Exhibit No.:	
Issues:	*Midwest ISO Expense; Legal Fees; and Environmental Expense*
Witness:	*JOHN P. CASSIDY*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Direct Testimony*
Case No.:	*EM-96-149*
Date Testimony Prepared:	*April 12, 2002*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

JOHN P. CASSIDY

FILED

APR 15 2002

Missouri Public Service Commission

UNION ELECTRIC COMPANY, d/b/a AMERENUE

CASE NO. EM-96-149

Jefferson City, Missouri
April 2002

****Denotes Proprietary Information****

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DIRECT TESTIMONY

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JOHN P. CASSIDY

UNION ELECTRIC COMPANY

d/b/a AMERENUE

CASE NO. EM-96-149

Q. Please state your name and business address.

A. John P. Cassidy, 815 Charter Commons, Suite 100B, Chesterfield, Missouri 63017.

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

A. I am employed by the Missouri Public Service Commission (Commission) as a Regulatory Auditor.

Q. Please describe your educational background.

A. I graduated from Southeast Missouri State University, receiving a Bachelor of Science degree in Business Administration, with a double major in Marketing and Accounting in 1989 and 1990, respectively.

Q. What has been the nature of your duties while in the employ of this Commission?

A. Since joining the Commission Staff (Staff) in 1990, I have directed or assisted with audits and examinations of the books and records of utility companies operating within the state of Missouri. I have also conducted numerous audits of small water and sewer companies in conjunction with the Commission's informal rate proceedings.

Q. Have you previously filed testimony before this Commission?

A. Yes, I have. Please refer to Schedule 1, which is attached to my direct testimony, for a list of cases in which I have previously filed testimony.

Q. With reference to this Case No. EM-96-149, have you made an examination of the data supporting the calculation of credits for the third sharing period of the second experimental alternative regulation plan (EARP) and other books and records of Union Electric Company d/b/a AmerenUE (AmerenUE or Company)?

A. Yes, in conjunction with other members of the Commission Staff.

Q. What are your areas of responsibility in this case?

A. My areas of responsibility include the Staff's adjustments to AmerenUE's credit calculation for Midwest Independent Transmission System Operator (Midwest ISO) expense, legal fees and environmental expense.

Q. What Income Statement adjustments are you sponsoring?

A. I am sponsoring the following adjustments, which appear on the Adjustments to Income Statement, Accounting Schedule 8:

Midwest ISO	S-7.2
Legal Fees	S-13.3
Environmental Expense	S-13.4

MIDWEST ISO

Q. Please explain the Midwest ISO.

A. In 1998, AmerenUE and AmerenCIPS joined the Midwest ISO. The Midwest ISO is made up of a number of member regional electric power companies. The Midwest ISO is responsible for avoiding potential "bottlenecks" in the flow of power and ensuring measures of reliability. The Federal Energy Regulatory Commission (FERC) regulates the Midwest ISO.

Q. Why has the Staff made Adjustment S-7.2 with regard to the Midwest ISO expense?

A. Staff adjustment S-7.2 removes $12,502,800 associated with AmerenUE's withdrawal of its membership in the Midwest ISO. During the year 2000, two of the Illinois members of the Midwest ISO, Commonwealth Edison and Illinois Power, announced their intent to withdraw from the Midwest ISO and, in turn, join the Alliance Regional Transmission Organization (Alliance RTO). In November 2000, following that announcement, AmerenUE determined that the operational configuration of the Midwest ISO was unacceptable and announced its withdrawal from the Midwest ISO and its intention to join the Alliance RTO. As a result of the Company's decision to withdraw from the Midwest ISO, AmerenUE incurred, during May 2001, a $12,502,800 exit fee. However, recent events at the federal level with FERC's non-approval of the Alliance as an RTO indicate that AmerenUE may rejoin the Midwest ISO in the near future and may be able to recover a full refund of the $12,502,800 exit fee.

Q. What is the Staff's justification for proposing this adjustment?

A. In Case No. EM-96-149, the Stipulation And Agreement states in sections 7.f.vi, 7.f.vii and 7.f.viii:

> 7.f.vi If Staff, OPC or other signatories find evidence that operating results have been manipulated to reduce

amounts to be shared with customers or to misrepresent actual earnings or expenses, Staff, OPC or other signatories may file a complaint with the Commission requesting that a full investigation and hearing be conducted regarding said complaint. UE shall have the right to respond to such request and present facts and argument as to why an investigation is unwarranted.

7.f.vii UE, Staff, OPC and other signatories reserve the right to bring issues which cannot be resolved by them, and which are related to the operation or implementation of the New Plan, to the Commission for resolution. Examples include disagreements as to the mechanics of calculating the monitoring report, alleged violations of the Stipulation and Agreement, alleged manipulations of earnings results, or requests for information not previously maintained by UE. 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 Commission will determine in the first instance whether a question of manipulation exists and whether that question should be heard by it.

7.f.viii Staff, OPC and other signatories have the right to present to the Commission concerns over any category of cost that has been included in UE's monitoring results and has not been included previously in any ratemaking proceeding.

I would also note that the Reconciliation Procedure, Attachment C, Section 2.g states, in part, that:

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

The Staff believes that the Midwest ISO exit payment represents a significant variation in expense with no reasonable explanation. Since AmerenUE did not remove this expense from its credits calculation, this represents a reduction in amounts to be shared with customers by the Company and, therefore, reflects a manipulation of earnings results as covered in the Stipulation And Agreement. Lastly, the Staff is unaware of any prior rate case proceeding, involving AmerenUE, where Midwest ISO expense was at issue and where Commission precedent exists.

LEGAL FEES

Q. Please explain how the Company accounts for the legal fees that are the subject of the Staff's adjustment.

A. The Company's treatment for these legal fees is based on accrual accounting. Under this accrual basis, the Company maintains a reserve of accumulated funds to pay for legal fees based on estimates of legal fees that the Company anticipates will be incurred rather than for what is actually paid. Accruals to increase the reserve are expensed and actual claims are charged against the reserve balance when paid. The following example shows journal entries that the Company records when it accrues for legal expense and then subsequently pays for legal expense:

Accrual

Debit (DR) Legal Services Expense

Credit (CR) Law Expense Accrual Reserve

Payment

DR Law Expense Accrual Reserve

CR Accounts Payable (or Cash)

Q. Please explain the Staff's proposed adjustment S-13.3 to legal fees.

A. During the third sharing period, July 1, 2000 through June 30, 2001, of the second EARP, the Company accrued, for Missouri electric operations, approximately ** ** of legal fees; however, the Company actually paid only ** ** for legal fees during the same period. The difference between the accrued legal fees and

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the actual paid legal fees resulted in an excess accrual of ** ** for the Company's Missouri electric operations, relating to legal fees. The Staff proposes to remove the ** ** of excess accrual over actual cash payments, in order to treat legal fees using a cash basis approach.

Q. Why does the Staff recommend a cash approach for the Company's legal fees?

A. The Staff recommends using a cash approach to account for the Company's legal fees in order to eliminate the impact of the excess accrual, which has resulted during the sharing period. The cash approach will provide a determination of credits based on actual known and measurable costs during the sharing period as opposed to the Company's accrual basis, which relies upon an estimate of what actual future payments and costs will be. The Staff's adjustment is reasonable because it allows the Company recovery of its actual legal fees payments during the third sharing period of the second EARP.

Q. What is the Staff's justification for proposing this adjustment?

A. The Staff asserts that sections 7.f.vi, 7.f.vii, 7.f.viii and the Reconciliation Procedure, Attachment C, Section 2.g from the Stipulation And Agreement in Case No. EM-96-149, as previously quoted in this direct testimony are applicable to the Company's accrued legal fees. The Staff believes that the difference between accrued legal fees and actual legal fees payments is excessive and also represents a significant variation in expense with no reasonable explanation. The Staff also believes that significantly accruing expense at a higher level than the actual cash payments incurred represents a reduction in amounts to be shared with customers by the Company and,

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therefore, reflects a manipulation of earnings results as covered in the Stipulation And Agreement. Finally, the Staff is unaware of any prior rate case proceeding, involving AmerenUE, where legal expense accruals were at issue and where Commission precedent exists.

ENVIRONMENTAL EXPENSE

Q. Please explain how the Company accounts for environmental expense.

A. Using an accrual basis of accounting, the Company maintains a reserve of accumulated funds which are set aside to pay for environmental costs related to the clean-up of contaminated sites. The Company charges major expenditures against the reserve. Small expenditures are charged directly to expense, to eliminate the constant adjustment of the reserve amount. The following example demonstrates journal entries that the Company records when accruing and then subsequently paying for environmental expense:

Set up of Reserve

DR Administrative & General Expenses – Miscellaneous

CR Reserve for Clean-up of Contaminated Facilities

Payment

DR Reserve for Clean-up of Contaminated Facilities

CR Accounts Payable

Q. In the past, how has the Company accounted for its environmental expenses?

A. The Staff has examined accruals, the charges made against the reserve, non-labor cash payments charged to expense and the total accrued reserve balance for environmental expenditures for the twelve month periods ending June 30, 1993 through June 30, 2001. The following chart summarizes these items:

**

**

This chart shows that by the end of the third sharing period of the second EARP the Company had a cumulative accrued reserve balance of ** **. Subtracting actual expenses from the accrued reserve balance reveals that the Company has amassed an over-accrued environmental reserve balance totaling ** **, through the end of the third sharing period of the second EARP. This ** ** over-accrued reserve balance represents the amount the Company believes it might incur at some undetermined time in the future.

Q. Please explain the Staff's adjustment S-13.4 to Company's environmental expense.

A. During the third sharing period of the second EARP, the Company accrued ** ** for environmental expenses; however, the Company only

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incurred actual non-labor-related environmental expense totaling ** **. The difference between the accrued environmental expense and the actual paid environmental expense resulted in an excess accrual of ** ** for the Company's Missouri electric operations, relating to legal fees. Staff Adjustment S-13.4 proposes to remove the ** ** of excess environmental accruals over and above the actual environmental payments, in order to treat environmental expense using a cash basis approach.

Q. Why does the Staff recommend a cash approach for the Company's environmental expenses?

A. The Staff recommends using a cash basis approach to account for the Company's environmental expenses in order to eliminate the impact of the ** ** of excess accrual on customer credits. Since 1992, the Company has never actually incurred a level of expense to justify the level of accruals that it has booked. The cash approach proposed by the Staff will provide a determination of credits based on actual known and measurable costs during the sharing period as opposed to the Company's accrual basis, which relies upon an estimate of what actual future payments and costs will be. Additionally, the Staff contends that even after making this adjustment to the third sharing period of the second EARP, the Company will still have an over-accrued reserve balance in excess of ** ** to pay for any large future electric environmental costs. The Staff believes that an approximate ** ** reserve for environmental costs is sufficient at this point in time and that the additional ** ** of excess accrual made during the third sharing period of the second EARP should be eliminated.

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Q. What explanation has the Company provided for its environmental accruals and why is this explanation unreasonable?

A. The Company has indicated that it needs to make accruals now for future environmental costs. In the response to Staff Data Request No. 32 (from Case No. EC-2002-1 also involving AmerenUE), the Company stated that:

> The (environmental) reserve is not booked by individual site, but within the minimum and maximum liability, as required by Statement of Financial Accounting Standard No. 5 and Financial Accounting Standards Board Interpretation No. 14. Ameren periodically evaluates the minimum and maximum environmental liability and adjusts the reserve accordingly. The amount recorded as a liability is not dependent upon when cash will be required to settle such obligations.

For purposes of calculating sharing credits, the Staff believes this is unreasonable because the actual timing and the amount of these expenditures are largely unknown.

Q. What is the Staff's justification for proposing this adjustment?

A. The Staff cites sections 7.f.vi, 7.f.vii, 7.f.viii and the Reconciliation Procedure, Attachment C, Section 2.g from the Stipulation And Agreement in Case No. EM-96-149, as previously quoted in this direct testimony, as applicable to the Company's accrued environmental expense. The Staff believes that the difference between accrued environmental expense and actual environmental expense is excessive and also represents a significant variation in expense with no reasonable explanation. The Staff also believes that accruing expense at a higher level than the actual payments incurred represents a reduction in amounts to be shared with customers by the Company and therefore reflects a manipulation of earnings results as covered in the Stipulation And Agreement. Finally, the Staff is unaware of any prior rate case proceeding, involving UE, where environmental expense accruals were at issue.

Q. Does this conclude your direct testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In The Matter Of The Application Of Union Electric Company For An Order Authorizing: (1) Certain Merger Transactions Involving Union Electric Company; (2) the Transfer of Certain Assets, Real Estate, Leased Property, Easements And Contractual Agreements To Central Illinois Public Service Company; And (3) In Connection Therewith, Certain Other Related Transactions.	)	Case No. EM-96-149

AFFIDAVIT OF JOHN P. CASSIDY

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

John P. Cassidy, is, of lawful age, and on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 11 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

John P. Cassidy

John P. Cassidy

Subscribed and sworn to before me this 10th day of April 2002.

Toni M Charlton

Notary Public

TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

RATE CASE PROCEEDING PARTICIPATION

JOHN P. CASSIDY

COMPANY	CASE NO.
Missouri Cities Water Company	WR-91-172
Missouri Cities Water Company	SR-91-174
St. Louis County Water Company	WR-91-361
Southwestern Bell Telephone Company	TC-93-224
Laclede Gas Company	GR-94-220
Empire District Electric Company	ER-95-279
Imperial Utility Corporation	SC-96-247
St. Louis County Water Company	WR-97-382
Laclede Gas Company	GR-98-374
United Water Missouri, Inc.	WR-99-326
Union Electric Company	EC-2000-795
Union Electric Company	GR-2000-512
Laclede Gas Company	GR-2001-629
Union Electric Company, d/b/a AmerenUE	EC-2002-01