Exhibit No.:	
Issue:	**Alternative Regulation Plan Agreements and Weather Issues**
Witness:	**Donald E. Brandt**
Type of Exhibit:	**Rebuttal Testimony**
Sponsoring Party:	**Union Electric Company**
Case Nos:	**EO-96-14 & EM-96-149**

MISSOURI PUBLIC SERVICE COMMISSION

Case No. EO-96-14
Case No. EM-96-149

FILED
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Missouri Public
Service Commission

REBUTTAL TESTIMONY

OF

DONALD E. BRANDT

ST. LOUIS, MISSOURI
April, 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 DONALD E. BRANDT

STATE OF MISSOURI)
) SS.
CITY OF ST. LOUIS)

Donald E. Brandt, being first duly sworn on his oath, states:

1. My name is Donald E. Brandt. I work in the City of St. Louis, Missouri, and I am the Senior Vice President, Finance of Ameren Corporation and Senior Vice President, Finance and Corporate Services for Union Electric Company.

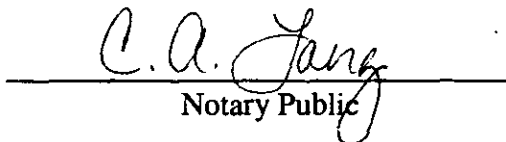
2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony consisting of pages 1 through 41, with Appendices A and B, all of which testimony has been prepared in written form for introduction into evidence in Missouri Public Service Commission Case Nos. EO-96-14 and EM-96-149 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.

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



Notary Public

1
2 **REBUTTAL TESTIMONY OF**
3
4 **DONALD E. BRANDT**
5
6 **1. Background**
7
8 **Q. Please state your name and address.**

9 A. My name is Donald E. Brandt and my business address is One Ameren Plaza,
10 1901 Chouteau Avenue, St. Louis, Missouri 63103.

11 **Q. What is your position with Ameren Corporation and Union Electric**
12 **Company ("Union Electric", "UE" or "Company")?**

13 A. My title at Ameren is Senior Vice President, Finance. My title at Union
14 Electric is Senior Vice President, Finance and Corporate Services. In these positions, I serve
15 as Ameren's and Union Electric's Chief Financial Officer, having responsibility for all
16 financial aspects of the companies. The Controller's, Treasurer's, Engineering &
17 Construction, and General Counsel's Functions are under my direction and supervision, as
18 well as the Tax and Internal Audit Departments.

19 **Q. Please describe your educational, professional and business experience.**

20 A. I received a Bachelor of Science Degree in Business Administration from St.
21 Louis University in 1975. In May 1975, I joined the independent public accounting firm,
22 Price Waterhouse (now PricewaterhouseCoopers LLP). While with Price Waterhouse I
23 specialized in the utility industry. I served on the Union Electric engagement in each of my
24 years with Price Waterhouse. I also served in a management capacity on a wide variety of
25 auditing, accounting and consulting engagements with other Price Waterhouse utility clients.

26 I joined Union Electric Company in May 1983 and assumed the Controller's position
27 effective July 1983. In this position, I served as the Company's Chief Accounting Officer

1 with responsibility for General and Property Accounting, Budgeting and Internal Audit. I
2 was elected Vice President of the Company in April 1985 and promoted to Senior Vice
3 President - Finance and Accounting 1988. It was at this time in 1988 that I first became
4 UE's Chief Financial Officer. I assumed my current position at UE on July 1, 1993 and my
5 current position with Ameren on December 31, 1997. In this position, among other duties, I
6 have primary responsibility for rate and regulatory matters.

7 I am a certified public accountant and a member of the Missouri Society of Certified
8 Public Accountants and the American Institute of Certified Public Accountants.
9 Additionally, I am a member of the Financial Executives Institute and have previously served
10 on the Accounting Management Committee of the Edison Electric Institute.

11 **2. Purpose of Testimony**

12 **Q. Mr. Brandt, why are you testifying before the Commission in this matter?**

13 A. The purpose of my testimony is to bring to the Commission's attention that
14 the Missouri Public Service Commission staff (the "Staff') and the Staff of the Office of
15 Public Counsel (the "OPC Staff") has taken certain positions on the Company's Final
16 Earnings Report for the third sharing period of the first experimental alternative rate plan
17 ("EARP") which are totally unacceptable and run counter to the contractual commitments
18 made under the Stipulation and Agreement made in 1995 and adopted by the Commission
19 that established the first EARP. Those positions similarly repudiate the nearly identical
20 contractual commitments made in the second EARP adopted in 1997. UE relied not only on
21 those commitments in entering into the first Stipulation and Agreement, but relied on the
22 anticipated faithful performance of those commitments in agreeing to enter into the second
23 EARP. (Since both the first and second Stipulation and Agreement are for most relevant

1 matters identical, I will refer to them collectively, unless otherwise necessary for clarity, as
2 "the Agreement.") In my testimony, I intend to make clear what these commitments are, as
3 well as refresh the memories of all parties to this Agreement as to the appropriate standards
4 by which the EARP was intended to operate.

5 All the parties should be clear about the consequences of the Staff's and OPC Staff's
6 positions in this proceeding: If those positions are embraced by the Commission, and the
7 adjustments proposed by the Staff and the OPC Staff to the Company's earnings calculations
8 are ordered by the Commission, those actions of the Commission would constitute a breach
9 of contract and impair the contractual obligations established by the Agreement; they would
10 effect an uncompensated taking of the Company's property rights; and they would deny the
11 Company's right to due process of law. At the very least, such actions now by the
12 Commission would repudiate the representations of the Commission upon which the
13 Company reasonably relied and destroy the investment-backed expectations of the Company
14 created by those representations.

15 In many respects, it is outrageous that this case has to be heard at all. I negotiated the
16 Agreement that put in place the experimental alternative rate plan that the Commission
17 adopted. The EARP was a contract, produced after extensive negotiations, that created
18 benefits and obligations for Union Electric and the Commission. This contract put in place a
19 mechanism for establishing rates that was truly forward-looking from a regulatory
20 perspective and reflected elements of the competitive market. This contract promised
21 incentives for Union Electric to run its business more efficiently, established a new
22 arrangement for customers to share in UE's profitability, and lowered the costs of regulation
23 by reducing the need for extensive regulatory intervention and proceedings.

1 The benefits of this contract for our customers were immediate. In reliance on the
2 terms of this bargain, UE guaranteed customers $120 million in credits and rate reductions
3 over three years, in the form of an up-front $30 million credit along with a $30 million
4 permanent rate decrease, which effectively gave back to customers $30 million per year. In
5 addition, customers received $44 million in earnings sharing credits for the first year of the
6 EARP and $18 million for the second year. For the final year of the EARP, UE has
7 calculated the earnings sharing credit to which its customers are entitled to be $24 million.
8 In total, the EARP has produced $206 million of benefits for customers over the three-year
9 period. And, as the Commission itself recognized, these benefits were achieved as the result
10 of the bargain with UE, for "the Commission could not under current statutes order UE to
11 adopt a plan to share earnings with customers," Report and Order, Case No. ER-95-411 at 7
12 (July 21, 1995) ("1995 Order"), and these benefits were achieved "without the expense and
13 delay of evidentiary proceedings." Id. at 4.

14 Moreover, all this is not to even mention the full range of other financial and legal
15 sacrifices UE made in reliance on the terms of the Agreement. For example, as part of the
16 deal, UE surrendered the right to file a rate case except in the most extreme circumstances,
17 thereby accepting the considerable financial risk of having to absorb increases in such major
18 components of the Company's costs of doing business as labor costs, fuel costs, and interest
19 rates. Furthermore, at the outset of the second EARP that began on July 1, 1998, UE agreed
20 not to seek to recover in rates the $232 million merger premium from its merger with
21 CIPSCO. Similarly, in reliance on the EARP, UE abandoned its proposal that its
22 shareholders should realize, over a 10-year period, half of the nearly $760 million in benefits
23 resulting from that merger. And, of course, UE relied on the promise of profit sharing in the

1 EARP to commit its best people and other resources to its regulated power business to create
2 the efficiencies that would in turn produce those profits it could realize under the EARP (and
3 the credits that would be shared with its customers). In the absence of the EARP, the
4 Company would have not shortchanged its core power business; rather, UE would have had
5 to turn to other unregulated lines of business to generate a comparable level of profits for its
6 shareholders. Such opportunities were simply not pursued in reliance on the EARP.

7 Because of my involvement in negotiating this contract, I am terribly disappointed by
8 the fact that -- months after $24 million of credits should have been paid to customers -- we
9 are debating matters that the Agreement conclusively resolved. I know what the Agreement
10 was designed to achieve: a mechanism in which earnings are calculated by objective and
11 well-understood accounting methodologies in order to provide for the efficient sharing of
12 those earnings with customers.

13 In negotiating this Agreement, I believed the parties were dealing in good faith. I
14 thought that the Agreement we negotiated would be good for consumers and for Union
15 Electric. I believed then, and I believe now, that this Agreement, if all parties honor their
16 obligations under it, offers a new, efficient regulatory plan that benefits both UE and its
17 customers.

18 Union Electric has faithfully abided by this Agreement. The Staff and the OPC Staff,
19 however, now have taken positions that completely repudiate their commitments under the
20 Agreement. We will not stand by and allow the Staff to undermine the achievement of this
21 Agreement and thereby cheat our customers and shareholders of the promise of our efforts.
22 The Staff's position, if adopted by the Commission, breaches a contract, abrogates
23 representations on which Union Electric reasonably relied, and deprives customers of the

1 benefits of this incentive-based regulatory plan. The Commission and Union Electric should
2 not let this happen.

3 In this testimony, I will remind the Commission of what was achieved when this
4 bargain was hammered out and adopted by the Commission in 1995. In so-remembering, I
5 think it will be clear to all how the Staff's position here not only breaks with the process
6 established by that bargain, but also is fundamentally at odds with the vision of future
7 ratemaking shared just four years ago by the then-Staff, the OPC, Union Electric, and several
8 other parties, and then embraced by this Commission. (A copy of each Commission Report
9 and Order, along with the attached Stipulations and Agreements, for each EARP, Case Nos.
10 ER-95-411 and EM-96-149, are appended to this testimony as Appendix A and B,
11 respectively.)

12 Four years ago, the parties put this vision in writing. They agreed to an experimental
13 alternative rate plan, according to which Union Electric would share earnings with customers
14 when it achieved specified levels of profitability. The success of this new plan depended
15 upon an up-front agreement as to how Union Electric would calculate its earnings, and
16 thereby how its profitability would be gauged.

17 The Company's established accounting practices and generally accepted accounting
18 principles ("GAAP"), as applied consistently for financial and regulatory purposes in its
19 books and records, provides the primary basis for calculating the Final Earnings Report.
20 That basis is subject to adjustments for certain items precisely spelled out in the Agreement.
21 Those adjustments are made according to specific accounting methodologies – again, listed
22 in writing in the Agreement -- that in some cases differ from the Company's established
23 accounting methodologies.

1 The Agreement also provides safeguards to ensure accurate calculation of earnings
2 through mechanisms that permit the parties to monitor UE's compliance and by allowing the
3 Commission to resolve issues resulting from a failure to comply with the accounting
4 methodolgoies set out in the Agreement, either inadvertently in the context of a simple error,
5 or deliberately in the context of a manipulation of earnings. In addition, the Agreement
6 allows the Commission to resolve any rare issues, unanticipated by the parties, that might
7 relate to new categories of costs which had never before been addressed in ratemaking
8 proceedings by the Commission.

9 This innovative plan was intended to be a machine that would go of itself, without the
10 need for intrusive regulatory oversight and time-consuming regulatory proceedings. This
11 Commission gave "careful consideration" to the plan and adopted it, using words that bear
12 emphasis today: "The Commission finds that a settlement of this magnitude is in the public
13 interest when it allows for a reduction of rates . . . and does so without the expense and delay
14 of evidentiary proceedings." 1995 Order at 4.

15 **3. Ratemaking Proceedings Prior to the 1995 Agreement**

16 **Q. Would you briefly describe the regulatory context that preceded the**
17 **development of the EARP?**

18 A. For over a decade prior to the Agreement, the Company, Staff, OPC and
19 others had been engaged in rate proceedings almost continually. Electric rate cases were
20 filed and litigated in 1981, 1982 and 1983. In 1984 and 1985, those same parties expended
21 even greater efforts litigating the rate case that reflected the addition of the Callaway Nuclear
22 Power Plant to the Company's rate base. During that same period, the Company was

1 simultaneously involved in similar rate cases in Illinois, Iowa, and at the Federal Energy
2 Regulatory Commission.

3 Following the Callaway case, in early 1987, the Staff and the OPC filed rate
4 complaint cases against the Company. Those cases took up almost all of that year, before a
5 settlement was reached in December. Then, in 1990 and 1993, additional complaint cases
6 were pursued by the Staff, each resulting in months of time and effort in negotiations and in
7 preparation for litigation.

8 The last matter resulted in a rate moratorium, which finally allowed for a period of
9 stability in rates, as well as relief from the almost constant regulatory proceedings that the
10 Company and the Staff had been experiencing for more than ten years.

11 **4. The 1995 Agreement**

12 **Q. Please describe the origins of the 1995 Agreement.**

13 A. The Agreement was the result of many months of labor on the part of Union
14 Electric, the Staff, and other interested parties. That contract reflected the considered
15 judgment of some of UE's most senior management, including myself, and of the Staff's
16 senior management and most experienced personnel. The parties understood that the
17 Agreement committed them to a new and, it was thought and I still believe, better method of
18 regulation.

19 As the Commission is aware, a rate moratorium was in place through September
20 1994. During the summer of 1994, the Staff and Union Electric began discussing an
21 appropriate regulatory strategy after the conclusion of the moratorium. By late 1994, the
22 Staff and UE were discussing the possible introduction of incentive rate regulation. In
23 January 1995, the Company submitted a proposal to the Staff, which responded, within

1 weeks, with a counter-proposal. By March 1995, the two parties had effectively hammered
2 out a deal. The Agreement that was the result of their collective labors was shared with
3 interested parties including the Office of Public Counsel and large industrial consumers. In
4 the course of the next three months, some minor changes were made; and in June, the Staff,
5 OPC, the Company and three other parties submitted an Agreement to the Commission for its
6 consideration.

7 **Q. Who negotiated the Agreement?**

8 A. I represented UE in the negotiations. The Staff was represented by David
9 Rauch, Executive Secretary; Ken Rademan, Director, Utility Operations; Jay Moore,
10 Manager, Financial Analysis Department; and Sam Goldammer, Director, Utility Services.
11 Messrs. Rademan, Moore, and Goldammer are no longer employed with the Staff.

12 **Q. You stated earlier that the Agreement introduced incentive rate**
13 **regulation. Please describe, broadly, how such regulation works.**

14 A. It's a form of regulation in which customers get rebates, or "credits,"
15 depending on how profitable a utility is in any given year. Basically, customer sharing is
16 linked to a utility's regulatory return on equity ("ROE"). Thus, when a utility does well, so
17 too do its customers.

18 **Q. Have other states implemented alternative rate regulation?**

19 A. Yes, many states have. For example, New York, Connecticut, Florida and
20 Illinois have all introduced incentive rate plans in recent years that could result in substantial
21 customer profit sharing.

22 **Q. Please describe how this bargain establishing incentive regulation worked**
23 **under the 1995 Agreement.**

1 A. The plan called for UE to begin customer sharing when its ROE reached the
2 level of 12.61%. When the ROE was between 12.61% and 14%, the Company and
3 customers shared these earnings 50/50. When the ROE rose above 14%, customers received
4 all of those earnings. If the Company's ROE dipped below 10% then, and only then, could
5 UE petition the Commission for a rate increase. However, from a practical standpoint, given
6 the time period to adjudicate a rate case, any concrete rate relief would not be achieved for 18
7 to 24 months.

8 **Q. Did the Commission comment on the reasonableness of these numbers?**

9 A. Yes, it did. The Commission stated that "based on its experience in recent
10 rate cases, the parameters established appear reasonable." 1995 Order at 5. The Commission
11 noted that "[t]he 12.61 per cent trigger for sharing should allow UE sufficient incentive to
12 manage its operation in an efficient manner." Id.

13 **Q. What were understood to be the goals of the Agreement?**

14 A. First, the EARP supplied Union Electric with an incentive to operate more
15 efficiently, for it now had the prospect of retaining a portion of the profits such efficiencies
16 might generate. Senior management of UE also planned to use the EARP to rally the
17 Company's employees to become even more efficient. We believed that employees would
18 be incented to act like entrepreneurs, and thus produce additional benefits for both customers
19 and shareholders.

20 Second, and flowing from the first point, customers were intended to benefit from this
21 Agreement immediately and in the future. The EARP provided for an up-front $30 million
22 customer credit, along with an additional $30 million permanent rate decrease. In addition,
23 to the extent that UE made itself into a more efficient company, customers would annually

1 share in that profitability through quickly delivered credits, based on the ROE levels
2 discussed above.

3 Third, the EARP was designed to reduce the cost of regulation, and improve its
4 efficiency and effectiveness, thereby benefiting all of the parties. This was to be
5 accomplished through the up-front agreement as to how Union Electric's earnings would be
6 calculated by clearly setting forth the appropriate accounting methodologies to calculate such
7 earnings, while providing for appropriate safeguards through the monitoring mechanisms.
8 Because Union Electric would need to devote fewer resources to regulatory issues, it could
9 pass through these savings to its customers and its shareholders. Further, senior management
10 could focus its attention on making UE a more efficient and competitive energy provider,
11 rather than devoting attention to managing time-consuming regulatory proceedings.

12 **Q. Was your assessment shared by the Commission?**

13 A. Yes. In adopting the 1995 Agreement, the Commission stated: "The
14 Commission finds . . . that the [Agreement] is in the public interest and meets the public
15 interest through several of its features. First, of course, is the establishment of just and
16 reasonable rates for UE's customers. The second is the establishment of the alternative
17 regulation plan which allows UE to retain its increased earnings to a certain level. Included
18 in the alternative regulation plan is the moratorium, which will provide stability for UE's
19 rates for three years. This plan should allow UE to remain a strong company." 1995 Order
20 at 6.

21 **<u>5. The Keys to Success</u>**

22 **Q. In your view, what was necessary for the success of the EARP?**

1 A. Two conditions have to be met for the successful implementation of this form
2 of incentive rate regulation. First, there must be an up-front agreement as to the accounting
3 methods to be employed in calculating earnings that is not subject to subsequent dispute or
4 change in regulatory proceedings. Second, all parties must be confident that those
5 accounting methodologies are being followed in practice, and so the application of those
6 methodologies must be open to scrutiny to demonstrate faithful compliance.

7 **Q. Why is the first condition – up-front agreement as to accounting methods**
8 **-- so important?**

9 A. As mentioned above, one of the principal goals of incentive rate regulation is
10 that it obviates the need for costly ratemaking proceedings and subsequent disputes.
11 Moreover, a settled accounting methodology for calculating earnings, on which new
12 efficiencies in the Company's operations have a direct, measurable, and objective effect, is
13 critical to creating and maintaining the incentive to work hard to achieve those efficiencies in
14 the first place, and with those efficiencies the profitability in which the Company's customers
15 share. With settled accounting methodologies, and not subsequent regulatory proceedings,
16 governing the calculation of earnings, the Company's employees can be confident that the
17 real efficiencies they achieve will have a direct impact on earnings, and that the fruits of their
18 labors will not be subject to later reduction because a regulatory body, pursuant to some
19 model not truly reflecting the incentives at work here, concluded those earnings were "too
20 high".

21 Both sides must therefore agree up-front to appropriate accounting methods. And
22 they must further commit themselves to behaving honorably in the application of those
23 methods. On the one hand, the Company must operate in a straightforward manner,

1 consistently applying the correct accounting treatment even if that means, in a given year,
2 that it is required to distribute substantial customer credits. On the other hand, the Staff and
3 other interested parties cannot challenge an accounting treatment for costs that they had
4 already contractually committed themselves to accept, even if that might mean, in a given
5 year, an increase in appropriately recorded costs will decrease customer sharing.

6 **Q. Why is the second condition – relating to monitoring mechanisms -- so**
7 **important?**

8 A. Interested parties must be able to monitor the utility's performance to confirm
9 that levels of profitability are in fact as the utility reports them to be.

10 **Q. Did the 1995 Agreement include provisions ensuring that these two**
11 **conditions – up-front agreement as to accounting methods and monitoring mechanisms**
12 **– would be satisfied?**

13 A. Yes. The parties spent considerable time negotiating clear and unambiguous
14 language to address precisely these two conditions.

15 **6. Calculating Earnings**

16 **Q. Let's begin with the up-front agreement as to accounting methods. Did**
17 **the 1995 Agreement address this point?**

18 A. Yes. Section 3.f.i. of the Agreement provides as follows: "The return on
19 common equity for determination of 'sharing' will be calculated by using the methodology
20 set out in Attachment C, Reconciliation Procedure, attached hereto." Section 3.f.ii provides:
21 "Staff, OPC and UE have conferred and determined what items, based on prior Commission
22 Orders, should be excluded from the calculation of UE's return on equity. These items are
23 identified in Attachment C." Looking at the Reconciliation Procedure set out in Attachment

1 C, you can see that the agreed accounting methodologies to be used to calculate the earnings
2 report under the EARP have been clearly set out by the parties as stated in Section 3.f.ii.
3 The calculation begins, as set out in Section 2(a) of the Reconciliation Procedure,
4 with the Company's Missouri revenues, expenses, and rate base, as recorded in its books and
5 records in accordance with the Company's established accounting practices and GAAP. The
6 remaining provisions of Section 2 set out various adjustments that all the parties agreed
7 should be made to the revenues, expenses and rate base for purposes of calculating the
8 earning reports to be used in the operation of the EARP. Indeed, even the Staff agrees with
9 this understanding of the Reconciliation Procedure. *See* Rackers Direct Testimony (p. 2,
10 lines 20-22) ("The achieved equity return is based on the average capital structure, the
11 average rate base and the booked earnings, as adjusted, during the particular one year sharing
12 period.").
13 The number and type of those adjustments reflects the careful work and extended
14 negotiations that went into establishing an agreed body of accounting methodologies to
15 govern the EARP. These adjustments also reflect the fact that the Commission does not have
16 to follow GAAP. As a result, the parties explicitly set out the specific accounting
17 adjustments, which in some cases diverge from the Company's established GAAP-based
18 accounting methodologies used in preparing the Company's books and records, that are a
19 part of this bargain governing the operation of the EARP. As evidence of the close attention
20 all the negotiators paid to this point, these agreed upon adjustments are not limited to "big-
21 ticket" items, but often involve relatively small, detailed adjustments. When the
22 Reconciliation Procedure does not set out one of these unique adjustments, the calculations
23 for the earning reports, obviously, are done according to the established accounting practices

1 and GAAP used in the Company's financial and regulatory books and records, which are,
2 after all, where those calculations for the earnings reports begin in the first place.

3 **Q. How is this Reconciliation Procedure different from normal ratemaking?**

4 A. The Reconciliation Procedure is vastly more efficient than normal ratemaking
5 because under the Reconciliation Procedure there is no need to focus on each of the
6 multitude of costs that affect the earnings of the Company. The Company's established
7 accounting practices, as modified by the specific adjustments agreed to and set out in the
8 Reconciliation Procedure, are used to produce, almost mechanically, the earnings reports that
9 determine whether the Company's operations were sufficiently profitable that customers are
10 due a credit. Put another way, the focus of the Reconciliation Procedure is on the bottom
11 line: Did the Company achieve the cost-savings and earnings that will allow its customers to
12 share in its profitability?

13 **Q. What role does the Agreement contemplate for the Commission in the**
14 **calculation of earnings?**

15 A. As I explained earlier, the Commission's Staff has an important role in
16 monitoring the Company's compliance with the Agreement to be sure we accurately followed
17 our established accounting practices and the specific adjustments set out in the Reconciliation
18 Procedure, identifying whether there is a failure to follow that Procedure, either because of
19 an error or a manipulation of earnings by the Company, or identifying a new category of
20 costs not addressed in a previous ratemaking proceeding. If the Company has accurately and
21 consistently calculated its earnings under that body of accounting methodologies, there is
22 nothing further for the Staff or the Commission to do.

1 Remember, all the parties agreed to a body of accounting methodologies that would
2 not favor any particular result or any party's interests, but would allow the Company's
3 earnings to be calculated in a fair, objective, and almost automatic way. If those
4 methodologies are accurately and consistently applied in calculating earnings, the whole
5 point of the bargain is that no further subjective adjustments are to be made to those numbers
6 and extended litigation over such adjustments would be avoided.

7 Beyond ensuring that no errors are made in the calculation of earnings as I described,
8 the Agreement does have a precise mechanism to protect against deliberate violation of the
9 Agreement. At the outset, let me emphasize that we have no intention to violate, or in any
10 way to fail to live up to our obligations under the Agreement, and we have fully complied
11 with the Agreement. But the Agreement does allow the Staff to go to the Commission if the
12 Company were "cooking the books."

13 **Q. How does the Agreement allow the Staff to address a problem of**
14 **"cooking the books"?**

15 A. The word the Agreement uses for "cooking the books" is "manipulation".
16 Section 3.f.vi of the Agreement reflects the gravity of the wrongdoing implied in the term
17 "manipulation":

18 If Staff, OPC or other signatories find evidence that operating results have
19 been manipulated to reduce amounts to be shared with customers or to
20 misrepresent actual earnings or expenses, Staff, OPC or other signatories may
21 file a complaint with the Commission requesting that a full investigation and
22 hearing be conducted regarding said complaint. UE shall have the right to
23 respond to such request and present facts and argument as to why an
24 investigation is unwarranted.
25
26 So manipulation occurs when the operating results of the Company have been
27 changed *solely* to reduce the amount to be shared with customers or to *misrepresent* earnings

1 or expenses. Put another way, manipulation cannot occur if the operating results of the
2 Company are calculated according to the accounting methodologies that were adopted as part
3 of the Agreement to govern the preparation of earnings reports. Calculation of earnings
4 according to the agreed methodologies by definition does not misrepresent earnings or
5 expenses, and certainly does not reduce operating results solely to reduce the amounts to be
6 shared with customers. (After all, surely neither the Staff nor the Commission would have
7 agreed to accounting methodologies that misrepresent the facts or that serve only to reduce
8 the amounts that ultimately could be shared with customers.)

9 Section 3.f.vii. of the Agreement further illustrates how "manipulation" is designed to
10 address the kind of wrongdoing that I would call "cooking the books." That section
11 authorizes the parties to bring certain issues to the Commission for resolution. One such
12 issue is the "alleged manipulation of earnings results." The Agreement goes on to explain:
13 "An allegation of manipulation could include significant variations in the level of expenses
14 associated with any category of cost, *where no reasonable explanation has been provided.*"
15 (Emphasis added.)

16 **Q. Please explain the meaning and significance of the phrase, "where no**
17 **reasonable explanation has been provided."**

18 A. As I have previously testified, the Agreement contemplates that, from year to
19 year, there will be variations – possibly significant variations – in the expenses incurred by
20 the Company, and the consequent earnings it reports. Far from being evidence of
21 manipulation, such variations are expected. What the Agreement requires is not consistency
22 in reported earnings, but consistency in the application of the appropriate accounting
23 methodologies, as prescribed by the Reconciliation Procedure. Of course, from year to year,

1 the same accounting methods will generate varying earnings results. That is just the nature
2 of business. If a party to the Agreement questioned a significant variation in the Company's
3 cost, the Company could answer with the "reasonable explanation" that it had applied the
4 accounting methodologies prescribed by the Reconciliation Procedure, and further explain
5 the reason why the cost had risen or fallen in that year.

6 **Q. Besides instances of manipulation, what other issues can a party to the**
7 **Agreement bring to the Commission's attention concerning the calculation of UE's**
8 **earnings?**

9 A. Because the earnings calculations were designed to operate almost
10 mechanically, and not involve significant regulatory proceedings, the category of
11 "manipulation" largely describes how issues concerning those calculations can come before
12 the Commission. This is why, as I described earlier, we spent so much time negotiating these
13 provisions and why they are set out in such detail in the Reconciliation Procedure. However,
14 Section 3.f.viii. does provide a kind of fail-safe provision for unpredictable items the parties
15 could not have thought of. Thus, that Section provides that the parties can present to the
16 Commission issues relating to categories of costs which had never before been addressed in a
17 ratemaking proceeding. This was intended as a fail-safe provision, designed and envisioned
18 to have a very narrow scope. The provision was included in the Agreement to protect all of
19 the parties by covering the extremely limited category of costs, if any, that might occur for
20 the first time during the operation of the EARP, but were not, and could not be, foreseen by
21 the parties when they were negotiating the Agreement.

22 **Q. Both Section 3.f.vii of the Agreement and Section 2.g of the Reconciliation**
23 **Procedure provide that the parties can bring to the Commission issues "which are**

1 **related to the operation or implementation of the Plan." How did the parties expect**
2 **this mechanism to operate?**

3 A. It is really quite simple. Section 3.f.vii of the Agreement and Section 2(g) of
4 the Reconciliation Procedure are nearly identical and mean the same thing.

5 Section 3.f.vii provides:

6 UE, Staff, OPC and other signatories reserve the right to bring issues which
7 cannot be resolved by them, and which are related to the operation or
8 implementation of the Plan, to the Commission for resolution.
9

10 This section goes on to give examples.

11 Section 2(g) of the Reconciliation Procedure, for its part, provides:

12 UE/Staff/OPC reserve the right to petition the Commission for resolution of
13 disputed issues relating to the operation or implementation of this Plan.
14

15 What Sections 3.f.vii and 2(g) recognize for Commission resolution are disputes
16 concerning compliance with the terms of the Agreement, or, in the words of those provisions,
17 issues relating to the "operation or implementation" of the EARP. There are a variety of
18 obligations set out in the Agreement that are part of its operation or implementation, ranging
19 from submitting reports to calculating annual earnings. If the Company failed to comply
20 with the requirements of the Agreement concerning a particular activity, a party has the right
21 to bring the issue to the attention of the Commission for resolution because it addresses the
22 "operation or implementation" of the EARP with respect to that activity. Clearly, neither
23 Sections 3.f.vii or 2(g) themselves describe the operation or implementation of the EARP
24 with respect to any particular activity. To learn what the EARP provides concerning its
25 operation or implementation with respect to a particular activity, one must obviously look at
26 the specific terms of the Agreement governing that activity.

1 The provisions governing the operation or implementation of the earnings
2 calculations are of two types: (1) provisions setting out how the calculations are to be done;
3 and (2) procedural provisions governing what kind of dispute over those calculations can be
4 brought to the Commission for its resolution. The Reconciliation Procedure embodies the
5 first type of provision and sets out the accounting methodologies to be followed in
6 calculating earnings. The second type, the procedural provisions, start in the Reconciliation
7 Procedure itself, for a party can claim that UE failed to correctly apply the Reconciliation
8 Procedure and bring that dispute to the Commission. *See* Section 2(g). In addition, a claim
9 that "operating results have been manipulated" may be the basis of a complaint to the
10 Commission. *See* Section 3.f.vi. Finally, if a dispute arises from a new category of costs,
11 that too can be brought to the Commission. *See* Section 3.f.viii.

12 Thus, neither Section 3.f.vii of the Agreement nor Section 2(g) of the Reconciliation
13 Procedure provide the Staff or any other party with discretion to question items reflected in
14 the Final Earnings Report if the accounting methodologies set forth in the Agreement have
15 been faithfully applied.

16 In short, these provisions are an enforcement mechanism for the terms of the
17 Agreement, not *carte blanche* to change those terms. This point is made perfectly clear by
18 the examples we put into Section 3.f.vii of the Agreement: "disagreements as to the
19 mechanics of calculating the monitoring report, alleged violations of the Stipulation and
20 Agreement, alleged manipulations of earnings results, or requests for information not
21 previously maintained by UE."

22 Apparently the Staff believes these provisions allow them to reopen and change the
23 terms of the Agreement governing earnings calculations by advocating accounting

1 methodologies not agreed to by the parties, or specific adjustments that are not part of the
2 agreed methodologies. Neither the Staff nor the Commission is free to impose new
3 accounting methodologies on the operation of this contract, regardless of what the Staff
4 might feel are the merits of those methodologies independent of this contract. Clearly, their
5 position is not faithful to what Sections 3.f.vii and 2(g) actually say. Indeed, if these
6 provisions give them the power to retroactively reopen and change the accounting
7 methodologies we all agreed to, or make adjustments that depart from those methodologies,
8 why would we have agreed to the EARP in the first place? Under the Staff's reading, no
9 party could ever be sure what it was we all agreed to.

10 **Q. Has UE manipulated its earnings or any other financial information?**

11 A. Absolutely not. I am the Chief Financial Officer of Ameren Corporation and
12 Union Electric Company, and I want my answer to be completely clear. I would not tolerate
13 any manipulation of numbers. I know for a fact that none of senior management would
14 tolerate manipulation of numbers. I know for a fact that none of the Board of Directors
15 would tolerate manipulation of numbers. In fact, notwithstanding the Staff's offensive
16 insinuations in its original filings, as the Commission now has ruled, no accusation of
17 manipulation is before the Commission in this case.

18 **7. Monitoring of the Plan**

19 **Q. Let's now consider the monitoring issue. How did the Agreement provide**
20 **a mechanism to ensure that all of the parties could confirm for themselves UE's**
21 **compliance with the Agreement?**

1 A. Under Section 3.e. of the 1995 Agreement, and Section 7.e of the 1997
2 Agreement, the parties agreed that monitoring of the Agreement would be based on UE
3 supplying the Staff and OPC, on a timely basis, the following reports and data.

4 i. Annual operating and construction budgets and any updates/revisions
5 with explanations/reasons for updates revisions;
6
7 ii. Monthly operating budgets and any updates/revisions with
8 explanations/reasons for updates/revisions;
9
10 iii. Annually – explanation of significant variations between budgets and
11 actual;
12
13 iv. Monthly Financial & Statistical (F&S) reports;
14
15 v. Directors reports;
16
17 vi. Current chart of accounts (revised/updated in 1994 when new general
18 ledger system installed – 29 digit numbers adopted);
19
20 vii. Monthly surveillance reports;
21
22 viii. Quarterly reports/studies of rate of return on rate basis including
23 supporting workpapers;
24
25 ix. Annual summary of major accruals.
26
27 As it is required to do under Section 3.e., UE has made dozens of documents available for
28 inspection each year. It is worth noting, furthermore, that Section 3.e. provides that *all* of the
29 parties may view these records.

30 **Q. Please describe the purpose of Section 3e.**

31 A. This Section is designed to give assurance to all of the parties that UE is
32 acting in accordance with the Agreement. The parties were thus able to verify that the
33 accounting methodologies for revenues, expenses, and rate base were appropriate, that the
34 Company applied those methodologies properly to calculate earnings (that is, it did not
35 engage in any manipulation of earnings), and that there was no new category of costs not

1 previously reviewed by the Staff. In addition, the parties of course were able to point out any
2 purely mechanical or other errors in the filings with the Commission.

3 **Q. Can the Parties request that UE produce even more documents than the**
4 **voluminous amount explicitly called for in Section 3.e.?**

5 A. Yes. Section 3e authorizes the other parties to "follow up with data requests,
6 meetings and interviews, as required, to which UE will respond on a timely basis."

7 **Q. Has Union Electric complied with the demands of Section 3.e.?**

8 A. Yes, it has.

9 **<u>8. The Staff's Initial Accusation of Manipulation</u>**

10 **Q: Mr. Brandt, please describe the origins of this case.**

11 A: On October 14, 1998, in accordance with Section 3.f.x. of the Agreement,
12 Union Electric filed its Final Earnings Report for the Third Sharing Period of the EARP (July
13 1, 1997 – June 30, 1998). Section 3.f.x. required the Staff and the other parties to the
14 Agreement to file any comments to the Earnings Report in thirty days, or November 13,
15 1998. Three days before that deadline, on November 10, representatives from the Company
16 met with members of the Staff and Public Counsel. At that meeting, the Staff claimed -- for
17 the first time -- that it was free to challenge any variation in the level of expenses associated
18 with a category of costs. The Staff alleged that any such variation constituted
19 "manipulation," as the word is used in the Agreement, and that therefore *any* variation,
20 regardless of the reason, was subject to Staff challenge and Commission review. In other
21 words, the Staff argued that "manipulation" did not suggest any intentional wrongdoing on
22 the Company's part, but rather was any significant fluctuation in costs and earnings, even
23 when the methodology set out in the Agreement was faithfully applied. In the Staff's view,

1 then, the 1995 Agreement authorized them to challenge any accounting treatment applied by
2 the Company that results in such variations, even if that treatment is consistent with the
3 Company's established past accounting practices and GAAP. Needless to say, the Company
4 did not acquiesce in this torturing of the plain meaning and obvious intent of the Agreement.
5 On November 13, 1999, the Staff filed a motion for an extension of time until
6 November 24, to allow it to file its belated comments on the Company's Final Earnings
7 Report. (As we shall see, the Staff's compliance with elementary Commission rules has been
8 less than exact throughout this case.) Six days later, on November 16, 1999, in a conference
9 call among the Staff, the OPC, and the Company, in which I personally participated, the Staff
10 once again advanced its strained reading of "manipulation" and once again the Company
11 declined to submit to the Staff's attempt to re-write the Agreement in the guise of
12 interpreting it. In fact, I expressed my outrage at the twisted and contorted way in which the
13 Staff was trying to redefine the Agreement.

14 **Q. Please explain why you disagreed with Staff's interpretation of the 1995**
15 **Agreement.**

16 A. The Staff's reading of "manipulation" was at odds with (1) the 1995
17 Agreement; and (2) the common sense.

18 **Q. How did the Staff's proposed reading of manipulation conflict with the**
19 **1995 Agreement?**

20 A. The Staff's interpretation of "manipulation" – cleansing it of any nefarious
21 intent – was at odds with the letter, spirit, and goals of the 1995 Agreement. An accountant's
22 understanding, as I have described it, became the basis of the bargain that we struck. You
23 can see that understanding in the specific language of Section 3.f.vi. and vii, which likens

1 manipulation to instances in which the Company "misrepresent[s] actual earnings" or is
2 unable to offer a "reasonable explanation" for a "significant variation" in costs. Clearly,
3 then, the language of the Agreement forecloses the value-neutral reading of "manipulation"
4 proposed by the Staff.

5 The spirit and the structure of the EARP as it was ultimately agreed to is one of up-
6 front agreement as to the appropriate accounting methodologies to be applied, not agreement
7 as to any particular earnings results. Indeed, the parties understood and accepted that
8 earnings results would fluctuate from year to year, although the accounting methodologies
9 used to generate those results remained constant. The Staff now rejects this understanding
10 and contends that it can question any variation in costs, even where the Company's
11 accounting methodologies are unchanged.

12 Finally, one of the principal goals of the 1995 Agreement was to eliminate the endless
13 bickering that so needlessly engulfed the Staff, the OPC, and UE in prior regulatory
14 proceedings. The Staff's strained reading of "manipulation" means that each year they are
15 free to challenge a single cost because they feel it by itself is too high. In short, the Staff
16 wants to abandon the neutral accounting methodologies, not biased to favor the interests of
17 any party, that were the basis of the bargain here. Besides breaching a contract and
18 repudiating the representations on which UE relied, the Staff's position would return us to
19 the expensive and time-consuming ratemaking proceedings of old.

20 **Q. How did you respond to the Staff's attempt to re-write the Agreement**
21 **with its novel interpretation of the word "manipulation"?**

22 A. On November 23, 1998, we filed a "Request for Guidance" with the
23 Commission. In that filing, we stated:

1 The Staff has stated that it interprets "manipulation" as it is used in the
2 Stipulation, as any variation in the level of expenses associated with a
3 category of cost. It has been made clear to the Company that Staff believes
4 that no explanation can justify a variation in the level of expenses – that any
5 variation is "manipulation" and therefore subject to adjustment. Specifically,
6 Mr. Schallenberg, of the Staff, has stated that there is no requirement of
7 "intent" in determining the existence of "manipulation" and that Staff is free
8 to contest any category of cost."
9
10 Request for Commission Guidance, at 2.

11 **Q. How did the Staff respond to your Request for Guidance?**

12 A. On November 24, we expected to see the Staff's comments to our Final
13 Earnings Report. Instead, the Staff filed a motion for a (second) extension of time, this time
14 until the following day. On November 25, the Staff filed a "Motion For Setting An
15 Expedited Early Prehearing Conference." In that filing, the Staff simply stated "it ha[d] not
16 been able to resolve [certain] items with UE; therefore, the Staff is bringing these items to the
17 Commission for resolution." Motion at 3. The Staff gestured in the direction of a litany of
18 sections from the Agreement, but nowhere in this filing was there any argument as to how
19 these sections provided any basis for the sorts of adjustments the Staff was proposing.
20 Over a week later, on December 3, 1998, the Staff responded to our "Request for
21 Commission Guidance" relating to the meaning of the word manipulation. Remarkably, the
22 Staff persisted in its contorted reading of this word. It strung together the following
23 syllogism: One of the dictionary definitions of manipulation is artful, the Staff's foray
24 began; the Staff then noted that one of the dictionary definitions of artful is "to treat or
25 manage with the mind or intellect"; therefore, the Staff announced, manipulation means
26 simply to use one's intellect. *See* Staff Response at 3-5. Of course, *this would mean that*
27 *every time the Company filed an earnings report, which concededly demands the use of the*

1 *intellect, it was manipulating earnings.* We made this point in a reply brief filed on February
2 1, 1999.

3 In tacit recognition of the absurdity of this argument, the Staff's position edged in a
4 new direction. It now claimed that it was free to challenge any variation in expenses
5 associated with a category of costs regardless of whether the Company was "manipulating"
6 earnings.

7 **Q. Did the Commission note this change in the Staff's argument?**

8 A. Yes, it did. In an order issued March 18, 1999, the Commission reflected this
9 change by narrowing the dispute to exclude allegations of manipulation. Specifically, the
10 Commission stated: "While the Staff and Public Counsel have indicated a need for the
11 Commission to resolve disputes under Stipulation and Agreement 3.f.vii., no party has filed a
12 formal complaint. Therefore, the Commission finds that this issue of the definition of the
13 term 'manipulation' is moot and needs not be addressed further by the Commission." Order
14 at 5. Moreover, the Commission held that "[a]s the Staff and Public Counsel have come
15 forward with their objections to the earnings report filed by AmerenUE, Staff and Public
16 Counsel bear the burden of proving that their objections are valid and correct." *Id.* at 6.

17 **Q. How did the Staff's interpretation conflict with common sense?**

18 A. I am not a lawyer. My background is in accounting. But I approached the
19 negotiations on behalf of UE with what was important – an accountant's understanding of
20 something that is, after all, an accounting issue. When I hear someone say that a company is
21 "manipulating earnings," that means it's cooking the books. For example, if UE received a
22 letter from the Securities and Exchange Commission ("SEC') to the effect that the Company

1 was "manipulating earnings," that means trouble. That does not mean, as the Staff suggests,
2 that the SEC is admiring the "intellectual" way we prepared our financial statements.

3 **9. The New Allegations**

4 **Q: On February 23, 1999, the Staff and the OPC Staff filed testimony in this**
5 **case. Was this testimony filed pursuant to any Commission order?**

6 A: No, it was not. This testimony was unilaterally filed despite the fact that there
7 was no indication from the Commission as to the schedule for submitting testimony, or any
8 Commission guidance as to the appropriate scope of that testimony.

9 **Q: Have you reviewed that testimony?**

10 A: Yes I have.

11 **Q: Please give an overview of that testimony.**

12 A: To me, what is remarkable about that testimony is how little acknowledgment
13 there is that this dispute is governed by a contract that clearly identifies the rights and duties
14 of all the parties. The OPC Staff simply makes no effort to justify its proposed adjustments
15 under the terms of the Agreement. Each Staff witness, on the other hand, after identifying a
16 proposed adjustment, spends several pages suggesting why the adjustment is somehow
17 appropriate, and -- at the end, almost as an afterthought -- the witness cites a provision or two
18 from the Agreement. No explanation is typically offered as to why these sections support the
19 notion that their proposed adjustment is appropriate for Commission resolution under the
20 Agreement, much less support the substantive merits of the adjustment being proposed.

21 The order in which the Staff members organize their "arguments" is inadvertently
22 revealing. The *threshold* question in proposing an adjustment should be: Is this the sort of
23 adjustment that is permissible under the Agreement? Only after that *threshold* issue is

1 resolved can one turn to consider whether there is any basis in fact or law for the proposed
2 adjustment. The Staff flips this proper order -- and thereby makes manifest that it does not
3 appreciate the binding nature of the contract and the limits it imposes.

4 **Q: Let's begin with the testimony of Stephen M. Rackers. He purports to**
5 **give an "overview" of the Staff's Testimony. Does he?**

6 A: No, not at all. On the cover page of his testimony, Mr. Rackers states that he
7 is providing an "overview," and so his testimony seemed like the natural place to start in
8 reviewing the Staff testimony. On page 4, the question is posed, "What is the basis for the
9 adjustments made by the Staff . . . ?" In response, Mr. Rackers cites and quotes a
10 hodgepodge of provisions. Rackers at 4-5. He devotes, however, not a single word to
11 explaining what, in his opinion, these sundry provisions mean or how they supply any
12 support for the variety of adjustments the Staff is proposing.

13 **Q: Mr. Rackers also advances adjustments relating to territorial agreements**
14 **and income taxes. Is there any support for these adjustments?**

15 A: At the outset, let me say that Warner Baxter, the Vice President and Controller
16 of the Company, will be responding in detail to each of the adjustments proposed by the
17 Staff. He will demonstrate that the Staff's proposed adjustments are (1) not permissible
18 under the Agreement, and (2) even assuming they were permissible under the Agreement, the
19 adjustments are inappropriate.

20 A case in point is Mr. Racker's proposed adjustment relating to Territorial
21 Agreements. *After* a page cursorily explaining why the Staff is proposing to "reverse the
22 effect on earnings related to two territorial agreements," (p. 6, lines 3-4) Mr. Rackers
23 belatedly addresses the threshold question: "What section of the [Agreement] provides the

1 Staff's justification for making this adjustment . . . ?" (p. 7, lines 1-2) In his answer, Mr.
2 Rackers cites two provisions, Sections 3.f.vii.& viii. With regard to the former provision,
3 Mr. Racker's writes, "Section 3.f.vii. states that the Staff reserves the right to bring issues
4 which are related to the operation or implementation of the EARP to the Commission for
5 resolution." (p. 7, lines 9-10) This single sentence -- paraphrasing the first sentence of the
6 provision -- is the sum total of Mr. Racker's "argument" justifying an adjustment under
7 Section 3.f.vii. One of course hesitates to read too much into so compact an "argument," but
8 under Mr. Racker's reading there seems to be no limiting principle to the adjustments that
9 can be proposed by the Staff under this provision. After all, what conceivable adjustment
10 does not, in the Staff's view, relate to the "operation or implementation of the EARP"?

11 Such an interpretation completely misses the point of this provision, as I
12 demonstrated above. As I discussed, there are a variety of obligations set out in the
13 Agreement that are part of its operation or implementation -- for example, the filing of a
14 monitoring report (by the Staff) and the production of relevant earnings information and
15 earnings results (by the Company). *See* Section 3.f.vii. If a dispute arises over these
16 obligations, the parties can take the matter to the Commission for resolution. Thus, if Union
17 Electric were to depart from the specific adjustments set out in the Reconciliation Procedure,
18 a claim of manipulation of earnings could be brought to the Commission's attention under
19 this section. *See id.* However, it is absurd to claim that Section 3.f.vii. invested the Staff
20 with the unfettered discretion it now claims -- to challenge any cost at all, because it
21 somehow relates to the operation of the EARP. According to Mr. Rackers, I signed a
22 contract in which the Company gave up hundreds of million dollars and in return the
23 Company got precisely nothing. The Staff, according to Mr. Rackers, fails to acknowledge

1 that the Agreement chose a *particular* accounting methodology by which the parties agreed
2 to calculate earnings, and which limits the accounting disputes that the parties can bring to
3 the Commission. These provisions set out and govern "the operation or implementation of
4 the EARP" with respect to the calculation of earnings. Put another way, the "operation or
5 implementation of the EARP" with respect to earnings calculations is set out in the
6 accounting methodology in the Reconciliation Procedure and in the provisions defining the
7 disputes that may be heard by the Commission. Given this clear structure adopted by the
8 parties in the Agreement, it is, upon reflection, little wonder that Mr. Rackers does not
9 condescend to explain how Section 3.f.vii. lends any support to this adjustment.

10 With regard to Section 3.f.viii., Mr. Rackers states that, under this provision, the
11 parties "have the right to present to the Commission concerns over any category of cost that
12 has been included in UE's monitoring results and has not been included previously in any
13 ratemaking proceeding. *The Staff is not aware of a situation where earnings results were*
14 *adjusted to prevent detriment to ratepayers as a result of the affect [sic] of a territorial*
15 *agreement in a revenue requirement determination proceeding.*" (p. 7, lines 4-9, emphasis
16 added) Oddly, two sentences after suggesting that there has not been a "proceeding"
17 addressing these territorial agreements, Mr. Rackers acknowledges that the Commission has
18 issued orders specifically addressing the Black River and Macon Electric territorial
19 agreements. Of course, as Mr. Baxter points out, before the EARP, Union Electric entered
20 into other territorial agreements, and thus this is hardly the sort of unforeseeable *category* of
21 cost that Section 3.f.viii. was intended to cover. More specifically, the very territorial
22 agreements cited by Mr. Rackers have been the subject of Commission review, and therefore
23 Section 3.f.viii. emphatically has no application whatsoever.

1 Mr. Rackers labors to escape this obvious point by stating that in both the Black River
2 and Macon Electric dockets "the Staff reserved the right to examine the revenue effect of the
3 territorial agreements in the context of a future rate case or sharing credit calculation." What
4 Mr. Rackers means when he states that "the Staff reserved the right" to re-examine the issue
5 is a mystery. In any event, the significance of this alleged "reservation of right" is both
6 unexplained and inexplicable. No such "reservation" is included in the Agreement, or was in
7 any other way made a part of the contract here. A *unilateral* act by one party to a contract
8 does not thereby effect a change in the explicit terms in that contract. Section 3.f.viii.
9 provides that the parties to the Agreement "have the right to present to the Commission
10 concerns over any category of cost that has been included in UE's monitoring results and has
11 not been included previously in any ratemaking proceeding." There is no suggestion
12 whatsoever that a party can somehow "reserve a right" to challenge what has already been
13 the subject of a "ratemaking proceeding."

14 **Q. Do you have any comments on Mr. Racker's proposed adjustment**
15 **relating to income taxes?**

16 A. This is a complex issue, which Mr. Rackers succeeds only in making more
17 complicated. As Mr. Baxter explains in his testimony, we are waiting for additional
18 information from the Staff to make clear the basis and purported appropriateness of this
19 proposed adjustment.

20 **Q. Arlene Westerfield and Ted Robertson propose a number of adjustments**
21 **related to computer expenses. Do you agree with their proposed adjustments?**

22 A. No, I do not.

1 **Q. Please explain why the adjustment they propose relating to computer**
2 **software repair and maintenance is erroneous.**
3 A. Ms. Westerfield and Mr. Robertson both argue that the Company should have
4 capitalized, rather than expensed, the costs incurred to repair computer software to remove
5 problems associated with the "Year 2000." Mr. Robertson does not even attempt to justify
6 his support for this adjustment in terms of the Agreement. For her part, after spending two
7 pages attempting to justify such an adjustment, Ms. Westerfield concludes where she should
8 have begun -- by identifying, as a threshold matter, the provision in the Agreement that
9 permits the proposed adjustment. Her argument consists of quoting Section 3.f.viii. and the
10 following sentence: "Rate/credit issues related to Year 2000 costs have never been presented
11 to the Commission for recovery prior to this proceeding." (p. 4, lines 4-5)
12 To the extent that one can tease Ms. Westerfield's "argument" out of this single
13 sentence, she is wrong on many levels. First of all, computer maintenance repair costs have
14 been incurred at least for decades. And they have always been, as the Staff and Commission
15 well know, expensed as incurred. Therefore, in no way can this be considered a new
16 *category* of cost. Ms. Westerfield attempts to avoid this point by narrowing the issue to
17 computer maintenance costs incurred to address the Year 2000 problem. Of course, any cost
18 is "new" if one artificially narrows the frame of reference. Under the Staff's position, an
19 automobile dealership incurs a new category of cost each year it buys a line of cars from the
20 manufacturer. After all, the dealership never bought the *1999* line of cars before. It was
21 precisely to avoid such nonsense that the drafters of the Agreement provided that the parties
22 could raise with the Commission a new *category* of cost, not a new *cost.* "Year 2000" costs
23 are simply part of the category of costs incurred maintaining and repairing computer software

1 programs. Indeed, Mr. Baxter demonstrates that repairs undertaken as a result of the "Year
2 2000" problem are no different from ordinary computer software repairs. Not surprisingly,
3 then, the Emerging Issues Task Force formed by the Financial Accounting Standards Board,
4 has specifically stated that such "Year 2000" costs should be accorded the same accounting
5 treatment as other software repairs -- that is, they should be expensed as incurred.

6 **Q. In her testimony, Ms. Westerfield asserts that the "Year 2000" costs are**
7 **non-recurring. Should that matter under the Agreement?**

8 A. Not at all. Ms. Westerfield is unwittingly revealing her -- and the Staff's –
9 erroneous view that this case is no different from a standard ratemaking proceeding. Of
10 course, Mr. Baxter addresses this issue in some detail. In brief, though, in the usual
11 proceeding, the Staff can, of course, propose an adjustment to "normalize" expenses in the
12 event of a large and non-recurring cost. The Agreement, however, together with the
13 Reconciliation Procedure, specified that *certain* costs might be normalized; for other costs,
14 normalization was not agreed to, and is therefore foreclosed. As I described above, the
15 EARP clearly recognized that a given cost might fluctuate -- up or down -- from year to year.
16 As long as the Company complied with the accounting methodology set forth in the
17 Reconciliation Procedure, the parties contractually agreed that that was the end of the matter.

18 **Q. Please comment on Ms. Westerfield's and Mr. Robertson's proposed**
19 **adjustments for "other computer costs."**

20 A. Both Ms. Westerfield and Mr. Robertson claim that the costs incurred
21 installing three computer software programs should have been capitalized, rather than
22 expensed as incurred. Once again, Mr. Robertson provides no basis for his proposed
23 adjustment under the Agreement. Ms. Westerfield's argument, on the other hand, reveals a

1 failure to appreciate that this is not an ordinary ratemaking proceeding. She notes the
2 "significance" of the amount of the costs and the software programs' abilities to provide
3 benefits over an extended period. (p. 5, lines 15-17; p. 7, lines 6-7; p. 9, lines 3-4) The Staff
4 might cite these as the basis for a proposed adjustment to allocate such costs to future periods
5 *were this an ordinary ratemaking*. This proceeding, however, is governed by a binding
6 contract. The Staff is contractually permitted to propose an adjustment only when there has
7 been an allegation of manipulation or there is a new category of costs. As the Commission
8 has ruled, manipulation is no longer alleged in this proceeding, and computer software costs -
9 - which have been incurred for decades -- are clearly not a new category of costs.

10 **Q. At the end of her discussion of each of the software programs, Ms.**
11 **Westerfield cites Sections 3.f.vii. and viii. Do these provisions support an adjustment**
12 **for computer software expenses?**

13 A. No, they do not. As discussed above, and by Mr. Baxter, Section 3.f.vii. is not
14 an open-ended provision, authorizing the Staff to propose every manner of adjustment. And
15 Section 3.f.viii. limits the permissible adjustments to new *categories* of costs. Given that the
16 Company has been incurring software development expenses for decades, the Staff cannot
17 argue that costs incurred installing the CSS, AMRAPS, and EMPRV programs were new
18 *categories* of costs. Indeed, the argument is especially meritless with regard to the latter two
19 programs, which the Company began to install during the First and Second Sharing Periods
20 of the EARP. The Company expensed those costs as incurred, as reflected in the Final
21 Earning Reports that were adopted by the Commission.

1 **Q: Ms. Westerfield also proposes an adjustment with regard to what she**
2 **calls "decommissioning trust funds." (p. 11, line 6) What is this adjustment and is it**
3 **appropriate under the Agreement?**

4 A: The Staff proposes that the Company reduce its expenses to reflect the
5 benefits it realized in the Third Sharing Period from being able to use decommissioning trust
6 funds. At the end of her treatment of the issue, Ms. Westerfield advances two bases for this
7 adjustment. The first is that this was "an item of dispute in the second sharing period." (p.
8 12, line 11) With all respect, I fail to understand how this makes any difference. The fact
9 that the Staff may, or may not, have taken issue with an accounting treatment in one sharing
10 period proves nothing as to whether that is, or is not, an appropriate adjustment in the next
11 sharing period. Under the apparent logic of Ms. Westerfield's position, all the Staff needs to
12 do is take issue with an accounting treatment in one sharing period, and *automatically*, it can
13 then raise the adjustment in the next sharing period. Again, under this position, the Company
14 gave up hundreds of millions of dollars and in return received nothing, because the Staff can
15 propose any adjustment at all in the second and the third sharing periods.

16 Ms. Westerfield also suggests that the adjustment is appropriate under Sections
17 3.f.vii. and 3.f.viii. because "this item has never been addressed in any previous ratemaking
18 proceeding." (p. 12, line 28) This is totally false. As Mr. Baxter points out, the Commission
19 has specifically addressed this issue and did not oppose the Company using decommissioning
20 trust funds between each payment date.

21 **Q: Michael Gruner proposes an adjustment for merger and acquisition**
22 **costs. (p. 2, line 21) Do you agree with this adjustment?**

1 A: No, I do not. In his testimony, Mr. Baxter explains how the Staff has –
2 consistent with it modus operandi throughout this case -- twisted the meaning of the
3 Agreement to suit its purposes. In Section 4 of the Agreement governing the second EARP,
4 the parties provided that "[t]he annual amortization of merger and transaction costs will be
5 the lesser of:

6 (1) the Missouri jurisdictional portion of the total amount of $ 7.2 million;
7 OR

8 (2) the Missouri jurisdictional portion of the total Ameren unamortized
9 amount of the actual merger transaction and transaction costs incurred to
10 date."
11
12 As Mr. Baxter shows, the Staff and OPC Staff simply inserts words into the second option to
13 change the meaning of the provision the parties actually agreed to, such that the provisions as
14 revised by the Staff and OPC Staff effectively reads: the Missouri jurisdictional portion of
15 the total Ameren unamortized amount of the actual merger transaction and transaction costs
16 incurred to date *divided by ten*.

17 **Q Mr. Gruner also proposes an adjustment for "injuries and damages**
18 **expenses." (p. 6, line 1) What is this adjustment and do you agree with it?**

19 A. Mr. Gruner proposes that the Company normalize the greater than average
20 expenses it incurred maintaining its injuries and damages reserve in the Third Sharing Period.
21 Mr. Baxter completely rebuts Mr. Gruner's argument in his testimony. I will simply note
22 that, once again, the Staff is proposing an adjustment that is inconsistent with the Agreement
23 and, more disturbingly, suggests that the Staff does not even realize that the Agreement limits
24 what is, and is not, an acceptable adjustment. The Reconciliation Procedure to the
25 Agreement specifically provides that *certain* costs were to be normalized; for other costs,

1 such as injuries and damages expenses, the parties thereby agreed that no normalization was
2 permitted.

3 **10. Weather Issues**

4 **Q. Other than these issues raised by the Staff that involve how various**
5 **expenses are treated for calculating earnings, are there other issues raised by the Staff**
6 **that seek to repudiate the terms of the Agreement?**

7 A. Yes. They are similarly seeking to repudiate the provisions included in the
8 Agreement for the second EARP that govern weather normalization.

9 **Q. What is weather normalization, and why is it important?**

10 A. UE's earnings for the three years of the first EARP forms the basis of the
11 calculation of a permanent rate reduction that is to be put in place during the first year of the
12 second EARP. Normalizing the effect of weather on those earnings is simply a process to
13 ensure that any extremes in the weather we might have experienced in those three years do
14 not skew the numbers. Put another way, in this instance, weather normalization is an effort
15 to factor out the effects, if any, of abnormal weather on the sharing credits provided during
16 the first three years of the Plan, based on a historical understanding of what normal weather
17 should have been.

18 **Q. What position with respect to weather normalization is the Staff taking**
19 **that repudiates the Agreement?**

20 A. At the outset, let me emphasize that this is a somewhat technical subject that
21 will be addressed in detail by the testimony of Mr. Allen Dutcher, who is the Nebraska State
22 Climatologist and Operations Climatologist for the High Plains Climate Center at the
23 University of Nebraska, and Mr. Richard Voytas, who is the Supervising Engineer, Corporate

1 Analysis in our Corporate Planning department. However, I think the common sense of the
2 matter, particularly as it relates to the obligations of the Agreement that govern the parties
3 here, is not difficult to grasp.

4 The Agreement for the second EARP expressly adopted a methodology by which
5 weather normalization was to be undertaken, which included the use of the Hourly Electric
6 Load Model ("HELM"). (Report and Order, Case No. EM-96-149 (Feb. 21, 1997),
7 Attachment 1 at 47.)

8 The Agreement also contained provisions governing the possibility of changes to that
9 methodology, changes that could include one of two types. First, the Agreement recognized
10 that changes to the HELM model itself could be made after notice to the parties thirty days
11 before the effective date of the change. Id. Another provision recognized that changes could
12 be made to the "data and assumptions utilized in the HELM model" without advance notice,
13 but such changes could only be "incorporated prospectively from the effective date of the
14 change." Id. at 48 (emphasis added). The change to Union Electric's weather normalization
15 calculations that has been proposed by the Staff is not a change to the HELM model itself.
16 Rather, it is a change to the data used in the model, but, contrary to the Agreement, it is a
17 retroactive change to the data.

18 This issue arose as a result of the National Weather Service installing a new device,
19 the Automated Surface Observation System ("ASOS"), to record temperatures at Lambert
20 Airport, the location for current and historical temperature data for Union Electric's weather
21 normalization calculations. Besides being a new technology, the ASOS device was located
22 approximately one mile from the location of the previous temperature recording station.
23 Both of these factors – the new technology and the new location – resulted in differences

1 between the temperature recorded by ASOS and that recorded by the prior device. Union
2 Electric turned to methodologies developed by climatologists who are experts in analyzing
3 temperature bias relative to historical temperatures, and to one of the two top experts in the
4 nation concerning the temperature differences attributable to ASOS, Mr. Allen Dutcher.
5 Consistent with the terms of the Agreement, and relying on these resources, we developed
6 adjustments to account for the differences between ASOS and the prior recording device on a
7 prospective basis.

8 Notwithstanding the actual terms of the Agreement, the Staff now proposes
9 retroactive adjustments in the decades of historical weather data that is used in weather
10 normalization. Clearly, the Staff seeks to repudiate the terms of the Agreement which
11 expressly contemplates changes in the calculations to be used in weather normalization, and
12 provides that such changes are to be prospective only. Moreover, as explained in the
13 testimony of Mr. Voytas and Mr. Dutcher, practically speaking it is impossible to go back
14 and make the kind of calculations suggested by the Staff on any kind of objective basis. The
15 empirical data for such calculations is simply not available, requiring estimates to be made.
16 As a result, the adjustments offered to supposedly deal with the biases in the historical data
17 are themselves no more reliable than the historical data and offer no guarantee that they are
18 objectively unbiased. Combined with the other problems described in the testimony of Mr.
19 Voytas and Mr. Dutcher, what we have with respect to weather normalization is the Staff
20 once again seeking to change the methodology that was expressly agreed to in the
21 Agreement. On this issue, the Staff's position might even be considered more extreme, since
22 they propose to replace the agreed upon methodology with an untried, novel methodology
23 fashioned simply for this case.

1 Finally, when negotiating the terms of the Agreement, in no way did the parties to the
2 Agreement envision that the process of weather normalization would entail challenging and
3 revising 38 years of historical weather data that has formed the basis for weather
4 normalization calculations for UE for decades. This makes no sense and, practically
5 speaking, is the clearest signal that the Staff is repudiating the terms of Agreement as it
6 relates to weather normalization.

7 **11. Conclusion**

8 **Q. Did UE live up to its end of the Agreement?**

9 A. Absolutely.

10 **Q. Has the Staff lived up to its end of the Agreement?**

11 A. No, they have not.

12 **Q. Do you have anything else to add?**

13 A. Yes. I thought at the time, and still think today, that the 1995 Agreement, and
14 the 1997 Agreement that followed it, was a great deal for all parties. I thought it would push
15 Union Electric to become an even better company, and I thought it would ensure that our
16 customers would continue to receive efficient and reliable electric service. I am saddened
17 that the current Staff, with its contorted and irrational interpretations, threatens to frustrate
18 those hopes and derail the EARP.

19 **Q. Does that conclude your testimony?**

20 A. Yes, it does.