulting from the failure to pick up certain Missouri jurisdictional revenues recorded in the Company's general ledger in the Final Earnings Report, or simply a clerical error in the mathematical calculation of certain numbers. With regard to manipulation of earnings, the Company noted in its November 23, 1998 Request for Commission Guidance that one of the principal dictionary definitions of "manipulate" is to "control or play upon by artful, unfair or insidious means especially to one's own advantage." (*Webster's Ninth New Collegiate Dictionary)* Consequently, appropriate application of the accounting methodologies specified in the Agreement, or the consistent application of established past accounting methodologies and generally accepted accounting principles (GAAP) is not manipulation. It does not reduce earnings solely to reduce the amounts shared with customers or misrepresent actual earnings or expenses.

It is in this context throughout my rebuttal testimony that I will address the issue of whether the Company has failed to apply the accounting methodologies under the Agreement in its Final Earnings Report for the third sharing period.

Q. Please describe what you consider to be a new category of costs that has not been previously included in any ratemaking proceedings under the terms of the Agreement.

A. Under the terms of the Agreement, a new category of costs would arise in those rare situations where a particular category of cost that had never been previously included in any ratemaking proceeding might be incurred during one of the sharing periods and that category of costs was not, and could not, be foreseen by the Parties to the Agreement during negotiations. It is quite difficult to pinpoint exactly what type of cost would fall under this category due to the limited circumstances when such an event would occur or was expected to occur. Certainly, none have occurred during the third sharing period. However, I would like to point out that a new category of cost does not arise under the terms of the Agreement by calling subsets of certain cost categories a new category of cost.. For example, deslagging of the boiler, sonaray testing of tubes, x-rays of welds, etc., ... are all subsets of costs associated with and reported as fossil power plant maintenance. The fact that the MPSC may not have specifically addressed the ratemaking of these subsets of costs by name in previous proceedings does not mean that the MPSC has not addressed the fossil power plant maintenance category of cost in previous ratemaking proceedings. They have clearly done so. In fact, our financial reporting system does not track these subsets of costs separately because they are all part of the cost category known as fossil power plant maintenance. As a result, a category of cost must be considered in a broad sense under the terms of the Agreement. The Agreement was not designed to reach down to subsets of cost categories not individually addressed in previous ratemaking proceedings and consider those new categories of costs.

It is in this context throughout my rebuttal testimony that I will address the issue of whether a proposed adjustment by the Staff or OPC Staff results from a new category of cost that has not been included in any ratemaking proceedings under the terms of the Agreement.

Q. Section 3.f.vii of the Agreement states that the Parties reserve the right to bring issues which cannot be resolved by them, and which are related to the operation or implementation of the Plan to the Commission for resolution. Do the Parties to the Agreement have the right to propose adjustments to the Final Earnings Report under this section of the Agreement?

A. Yes, but only to the extent that the adjustments relate to a failure to comply with the accounting methodologies mandated by the Agreement, whether by an error or a manipulation of earnings or relate to a new category of costs that has not been included in any previous ratemaking proceeding. As fully explained in the rebuttal testimony of Mr.

Donald E. Brandt, these limits are a function of the provisions of the Agreement governing the operation or implementation of the Plan with respect to the calculation of earnings.

Q. In the preparation of your rebuttal testimony, did the Company have all of the documentation supporting the Staff's or OPC Staff's proposed adjustments in its possession?

A. No, it did not. The Company submitted data requests to the Staff and OPC Staff on March 25, 1999, and at the time of the preparation of my rebuttal testimony, did not receive all of the information it had requested. Once this information is received, the Company may have further comments to supplement its rebuttal testimony.

COMPUTER SOFTWARE MAINTENANCE EXPENSES

Q. Please state your understanding of the Staff's and OPC Staff's proposed adjustments in this area.

A. The computer software maintenance expenses at issue are Year 2000 costs that result from the need to update or reprogram certain computer software so that the software will appropriately recognize dates as Year 2000 as opposed to the Year 1900. Staff witness Westerfield proposes that the Company defer computer software maintenance expenses associated with the Year 2000 that the Company incurred during the third sharing period until the project is complete and the prudence of UE's expenditures, as well as the appropriate method of recovery, is determined. This proposed adjustment, which reduces the expenses the Company reflected in its Final Earnings Report, amounts to approximately $672,000.

With regard to OPC Staff witness Robertson, it appears that he has totally ignored the terms of the Agreement. He has not provided any rationale under the terms of the Agreement for proposing his adjustment. Further, it is not totally clear what his proposed adjustment is in this area. Mr. Robertson merely states that the costs incurred by the Company to modify its computer systems to address Year 2000 matters should be capitalized and amortized over the useful life of the modifications. Mr. Robertson did not state in his direct testimony the specific amount of costs he is proposing to defer and amortize, nor the period to amortize these costs over. As stated previously, the Company has submitted a data request asking for supporting workpapers behind Mr. Robertson's proposed adjustments but has not yet received a response at this time. As a result, the Company may need to file supplemental rebuttal testimony upon receipt of this information.

Q. Did the Company apply the accounting methodologies under the Agreement with respect to the computer software maintenance expenses reflected in its Final Earnings Report for the third sharing period?

A. Yes, it did. These costs are software maintenance expenses. When the Company incurs costs to maintain its existing computer systems, or repair those systems if they become inoperable for various reasons, those costs are expensed as incurred. They are expensed because they do not improve the software beyond the state in which it was originally intended to be used and do nothing more than restore the software to its normal state. This accounting treatment has been an established accounting practice of the Company for years, and is in accordance with generally accepted accounting principles (GAAP). In particular, the Company's accounting policy is in accordance with the consensus reached in Emerging Issues Task Force Issue No. 96-14, "Accounting for the Cost Associated with Modifying Computer Software for the Year 2000." (EITF 96-14) In EITF 96-14, the Task Force reached a consensus that such costs should be charged to expense as incurred. It should be noted that the Emerging Issues Task Force is an accounting standard setting body established to address certain accounting issues in a timely fashion. A consensus by the Task Force becomes a source for GAAP.

In addition, the Company has expensed the Year 2000 computer maintenance costs in accordance with the Federal Energy Regulatory Commission Uniform System of Accounts (FERC USOA). The operating expense instructions of the Uniform System of Accounts state that "work performed specifically for the purpose of preventing failure, restoring serviceability or maintaining life of plant" should be expensed as maintenance costs. Clearly, the repair and maintenance costs incurred for correcting the Year 2000 problem were done in order to prevent the failure of or restore systems to their normal state.

Consequently, a failure to apply the accounting methodologies under the Agreement did not occur because the Company's accounting for such software maintenance expenses was consistent with the Company's past accounting practices, GAAP, the Agreement and the FERC USOA.

Q. Are such software maintenance expenses a new category of costs that has not been included previously in any ratemaking proceeding?

A. No. Despite all of the attention that the Year 2000 issue receives, the Union Electric work associated with this issue is nothing more than repairing existing software so that it may perform the functions it was originally intended to perform. As a result, such costs are computer software maintenance expenses.

While there are a number of activities involved with addressing the Year 2000 issue, it begins with reviewing the software code to determine if and where there are modules that are date dependent. Once that is determined, the approach is basically the same as doing any computer program maintenance: the system modifications are designed and coded, the code is incorporated into the existing application, the module is tested to be sure the changes accomplish the desired result, the overall application is regression tested to be sure no other part of the logic has been "broken" by the modifications made, the application is tested in conjunction with any other applications with which it interfaces, and then the application is placed into production.

These activities mirror closely the other activities the Company performs for other software maintenance. Software maintenance is an ongoing activity. We are continually required to make changes to software, whether it be incorporating new releases from vendors, making changes to rules or tariffs in billing systems, incorporating changes in employee programs or tax changes in Human Resources programs, or making a myriad of other changes that are required as our business evolves. Also, because many of our systems are tightly integrated with one another, there are many examples where making changes in one application will necessitate changes in many others. For example, a change in the code block used for our accounting systems requires going in to every system that feeds accounting information to those systems to make sure that they maintain compatibility. The approach outlined above for the Year 2000 maintenance activities is essentially the same as that used for these other types of maintenance activities. In fact, the only difference is that the Year 2000 testing has been performed in an environment that allows us to set the date to varying starting points so we can confirm that the logic will perform correctly on the turn-over of various key dates.

In Ms. Westerfield's direct testimony, she states that the Staff's proposed adjustment in this area is appropriate under the terms of the Agreement because they consider Year 2000 costs a new category of costs that have not been included previously in any ratemaking proceeding. I disagree. As I have pointed out above, Year 2000 costs are simply computer software maintenance expenses. It must be understood that the name of the issue is not what determines whether there is a new category of costs under the Agreement. "Year 2000" merely describes the nature of the software repairs that are being made. The fact that the issue is called "Year 2000" does not make these expenditures a new category of costs any more than the expenditures associated with cleansing a computer system of a "computer virus" made those a "new category of costs." Both of these costs are merely subsets of computer software maintenance expenses. Under the Staff's reading, even the purchase of a Year 2000 model set of tires for a line truck would be a new "category of costs" because the Company has not purchased Year 2000 model tires previously.

The Company has been incurring computer software maintenance costs since it installed its first computer (in the 1960's). And since that time, it has consistently applied an accounting policy of expensing those costs as incurred. The fact that some of those maintenance costs may now bear the label of Year 2000 maintenance does not in any way change the character of those costs. These costs have been incurred to restore the software to its normal state, not to improve it. The table below sets forth the computer software maintenance expenses incurred by the Company for the four previous fiscal years ended June 30, 1997, which include the first two sharing periods of the Agreement and periods prior to the Agreement:

Fiscal Year	**Computer Maintenance Expenses** (in thousands)
1994	$ 9,538
1995	$13,414
1996	$18,420
1997	$20,450

As you can see, the Company has been incurring significant computer software maintenance costs over a long period of time. These are clearly costs that have been considered previously in ratemaking proceedings.

Q. Are the adjustments proposed by Ms. Westerfield and Mr. Robertson appropriate under the terms of the Agreement?

A. No, they are not. The treatment of computer software maintenance expenses in the Company's Final Earnings Report did not result in a failure to apply the accounting methodologies under the Agreement or a new category of costs that have not been included previously in any ratemaking proceeding.

Q. In her direct testimony, Ms. Westerfield cites case No. 00-99-43 as precedent for the Staff's position to defer and amortize computer maintenance expenses related to Year 2000 work. Do you agree with Ms. Westerfield's assertion?

A. No. Statements made subsequent to this Agreement by the MPSC in a case not directly involving Union Electric does not provide the Staff with any basis to propose adjustments to the Final Earnings Report under the terms of the Agreement. In fact, that case has absolutely nothing to do with this proceeding or the terms of the Agreement. As stated in both Mr. Brandt's and my rebuttal testimony, adjustments to the Final Earnings Report can be made only if UE has failed to correctly apply the accounting methodologies provided in the Agreement, or a new category of costs has arisen. As stated previously, these instances did not arise for this issue.

Q. Notwithstanding the fact that the Staff's and OPC Staff's proposed adjustments in this area are inappropriate under the terms of the Agreement, do

you have any other further comments or concerns about their proposed adjustments in this area?

A. Yes, I do.

Q. In Mr. Robertson's direct testimony, he implies that the Company may not be following GAAP for computer software maintenance expenses related to the Year 2000 by following EITF 96-14. Do you agree?

A. No, I do not. In his direct testimony, Mr. Robertson asserts that guidance of the EITF is not GAAP. He states that:

> EITF No. 96-14, while an authoritative accounting body, is not the premier body responsible for promulgation of "Generally Accepted Accounting Principles ("GAAP"). The Financial Accounting Standards Board ("FASB") has that responsibility.

Mr. Robertson is incorrect. As noted in the rebuttal testimony of Mr. Benjamin A. McKnight of Arthur Andersen LLP, the Company is required to follow the accounting set forth in an Emerging Issues Task Force ("EITF") consensus. The FASB established the EITF in 1984 to assist the FASB in improving financial reporting through timely identification, discussion, and resolution of financial issues within the framework of existing authoritative literature. There are two reasons the Company is required to follow a consensus reached by the EITF. First, Statement on Auditing Standards No. 69, *The Meaning of "Presents Fairly in Conformity With Generally Accepted Accounting Principles" in the Independent Auditor's Report,* makes application of an EITF consensus mandatory. Further, the SEC's Chief Accountant has said that he would challenge any accounting that differs from a consensus of the EITF because the consensus position represents the best thinking on areas for which there are no specific standards. For these reasons the Company has been consistently applying the provisions of EITF No. 96-14 throughout all of the sharing periods of the Agreement.

Q. **Mr. Robertson recommends that these maintenance costs should have been capitalized and amortized over a period representative of the usefulness or the service life of the modifications. Can you state what that period would be?**

A. No, I cannot. As I stated earlier in my direct testimony, these costs are expensed because they do not improve the software beyond the state in which it was originally intended to be used and do nothing more than restore the software to its normal state. There is, therefore, no period that is representative of the usefulness or service life of the modifications. It is for these reasons that the EITF reached the consensus it did.

Q. **On page 3, lines 15 through 20, of Ms. Westerfield's direct testimony, she asserts that it is inappropriate to expense computer maintenance costs associated with Year 2000 work because, for ratemaking purposes, nonrecurring items should not be charged to expense because they would unduly burden ratepayers in the year incurred if rates/credits reflect those costs. Do you agree with this assertion in the context of the Agreement?**

A. No, I do not. First, I find it a bit of an oxymoron to assert that these costs are both "ongoing" and "non-recurring," as Ms. Westerfield suggests in her direct testimony, on page 3, lines 8-9 and line 16. Computer software maintenance expenses are in fact ongoing, and they are very much recurring. This can be seen by the historical figures shown previously. The end of 1999 will not end UE's requirement to maintain its software. As technology continues to change that requirement will no doubt continue and possibly grow. As a result, deferral of these costs into the future may have the exact opposite effect from that intended by Ms. Westerfield. Future customers may be burdened by both regular on-going computer maintenance costs together with the deferred Year 2000 costs incurred in the third sharing period and beyond.

Second, this Agreement was not established to determine future rates to be charged to customers, as is the case in a typical ratemaking proceeding. If this were the case, other typical ratemaking adjustments would be factored into the analysis, including the normalization of the effects of weather on revenues and expenses. The terms of this Agreement were established to determine the "sharing credits" to be provided to customers for a specified sharing period. Mr. Rackers of the MPSC Staff appears to agree. On lines 10 through 13 of his direct testimony, Mr. Rackers defines the term "sharing credits" as "the amount of earnings that are returned to the ratepayers, <u>on a one-time basis</u>, depending on UE's achieved equity return during each annual sharing period." (emphasis added)

Q. Did the Staff or OPC Staff question the treatment of computer software maintenance expenses associated with Year 2000 work during the first two sharing periods?

A. No, they did not.

Q. Did the Company incur computer software maintenance expenses associated with Year 2000 work prior to the third sharing period?

A. Yes, it did. The Year 2000 issue has been around for several years and work commenced on this project, either directly or indirectly, several years ago. However, because of the nature of these costs, the Company has consistently classified these costs as repair and maintenance costs. Prior to the SEC Staff's release of its requirements regarding disclosure of Year 2000 costs, the Company did not do anything to segregate its Year 2000 maintenance costs from its other software maintenance costs. There was no need, either from a cost classification or disclosure perspective, to do such.

Q. In Ms. Westerfield's direct testimony, she states that the Staff recommends that Year 2000 computer software maintenance expenses be deferred until the project is complete and the prudence of UE's expenditures, as well as the appropriate method of recovery, is determined. She further commits to having the Staff making such a determination by June 30, 2001. Do you have any comments on this statement?

A. Yes, I do. In her direct testimony, Ms. Westerfield gives the meaningless promise of assuring the parties that the Staff will make a determination as to the appropriate method for the recovery, if any, of Year 2000 computer maintenance expenses prior to the end of the second three-year experimental alternative regulation plan, (June 30, 2001) without giving any rationale for the wait. Nor does she give a glimpse of how she believes the Staff will deal with these costs.

As the MPSC noted in Case No. 00-99-43, which Ms. Westerfield cites in her testimony, "the cost issue may not need to be delayed until 2001..." Therefore, there is no reason for delaying the decision on how these costs should be treated. After all, the Commission's primary concern was with making sure that companies acted timely. Union Electric clearly has acted in a timely fashion, and there is no reason to delay a decision on how to treat these costs. In fact, and as stated previously, I believe that the Agreement is clear that these costs should be expensed as incurred in the Company's Final Earnings Report.

OTHER COMPUTER COSTS

Q. Please state your understanding of the Staff's and OPC Staff's proposed adjustment in this area.

A. Staff witness Westerfield proposes to capitalize the costs the Company has incurred for its human resource and payroll system (AMRAPS), customer information system (CSS) and its power plant maintenance scheduling system (EMPRV). Once in-service, Ms. Westerfield states these capitalized costs should be amortized over ten years. In the Company's Final Earnings Report, the Company expensed these costs as incurred. Ms. Westerfield proposes that the Company capitalize approximately $1.6 million, $8.8 million and $468,000 for AMRAPS, CSS and EMPRV costs, respectively.

With regard to Mr. Robertson, his position is similar to Ms. Westerfield's in that he proposes that costs incurred by the Company during the third sharing period for these projects be capitalized and amortized over their useful life once placed in-service.

However, once again, Mr. Robertson failed to provide the basis for his proposed adjustment under the terms of the Agreement. In addition, it is not clear from his direct testimony the amount of the expenses incurred by the Company for these projects that he proposes to be capitalized and amortized. Finally, Mr. Robertson did not specify in his direct testimony the period over which these costs should be amortized. As stated previously, the Company has submitted a data request asking for supporting workpapers behind Mr. Robertson's proposed adjustments, but has not yet received a response. As a result, the Company may need to file supplemental rebuttal testimony upon receipt of this information.

Q. Did the Company apply the accounting methodologies under the Agreement with respect to the computer software expenses that the Company reflected in its Final Earnings Report for the third sharing period?

A. Yes, it did. The Company's accounting treatment during the third sharing period, to expense as incurred its computer software costs, is consistent with the Company's long established accounting methodology in this area, which was in accordance with GAAP and the Agreement.

Since the Company's accounting for computer software costs was in accordance with its established accounting practices, which were in accordance with GAAP, a failure to apply the accounting methodologies under the Agreement did not occur for these costs.

In her direct testimony, Ms. Westerfield indirectly alleges that the Company manipulated earnings. On page 8, lines 11-14, Ms. Westerfield states the following:

> Additionally, the Staff has not received a reasonable explanation from UE why an asset is being expensed or why a project which was not in service during the third sharing period, should be included in the calculation of costs.

This statement relates to the manipulation issue due to the provisions set forth in Section 3.f.vii of the Agreement which states the following:

> An allegation of manipulation could include significant variations in the level of expenses associated with any category of cost, where no reasonable explanation has been provided.

The Company's accounting for its computer software costs is quite clear, as it has been since at least 1986. Our policy has been to expense these costs as incurred. I am not sure what better explanation we could have provided to the Staff. To suggest that the Company has not provided the Staff with a reasonable explanation on the variations of its level of expense in this area is incomprehensible.

Q. Are computer software costs a new category of costs that has not been included previously in any ratemaking proceeding?

A. No. The Company has incurred expenses for computer software costs for periods back until the mid-1960's, as I pointed out previously . These expenditures have been addressed in several ratemaking proceedings and are therefore not a new category of costs.

In Ms. Westerfield's direct testimony, she points to the section of the Agreement (Section 3.f.viii) relating to new categories of costs as support for her adjustment, yet Ms. Westerfield provides no basis for her assertion. Based on the fact that the Company has incurred computer software expenses for decades and has expensed these costs as incurred, it is not appropriate for Ms. Westerfield to assert that these costs are new categories of costs that have not been addressed in previous ratemaking proceedings.

Q. Are the adjustments proposed by Ms. Westerfield and Mr. Robertson appropriate under the terms of the Agreement?

A. No, they are not. The treatment of computer software maintenance expenses in the Company's Final Earnings Report are in accordance with the accounting methodologies under the Agreement and these costs are not a new category of costs that have not been included previously in any ratemaking proceeding.

Q. In Ms. Westerfield's direct testimony, she states that the Staff's proposed adjustment may be brought to the attention of the Commission in accordance with paragraph 3.f.vii of the Agreement. Do you agree with Ms. Westerfield's conclusion?

A. No, I do not. This provision obviously does not itself set out the terms of the Agreement with respect to the operation or implementation of all the various aspects of the Plan, ranging from the submission of reports to the calculation of earnings. To know what the Plan provides concerning the operation or implementation of any particular activity under the Plan, one must turn to the specific provisions governing that activity. It is those specific provisions that give meaning to "operation or implementation" with respect to a particular activity.

As I have already explained, the provisions governing the operation or implementation of the Plan with respect to the calculation of earnings set out the accounting methodologies for doing that calculation and describe the kinds of disputes that can be brought to the Commission for resolution by it. Again, these disputes are those that either arise from a failure to correctly apply the agreed accounting methodologies (due to a mistake or intentional manipulation) or arise from a new category of costs. As discussed more fully in the rebuttal testimony of Mr. Brandt, this section of the Agreement does not allow the Staff to propose adjustments for any reason it deems fit. As I have just explained, the computer software costs reflected in the Final Earnings Report are in accordance with the accounting methodologies under the Agreement and are not a new category of costs that have not been included previously in any ratemaking proceeding.

Q. Notwithstanding the fact that the Staff's and OPC Staff's proposed adjustments in this area are inappropriate under the terms of the Agreement, do you have any other further comments or concerns about their proposed adjustments in this area?

A. Yes, I do.

Q. In Ms. Westerfield's direct testimony, she presents several other arguments which she believes supports her view that the costs for AMRAPS,

EMPRV and CSS projects should be capitalized and amortized over ten years. One such argument is that expensing the costs associated with these projects is inappropriate because of the significance of the amounts involved and because these costs will produce future benefits. Do you have any comments on Ms. Westerfield's assertion?

A. Yes, I do. First, I do not believe the significance of the amounts incurred is relevant to this analysis. What is relevant under the terms of the Agreement is whether or not the Company has consistently applied an accounting methodology for these costs. It has, and this accounting methodology has been employed since at least the mid-1980's, a fact which should have been known by the Staff. Second, the Staff must have been aware that computer software development expenses of the Company were significant prior to this third sharing period and even prior to the consummation of this Agreement. However, no issues were ever raised during negotiations of the Agreement or in the first two sharing periods. The table below includes expenses incurred by the Company for the four previous fiscal years ended June 30, 1997, which includes the first two sharing periods and periods prior to the Agreement:

Fiscal Year	**Computer Software Development Expenses** (in thousands)
1994	$ 6,593
1995	$ 6,569
1996	$ 5,565
1997	$13,044

Included in these costs are expenses incurred by the Company during the first two sharing periods (the fiscal years ended June 30, 1996 and 1997) for AMRAPS, EMPRV and CSS. They were approximately $8 million, $2.5 million and $1.2 million, respectively. Yet, the Staff never proposed adjustments to the relevant earnings reports in the first two sharing periods. Further, evidence exists in the language of the Agreement that the Staff was well aware of the Company incurring significant expenses for computer software development prior to the Agreement being entered into. In Section 3.e.vi of the Agreement, the installation of the Company's new general ledger system in 1994 (a major financial system) is specifically identified. Clearly, the Staff had an opportunity to express its concerns over the Company's accounting for its computer software development expenses, and propose changes prior to entering into the Agreement, yet the Staff chose not to. Requiring that the Company change its accounting methodology for computer software development costs at this point is not only inconsistent with the Staff's past actions with UE, but is also contrary to the terms of the Agreement.

Q. Would you comment on the argument made by Ms. Westerfield that these costs are intended to provide future benefits and therefore should be capitalized?

A. Yes. The fact that these expenditures are intended to provide future benefit is also irrelevant. The Company's accounting policy recognizes that the nature of the benefit, if any, from computer software development costs is difficult to measure and that the rapidity of changes in technology and the significant maintenance requirements of software make expensing of these costs preferable. As I mentioned earlier, the Company's accounting policy for software development costs was the predominant practice among all companies and was considered the preferable practice by the staff of the SEC. The appropriateness of the Company's accounting policy is also confirmed by Mr. Benjamin A. McKnight of Arthur Andersen LLP.

Q. Ms. Westerfield also comments on the fact that SOP 98-1 provides the basis for the Company to capitalize its computer software costs. Do you agree?

A. No. SOP 98-1 became effective on January 1, 1999, after the terms of the Agreement had been agreed to, and so could not change the terms of that contract. Further, as stated in the rebuttal testimony of Mr. Benjamin A. McKnight, under GAAP it is inappropriate for UE to change its accounting policy for these costs until the Company's rates are adjusted to reflect a corresponding change in regulatory treatment by the MPSC.

Q. Please comment on Ms. Westerfield's comments about the CSS system not being in service during the third sharing period, and that it only will benefit large industrial and commercial customers.

A. First, the CSS system was placed in service in December 1998 as opposed to February 1999. In addition, the fact that the CSS system was not completed during the sharing period and may not benefit all classes of customers is irrelevant. Given the Company's accounting policy, the in-service date of the software does not affect the timing of when these costs should be recorded as an expense. Further, we need to keep in mind the purpose of this proceeding. It is to determine the amount of the sharing credit for the third sharing period in accordance with the terms of the Agreement. It is not a typical ratemaking proceeding or rate design case. Which customer classes will or will not directly benefit from the CSS software should not affect the analysis of whether or not these costs are correctly included in the determination of the sharing credit in accordance with the terms of the Agreement.

Q. Ms. Westerfield proposes that the third sharing period costs of the CSS, EMPRV and AMRAPS systems be capitalized, placed in rate base and depreciated using a 10% rate. If the Commission were to determine that capitalization of these costs is appropriate, do you agree with the use of a 10% depreciation rate?

A. No. Given the rapid changes in technology and the significant ongoing maintenance requirement of software systems, I do not believe a 10 year life for this intangible asset can be supported. The case Ms. Westerfield cites as support for her proposed depreciation rate acknowledges this very issue. In addition, SOP 98-1 indicates in paragraph 37, "[g]iven the history of rapid changes in technology, software often has had a relatively short useful life."

I believe that a more appropriate life for these systems would be a maximum of five years. This shorter life is consistent with predominant practice as evidenced by a survey conducted by PricewaterhouseCoopers of Fortune 500 companies. This survey indicated that the majority of companies that amortized computer software costs did so over a period of 3 to 5 years. Nevertheless, I reiterate that capitalizing computer software development costs is inappropriate.

MERGER COSTS

Q. Please state your understanding of the Staff's and OPC Staff's proposed adjustment in this area.

A. Staff witness Gruner and OPC Staff witness Robertson propose to change the methodology by which merger costs are amortized. As a result, the Staff's and OPC Staff's proposed adjustment reduces the Company's annual amortization of merger costs reflected in its Final Earnings Report by approximately $232,000.

Q. Did the Company apply the accounting methodologies under the Agreement with respect to the amortization of merger costs reflected in the Final Earnings Report of the third sharing period?

A. Yes, it did. The appropriate annual amortization of merger costs is specifically addressed in the Stipulation and Agreement approved by the MPSC in February 1997 (Merger Agreement) agreed to in connection with the Company's merger with CIPSCO. (Case No. EM-96-149) In the Merger Agreement, the potential for the actual merger costs to be less than the Company's original estimate was also specifically considered, thereby ensuring that the Company would not amortize to expense an amount greater than what was actually expended. Section 4 of the Merger Agreement states the following:

> The annual amortization of merger transaction and transition costs will be the lesser of: (1) the Missouri jurisdictional portion of the total Ameren amount of $7.2 million; or (2) the Missouri jurisdictional portion of the total Ameren unamortized amount of actual merger transaction and transition costs incurred to date.

The Missouri jurisdictional portion of the total Ameren amount of $7.2 million approximates $6.2 million annually, while the Missouri jurisdictional portion of the total Ameren unamortized amount of actual merger transaction and transition costs incurred as of June 30, 1998 was approximately $44 million. In accordance with the provisions of the Merger Agreement, the Company amortized the lesser of these two amounts ($6.2 million) in its Final Earnings Report for the third sharing period (it should be noted that because the merger was not consummated until January 1, 1998, only 6 months of the annual $6.2 million amortization was reflected in the Final Earnings Report during the third sharing period, or $3.1 million). As the Company was following the specific terms of the Merger Agreement, a manipulation of earnings did not occur with regard to the amortization of merger costs.

Q. Is the amortization of merger costs a new category of costs that has not been included previously in any ratemaking proceeding?

A. No. As stated previously, the amortization of merger costs was addressed in Case No. EM-96-149.

Q. Are the adjustments proposed by Mr. Gruner and Mr. Robertson appropriate under the terms of the Agreement?

A. No, they are not. The amortization of merger costs reflected in the Company's Final Earnings Report were in accordance with the accounting methodologies under the Agreement and these costs are not a new category of costs that have not been included previously in any ratemaking proceeding.

Q. Notwithstanding the fact that the Staff's and OPC Staff's proposed adjustments in this area are inappropriate under the terms of the Agreement, do you have any further comments or concerns to add about their proposed adjustment in this area?

A. Yes. In both Mr. Gruner's (page 3, lines 11-18) and Mr. Robertson's (page 14, lines 5-13) direct testimony, the appropriate section of the Merger Agreement is cited which forms the basis for the amount of merger costs that the Company has amortized to expense during the third sharing period. As I stated previously, the annual amortization of merger costs is simply the lesser of the Missouri jurisdictional portion of the total Ameren amount of $7.2 million (which approximates $6.2 million) or the Missouri jurisdictional portion of the total Ameren unamortized amount of actual merger transaction and transition costs incurred to date (at June 30, 1998, that amount approximated $44 million). Clearly, $6.2 million is less than $44 million and, therefore, the Company used the annual $6.2 million figure for its merger cost amortization. Both Mr. Gruner and Mr. Robertson ignore the specific terms of the Agreement in proposing their adjustment. No where does the Agreement state that the "annual amortization should be the lesser of $7.2 million or the 10-year amortization of the actual costs incurred to date," as stated by

Mr. Robertson in his direct testimony (page 16, lines 12-14) or that the unamortized Missouri jurisdictional merger costs incurred to date be divided by ten to determine the annual amortization amount, as Mr. Gruner implies.

INJURIES AND DAMAGES EXPENSE

Q. Please state your understanding of the Staff's proposed adjustment in this area.

A. Staff witness Gruner proposes to reduce injuries and damages expenses reflected in the Final Earnings Report to a level that equals the actual amount of claims paid during the third sharing period, plus an amount necessary to restore the injuries and damages reserve to a "normal" level. Mr. Gruner's proposed adjustment would reduce injuries and damages expenses reflected in the Final Earnings Report by approximately $2.3 million.

Q. Did the Company apply the accounting methodologies under the Agreement with respect to the injuries and damages expenses that are reflected in its Final Earnings Report for the third sharing period?

A. Yes, it did. The Company's long established accounting policy for injuries and damages expenses is to expense these costs as incurred, which is in accordance with GAAP. The Company's accounting policy for injuries and damages expenses incurred in the third sharing period is consistent with the Company's established accounting practice, which is in accordance with GAAP.

Q. Are injuries and damages expenses a new category of costs that has not been included previously in any ratemaking proceeding?

A. No, they are not. Injuries and damages expenses are recurring expenses that the Company has encountered during the course of its business for decades, and are therefore not a new category of costs that have not been addressed in previous ratemaking proceedings.

Q. Is the adjustment proposed by Mr. Gruner appropriate under the terms of the Agreement?

A. No, it is not. The treatment of injuries and damages expenses in the Company's Final Earnings Report was in accordance with the accounting methodologies under the Agreement and are not a new category of costs that have not been included previously in any ratemaking proceeding.

Q. In Mr. Gruner's direct testimony, he states that the Staff's proposed adjustment may be brought to the attention of the Commission in accordance with paragraph 3.f.vii of the Agreement. Do you agree with Mr. Gruner's conclusion?

A. No, I do not. First, Mr. Gruner cites this section of the Agreement as support for his argument, yet provides no further rationale as to why this section applies to his proposed adjustment.

Second, this provision obviously does not itself set out the terms of the Agreement with respect to the operation or implementation of all the various aspects of the Plan, ranging from the submission of reports to the calculation of earnings. To know what the

Plan provides concerning the operation or implementation of any particular activity under the Plan, one must turn to the specific provisions governing that activity. It is those specific provisions that give meaning to "operation or implementation" with respect to a particular activity.

As I have already explained, the provisions governing the operation or implementation of the Plan with respect to the calculation of earnings set out the accounting methodologies for doing that calculation and describe the kinds of disputes that can be brought to the Commission for resolution by it. Again, these disputes are those that either arise from a failure to correctly apply the agreed accounting methodologies (due to a mistake or intentional manipulation) or arise from a new category of costs. As discussed more fully in the rebuttal testimony of Mr. Brandt, this section of the Agreement does not allow the Staff to propose adjustments for any reason it deems fit. As I have just explained, the injuries and damages costs reflected in the Final Earnings Report are in accordance with the accounting methodologies under the Agreement and are not a new category of costs that have not been included previously in any ratemaking proceeding.

Q. Did the Company provide the Staff with a reasonable explanation for the variation in the level of expenses for injuries and damages?

A. Yes. The Company is required under GAAP to recognize liabilities for loss contingencies that are "probable" and "reasonably estimable." The Company's injuries and damages reserve represents management's best estimate of the ultimate amount necessary to settle all claims or damages that arose from events that occurred prior to the balance sheet date. This is not, as Mr. Gruner asserts, a reserve for "possible future claims against the Company."

As the Company explained to the Staff, there were two primary causes for the increase. First, during the period, the Company settled a high number of claims, some of which were vary large ($17 million). Many of these claims were settled for amounts in excess of the original reserve established. In addition, there was an increase in the occurrences that the Company believes will result in payments by the Company. And, given the trends in the amounts of payments required in the third sharing period, the Company believes the amount to settle these current claims will be greater than those required in prior years.

Q. Is it unusual for the accruals in this area to vary from year to year?

A. No. By its very nature, one would expect the amount of the accruals to be volatile. Evidence of this can be seen from the amount of the expense over the last four fiscal years ended June 30, 1998:

Fiscal Year	Injuries and Damages Expense (in thousands)
1995	$11,100
1996	$ 5,950
1997	$ 6,670
1998	$20,270

Q. In his direct testimony, Mr. Gruner states that precedent has been established by the MPSC for the normalization of injuries and damages expenses.

Does this precedent provide a basis for the Staff to propose an adjustment under the terms of the Agreement?

A. Absolutely not. As noted in Section 3.f.ii, MPSC precedent was utilized as the basis for certain adjustments to the Company's reported earnings in the preparation of the Final Earnings Report (e.g., the normalization of Callaway refueling expenses). Others were not, the most notable of which is the normalization of the effects of weather on revenues and expenses in the preparation of the Final Earnings Report. As a result, unless otherwise specified in the Agreement, past MPSC precedent for normalizing injuries and damages expenses is not an appropriate basis to propose an adjustment to the Final Earnings Report under the terms of the Agreement if it was not specifically set forth in the Agreement.

Q. Notwithstanding the fact that the Staff's proposed adjustment in this area is inappropriate under the terms of the Agreement, do you have any further comments or concerns about the Staff's proposed adjustment in this area?

A. Yes, I do. First, Mr. Gruner's concept of normalization associated with his proposed adjustment is akin to that which may be considered in a typical rate case. This Agreement was not established to determine future rates to be charged to customers, as is the case in a typical ratemaking proceeding. If this was the case, other typical ratemaking adjustments would be factored into the analysis, including the normalization of the effects of weather on revenues and expenses. These adjustments have not been made to the Final Earnings Report, and appropriately so. To the extent that any adjustments are made to the Company's reported revenues and expenses (e.g., the normalizing of Callaway refueling expenses), those adjustments were specifically agreed to and set out in the Agreement. Instead, and as stated previously in my rebuttal testimony, the terms of this Agreement were established to determine the "sharing credits" to be provided to customers for a specified sharing period.

Second, the Staff is adopting an entirely different accounting policy for injuries and damages expense than that utilized during the first two sharing periods and previously, where injuries and damages expenses were expensed as incurred. Given the Staff's new position in this area, it is not clear how injuries and damages expenses are to be handled under the terms of the Merger Agreement and second EARP for the next three years. If injuries and damages expenses decrease to whatever the Staff considers to be a "normal" level in the future, then should the Company abandon the Staff's proposed approach identified above, continue to use the new Staff method (which could result in injuries and damages expenses reflected in the Final Earnings Report being significantly higher than those recorded under the Company's current accounting method), or employ some other method? Clearly, another significant concern to the Company is that when accounting policies change arbitrarily, the likelihood of expenses that the Company incurs not being fully recovered significantly increases. This is clearly an unacceptable situation given that no one has questioned the propriety of these costs.

Still, another example that this adjustment is arbitrary and in bad faith rests in the fact that the Staff chose not to propose an adjustment to injuries and damages expenses during the first sharing period, when those expenses had significantly decreased from that incurred in the prior fiscal year. The Staff only chose to propose such an adjustment when it appears to work toward increasing the credit to customers, as opposed to decreasing the credit.

ADVERTISING

Q. Please state your understanding of the Staff's proposed adjustment in this area.

A. Staff witness Gruner proposes that certain advertising costs incurred by the Company are merger-related expenses and therefore should be capitalized as a merger cost and amortized over ten years. This adjustment reduces the Company's expenses which are reflected in the Company's Final Earnings Report by approximately $1 million.

The Company agrees with certain aspects of Mr. Gruner's proposed adjustment. In particular, we agree with Mr. Gruner's assertion that approximately $1 million of advertising costs incurred by the Company during the third sharing period should be capitalized as merger costs. The Company inadvertently did not identify certain advertising costs incurred as merger-related costs.

However, the Company does not agree with Mr. Gruner's proposal that these merger costs be amortized over ten years. As stated previously, the Company maintains that the amortization of these merger costs should be consistent with the amortization method that I proposed earlier under "Merger Costs" when I addressed the Staff's and OPC Staff's proposed adjustments for merger costs. As a result, the merger transition and transaction costs incurred as of June 30, 1998, now increases to approximately $45 million.

Q. You have previously stated that proposed adjustments were inappropriate under the terms of the Agreement. Why is this proposed adjustment not also inappropriate?

A. As stated by Mr. Brandt, the Staff and OPC Staff have an important role in monitoring the Company's compliance with the Agreement to be sure we accurately followed our established accounting practices and the specific adjustments set out in the Reconciliation Procedure. Obviously, if an error is discovered by the Staff or OPC Staff, and verified by the Company, it is appropriate under the terms of the Agreement to make the correction.

TERRITORIAL AGREEMENTS

Q. Please state your understanding of the Staff's proposed adjustment in this area.

A. In Case Nos. EO-95-400, et al. and EO-97-6, et al., the MPSC approved the exchange of territories and related customers between the Company and Black River Electric Cooperative, Inc. and the Macon Electric Cooperative, Inc., respectively. Staff witness Rackers claims that the exchange of these territories has resulted in the loss of net revenues by the Company during the third sharing period. The Staff proposes to add the loss of these net revenues back in the Company's Final Earnings Report. As stated previously, at this time, the Company has not been able to fully determine the amount of the Staff's proposed adjustment in this area, and the Company has submitted a data request asking for supporting workpapers behind Mr. Rackers' proposed adjustments, but has not yet received a response at this time. As a result, the Company may need to file supplemental rebuttal testimony upon receipt of this information.

Q. Did the Company apply the accounting methodologies under the Agreement with respect to the net revenues reflected in the Final Earnings Report for the third sharing period associated with the exchange of territories and related customers between the Company and Black River Electric Cooperative, Inc.?

A. Yes, it did. The net revenues reflected in the Final Earnings Report were the direct result of MPSC-approved orders approving the exchange of territories and customers between the Company and the cooperatives.

Q. Are the net revenues a new category of costs that has not been included previously in any ratemaking proceeding?

A. No. As stated previously, the net revenues resulting from these territorial agreements were addressed in Case Nos. EO-95-400 and EO-97-6. In addition, there are at least two examples where the Company, prior to the start of the Agreement, consummated territorial exchange transactions (see Case Nos. EO-91-204 and EO-93-166). The Company's accounting for the net revenues from all of these territorial agreements has been consistently applied. The relevant revenues and expenses of the territories serviced were recognized in the period realized and incurred, respectively. Because the Company's accounting methodologies for the net revenues from territorial agreements in the periods prior to the Agreement and throughout the three sharing periods have been consistently applied, this issue is not a new category of costs.

Further, in Mr. Rackers' direct testimony, he states that this issue is a new category of costs that have not been addressed previously in any ratemaking proceeding. His assertion is that the Staff is not aware of a situation where earnings results were adjusted to prevent detriment to ratepayers due to the effect of a territorial agreement. The Company has no doubt that this is the case, otherwise the MPSC would not have approved the territorial agreement in the first place. On page 6, lines 10-11, Mr. Rackers clearly points out that the criteria for approval of such an agreement is that it cannot result in a detriment to ratepayers. This agreement was approved by the MPSC because it does not harm ratepayers. Mr. Rackers is employing a backwards sense of logic by asserting that his proposed adjustment is appropriate under this section of the Agreement.

Q. Is the adjustment proposed by Mr. Rackers appropriate under the terms of the Agreement?

A. No, it is not. The treatment of territorial agreements in the Company's Final Earnings Report and in accordance with the accounting methodologies of the Agreement and are not a new category of costs that have not been included previously in any ratemaking proceeding.

Q. In Mr. Rackers' direct testimony, he states that the Staff's proposed adjustment may be brought to the attention of the Commission in accordance with paragraph 3.f.vii of the Agreement. Do you agree with Mr. Rackers' conclusion?

A. No, I do not. This provision obviously does not itself set out the terms of the Agreement with respect to the operation or implementation of all the various aspects of the Plan, ranging from the submission of reports to the calculation of earnings. To know what the Plan provides concerning the operation or implementation of any particular activity under the Plan, one must turn to the specific provisions governing that activity. It is those specific provisions that give meaning to "operation or implementation" with respect to a particular activity.

As I have already explained, the provisions governing the operation or implementation of the Plan with respect to the calculation of earnings set out the accounting methodologies for doing that calculation and describe the kinds of disputes that can be brought to the Commission for resolution by it. Again, these disputes are those that either arise from a failure to correctly apply the agreed accounting methodologies (due to a mistake or intentional manipulation) or arise from a new category of costs. As discussed more fully in the rebuttal testimony of Mr. Brandt, this section of the Agreement does not allow the Staff to propose adjustments for any reason it deems fit. As I have just explained, the net revenues related to the exchanged territories reflected in the Final Earnings Report are in accordance with the accounting methodologies under the Agreement and are not a new category of costs that have not been included previously in any ratemaking proceeding.

Q. Notwithstanding the fact that the Staff's proposed adjustment in this area is inappropriate under the terms of the Agreement, do you have any other further comments or concerns about their proposal adjustment in this area?

A. Yes, I do.

Q. Do you agree with the Staff's proposed adjustment in this area?

A. No, I do not. First in a filing with the MPSC, the Company cited numerous benefits that it and its ratepayers would realize as a result of the exchanges in these territories. In approving these exchanges, the MPSC agreed that the exchanges would not result in a detriment to ratepayers. All parties, however, recognized that those benefits may not be realized immediately. The nature of the Staff's adjustments suggest that all long-term decisions require a one-year payback, or the Company will be penalized. This type of shortsighted ratemaking provides no incentives for the Company to take long-term actions for the benefits of its ratepayers.

Second, the figures used by Mr. Rackers in computing his adjustment are not based on the Company's actual results. Based upon updated estimates of the impact of these exchanges, the Company has received an immediate benefit from these exchanges under the accounting methodology used by the Company in preparing its earnings report. Ratepayers are now sharing in those immediate economic benefits under the Agreement. A comparison of the revenues and Kwh sales for the areas included in the Black River Cooperative territorial exchange show that revenues for the twelve months ended June 30, 1998, compared to the twelve months ended June 30, 1996, have increased by $276,000. Similarly, the Company has received an immediate benefit from the Macon Electric Cooperative territorial exchange. The Company estimates that the net revenues associated with the Macon territorial agreement increased approximately $217,000. A schedule supporting the Company's calculation of the net revenues is presented at Schedule 6 in Mr. Weiss' rebuttal testimony.

DECOMMISSIONING TRUST FUND DEPOSITS

Q. Please state your understanding of the Staff's and OPC Staff's proposed adjustments in this area.

A. Pursuant to the Internal Revenue Code, the Company was unable to make its quarterly deposits to the decommissioning trust fund in 1997 due to a delay in receiving an order from the MPSC. After the Company received the order from the MPSC, it made all of its deposits for 1997 in March 1998. Staff witness Westerfield and OPC Staff witness Robertson claim that the Company received a working capital benefit due to the fact that it had use of these funds during the third sharing period. Ms. Westerfield and Mr. Robertson propose to reduce the Company's expenses by approximately $287,000 and $349,000, respectively, in its Final Earnings Report to reflect their estimated benefits realized by the Company. The primary differences between Ms. Westerfield's and Mr. Robertson's proposed adjustments are the interest rates they use to determine the working capital benefit and the excess funds they estimated the Company to have in its possession. Also, with regard to Mr. Robertson, he again failed to provide the basis for his proposed adjustment under the terms of the Agreement.

Q. Is the cash working capital rate base offset reflected in the Final Earnings Report for the third sharing period in accordance with the accounting methodologies of the Agreement?

A. Yes, it is. The Company's treatment of cash working capital matters is consistent with the specific terms of the Agreement. As stated in the Agreement, the Company is required to include a cash working capital rate base offset of $24 million in its Final Earnings Report. This adjustment was specifically agreed to by all the parties as part of the Agreement negotiations, recognizing the many differences in cash flows throughout the course of the sharing periods. In addition, a previous MPSC order clearly supports that no adjustment should be made in this matter. In Case Nos. EO-85-17 and EO-85-160, the MPSC stated that "The Commission believes UE should make payments to the fund in accordance with IRS regulations and does not oppose the use of the funds by UE between each payment if IRS regulations permit." This is clearly the case in the instant proceeding whereby the Company was not allowed to make payments to the decommissioning trust fund due to a delay by the MPSC in issuing its order. This delay in the payment was required by the Internal Revenue Code. Based on the fact that the Company is complying with the specific terms of the Agreement, previous MPSC orders and IRS regulations, a manipulation of earnings did not occur in this area.

Q. Is the cash working capital rate base offset a new category of costs that has not been included previously in any ratemaking proceeding?

A. No. As stated previously, the terms of the Agreement specifically set forth how the cash working capital rate base offset should be handled in the Final Earnings Report. In addition, this matter was also addressed in Case Nos. EO-85-17 and EO-85-160.

In Ms. Westerfield's direct testimony, she states that this adjustment is appropriate under the terms of the Agreement because the circumstances surrounding the decommissioning trust fund deposits resulted in a new category of cost that have not been included previously in any ratemaking proceeding. This is clearly not the case. As I stated previously, during the negotiations of the Agreement, a cash working capital rate base offset of $24 million was specifically agreed to by the Parties because it was recognized that cash flows could vary due to a wide variety of reasons, either positively or negatively, for the Company. The Parties knew it would be inherently impractical and unfair to attempt to isolate certain cash flows, while ignoring others, in the context of the preparation of the Final Earnings Report. As a result, a number ($24 million) was negotiated and agreed to under the Agreement. To suggest that a change in the cash flows for this one area now results in a new category of cost not addressed in a previous ratemaking proceeding violates those specific terms of the Agreement. In addition, the Commission expressly stated in EO-85-17 and EO-85-10 that it did not oppose the

Company using these funds between each payment date if IRS regulations permit it to do so. This is clearly the case in the instant matter, as described previously.

Q. Are the adjustments proposed by Ms. Westerfield and Mr. Robertson appropriate under the terms of the Agreement?

A. No, they are not. The Company's treatment of decommissioning trust fund deposits in its Final Earnings Report for the third sharing period is in accordance with the specific provisions of the Agreement, and these costs are not a new category of costs that have not been included previously in any ratemaking proceeding.

Q. In Ms. Westerfield's direct testimony, she states that the Staff's proposed adjustment may be brought to the attention of the Commission in accordance with paragraph 3.f.vii of the Agreement. Do you agree with Ms. Westerfield's conclusion?

A. No, I do not. This provision obviously does not itself set out the terms of the Agreement with respect to the operation or implementation of all the various aspects of the Plan, ranging from the submission of reports to the calculation of earnings. To know what the Plan provides concerning the operation or implementation of any particular activity under the Plan, one must turn to the specific provisions governing that activity. It is those specific provisions that give meaning to "operation or implementation" with respect to a particular activity.

As I have already explained, the provisions governing the operation or implementation of the Plan with respect to the calculation of earnings set out the accounting methodologies for doing that calculation and describe the kinds of disputes that can be brought to the Commission for resolution by it. Again, these disputes are those that either arise from a failure to correctly apply the agreed accounting methodologies (due to a mistake or intentional manipulation) or arise from a new category of costs. As discussed more fully in the rebuttal testimony of Mr. Brandt, this section of the Agreement does not allow the Staff to propose adjustments for any reason it deems fit. As I have just explained, the Company's treatment of decommissioning trust fund deposits in the Final Earnings Report are in accordance with the accounting methodologies under the Agreement and these costs are not a new category of costs that have not been included previously in any ratemaking proceeding.

Q. Ms. Westerfield states in her direct testimony that this matter was brought to the attention of the Commission during the second sharing period in an MPSC staff filing in November 1997. Does the fact that the Staff noted this matter during the second sharing period allow the Staff to propose an adjustment in this area during the third sharing period?

A. No, it does not. In its November 1997 filing, the Staff stated that the Commission may be called upon to address this item during the third sharing period, but that the Staff was not certain at that time if it would bring the issue to the attention of the Commission. We did not agree then, and we certainly do not agree now, that this matter was an appropriate item to bring to the attention of the Commission under the terms of the Agreement, as I have stated previously. The Company was certainly not compelled to address this matter at the time of the Staff's filing in 1997, as even then the Staff was not sure what its ultimate position would be in this matter. The fact that the MPSC Staff merely cited this as a possibility in a filing with the Commission in November 1997 does not provide it with the right to propose an inappropriate adjustment during the third sharing period.

As Mr. Brandt noted in his testimony, under the illogical position now advanced by Ms. Westerfield, if the Staff proposes an adjustment – any adjustment – in one sharing period, it automatically can raise the adjustment in subsequent periods. There is no support in the Agreement for this interpretation.

Q. Notwithstanding the fact that the Staff's proposed adjustment in this area is inappropriate under the terms of the Agreement, do you have any further comments or concerns about the Staff's and OPC Staff's proposed adjustment in this area?

A. Yes I do. Ms. Westerfield's proposed adjustment in this area reduces the Company's expenses by approximately $287,000 in its Final Earnings Report. First, the Staff's calculation of the proposed adjustment is flawed because cash working capital items are factored into the rate base calculation for the Final Earnings Report, as opposed to these adjustments directly reducing expenses. In addition, the rate that the Staff uses to calculate its adjustment utilized the Company's AFUDC rate (which ranged from 8-10% during the third sharing period). To the extent that the Company was able to realize any benefits from the excess funds it had during the third sharing period, it would only realize a benefit from the use of those funds at its weighted average short-term borrowing rate (which is the avoided cost or benefit the Company may have realized during this period). That rate ranged between 5% and 6% during the third sharing period. Finally, Ms. Westerfield's calculation of the proposed decommissioning trust fund adjustment includes imputed interest earned on funds associated with deposits which were to be made during the second sharing period (March 1997 and June 1997). Upon settlement of the credits associated with the second sharing period, the Staff relinquished their right to propose adjustments on these items during the third sharing period.

Therefore, if one would accept the concept of Ms. Westerfield's proposed adjustment under the terms of the Agreement (which, as stated previously, the Company does not), the adjustment should be a rate base adjustment in the Final Earnings Report. This adjustment would amount to an increase in the Company's earnings under the Sharing plan of approximately $31,000 in the Final Earnings Report. The schedule calculating this adjustment is presented in Mr. Weiss' rebuttal testimony as Schedule 5.

Q. Do the comments you made immediately above, as to the fundamental flaws in Ms. Westerfield's calculation of the adjustment for decommissioning trust fund benefits, apply in a similar fashion to the adjustment proposed by Mr. Robertson in this area?

A. Yes they do. Mr. Robertson's calculation of his proposed adjustment in this area is similar to Ms. Westerfield's, except that he utilized a different interest rate to be applied to the excess funds (the expected rate of return on those funds) and he also calculated benefits for the use of funds by the Company for its March 1998 decommissioning trust fund payment. As a result, Mr. Robertson is proposing an adjustment of approximately $349,000 that should be refunded directly to customers, or have this amount deposited directly into the decommissioning trust fund. As stated above, the Company believes that the interest rate that Mr. Robertson utilizes in his calculation is inappropriate. The appropriate rate is the Company's weighted average short-term borrowing rate. In addition, it is not appropriate to calculate earnings for excess funds for the March 1998 decommissioning trust fund payment because that payment was made on a timely basis, in accordance with IRS regulations. By this time, the Company had already made retroactive payments to the IRS for its delayed 1997 deposits. Also, as noted above, it is inappropriate to impute earnings on excess funds for deposits related to the second sharing period (March 1997 and June 1997) as the issues associated with the second sharing period have been settled. Finally, Mr. Robertson's adjustment should be a rate base adjustment in the Final Earnings Report, as noted above.

Therefore, if one would accept the concept of Mr. Robertson's proposed adjustment under the terms of the Agreement (which, as stated previously, the Company does not), the adjustment should be a rate base adjustment in the Final Earnings Report. This adjustment would amount to an increase in the Company's earnings of approximately $31,000 in the Final Earnings Report. The schedule calculating this adjustment is presented in Mr. Weiss' rebuttal testimony as Schedule 5.

LOBBYING EXPENSES

Q. Please state your understanding of the OPC Staff's proposed adjustment in this area.

A. OPC Staff witness Robertson believes that the Company has not excluded all of its lobbying expenses from the Company's Final Earnings Report during the third sharing period in accordance with the terms of the Agreement. Due to the fact that responses to certain data requests were still pending at the time Mr. Robertson prepared his direct testimony, Mr. Robertson recommended that all expenses associated with four work orders (AO387 and AO393 – Legislative and Lobbying Activities for UE and CIPS, respectively and AO386 and AO392 – Regulatory Legal Work for AmerenUE and Regulatory Legal Work for AmerenUE and AmerenCIPS) be excluded entirely from the Company's Final Earnings Report. Upon further investigation, the Company agrees in part with Mr. Robertson's proposed adjustment in this area. In particular, the Company agrees that certain labor costs reflected in work orders AO387 and AO393 should have been considered lobbying activities and excluded from the Company's Final Earnings Report. These costs total approximately $50,000. However, all costs reflected in AO386 and AO392 relate to legal work performed in the ordinary course of business for UE and/or CIPS and do not relate to lobbying activities at all. Those expenses related to UE are appropriately included in the Company's Final Earnings Report. Mr. Weiss has provided the supporting documentation for this matter in Schedule 4.

Q. You have previously stated that proposed adjustments were inappropriate under the terms of the Agreement. Why is this proposed adjustment not also inappropriate?

A. As stated by Mr. Brandt, the Staff and OPC Staff have an important role in monitoring the Company's compliance with the Agreement to be sure we accurately followed our established accounting practices and the specific adjustments set out in the Reconciliation Procedure. Obviously, if an error is discovered by the Staff or OPC Staff, and verified by the Company, it is appropriate under the terms of the Agreement to make the correction.

PLANT HELD FOR FUTURE USE

Q. Please state your understanding of the OPC Staff's proposed adjustment in this area.

A. OPC Staff witness Robertson proposes that the Company exclude property taxes associated with Plant Held for Future Use from the Company's Final Earnings Report for the third sharing period. Mr. Robertson's adjustment amounts to approximately $62,000. The Company agrees with Mr. Robertson's proposed adjustment in this area.

Q. You have previously stated that proposed adjustments were inappropriate under the terms of the Agreement. Why is this proposed adjustment not also inappropriate?

A. As stated by Mr. Brandt, the Staff and OPC Staff have an important role in monitoring the Company's compliance with the Agreement to be sure we accurately followed our established accounting practices and the specific adjustments set out in the Reconciliation Procedure. Obviously, if an error is discovered by the Staff or OPC Staff, and verified by the Company, it is appropriate under the terms of the Agreement to make the correction.

INCOME TAXES

Q. Please state your understanding of the Staff's proposed adjustment in this area.

A. In his direct testimony, Staff witness Rackers discusses several issues associated with income taxes. Many of these issues are rather complex and need further explanation from the Staff, as well as supporting workpapers. As stated previously, the Company has submitted a data request asking for supporting workpapers behind Mr. Rackers' proposed adjustments, but has not yet received a response at this time. As a result, the Company may need to file supplemental rebuttal testimony upon receipt of this information.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.