

ILLINOIS COMMERCE COMMISSION

DOCKET NO. 04-0294

SUPPLEMENTAL DIRECT TESTIMONY

OF

WARNER L. BAXTER

Submitted On Behalf

Of

AMEREN CORPORATION

April 30, 2004

1 **ILLINOIS COMMERCE COMMISSION**

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4 **WARNER L. BAXTER**

5
6 **Q. Please state your name and business address.**

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

9 **Q. Are you the same Warner L. Baxter that filed direct testimony in this proceeding**
10 **identified as Applicants' Exhibit 2.0?**

11 A. Yes.

12 **Q. What is the purpose of your supplemental direct testimony?**

13 A. The purpose of my testimony is three-fold: 1) to introduce and explain the reasons for the
14 Applicants' supplemental filing; 2) to discuss the need for certain regulatory conditions in
15 the Stock Purchase Agreement ("SPA"); and 3) to provide further explanation both of
16 why the proposed Hazardous Materials Adjustment Clause ("HMAC") rider should be
17 approved in this proceeding rather than be considered in a separate proceeding and of
18 why approval of the HMAC rider is necessary in order for the Applicants to effectuate
19 the reorganization.

20 **Q. Please discuss why Applicants are making this supplemental filing.**

21 A. Applicants are aware that there are several points on which other parties and the Staff
22 seek additional information. Specifically, Applicants are responding to a list of suggested
23 topics for supplemental testimony that were circulated by Staff on April 15, 2004.

24 **Q. What information are Applicants providing in the supplemental filing?**

25 A. In addition to my supplemental direct testimony, Applicants are providing the testimony
26 of the following witnesses:

- 27 - Mr. Jerre Birdsong, who addresses Ameren's proposed dividend policy for
28 Illinois Power Company ("Illinois Power") after the closing of this
29 acquisition, and participation by Illinois Power in Ameren's Utility Money
30 Pool Agreement;
- 31 - Mr. Craig Nelson, who presents forecasted financial statements for Illinois
32 Power for the years 2004 through 2012, along with key assumptions,
33 assuming Ameren ownership beginning January 1, 2005; support for the
34 sources of savings reflected in the revenue requirements analysis in
35 Applicants' Exhibit 3.4; and comparative financial information for 2007
36 based on continued Dynegy ownership of Illinois Power versus Ameren
37 ownership of Illinois Power, including AmerenIP's cash flow; and
- 38 - Mr. Martin Lyons, who presents specific information regarding how
39 Ameren proposes to record and track the effects of purchase accounting in
40 the books and records of Illinois Power upon acquisition and
41 prospectively, and additional information regarding the costs of
42 accomplishing the reorganization for which Ameren is requesting
43 recovery.
- 44 - Q. Turning to your second topic, what do you mean by the "regulatory
45 conditions" in the SPA?
- 46 - A. From Ameren's perspective I mean "Buyer's Required Regulatory
47 Approvals" listed in Section I (ICC Approvals) of Schedule 8.2(b) to the

SPA. Based on the data requests to date, discussion with the parties and Staff's list of supplemental testimony topics, the regulatory conditions of greatest interest to the parties are items I(iv), (v) and (vii) on Schedule 8.2(b). These regulatory conditions were addressed in Sections VI.B and VI.G1, 2 and 4 of the Application in this docket.

Q. What additional comments are you offering about the regulatory conditions set forth in the SPA?

A. When the Ameren team negotiated the terms of this acquisition, it recognized that, while Ameren was very interested in acquiring Illinois Power, there were limits to the costs and risks that Ameren could accept. Recapitalizing Illinois Power and restoring it to good credit standing will be challenging, but I am confident that these are challenges that Ameren can and will meet. Ameren has done an extraordinary amount of planning for this acquisition, and fully understands, and is prepared for, what lies ahead. Because Ameren understands the challenges before it, Ameren insisted that the SPA include certain conditions that would set parameters acceptable to Ameren on the costs and risks that Ameren would be taking on in making this acquisition. These are the terms that Ameren negotiated, and Ameren is not willing to acquire Illinois Power and accept challenges, costs and risks not otherwise contemplated..

I am concerned, however, based on the discovery requests I have seen and comments I have heard that the transaction is not being viewed in the correct light. The transaction that the Applicants have put before the Illinois Commerce Commission (Commission) should not be compared to some hypothetical, "perfect" transaction . Rather, the Commission should evaluate whether the transaction that is before it meets the statutory criteria. Thus, the transaction should be assessed this way: Illinois Power

72 has a credit rating that is below investment grade. It has access to the capital markets
73 only on restrictive terms. Its balance sheet is out-sized; total capitalization far exceeds
74 rate base. Illinois Power's liquidity depends, indefinitely, on the continued receipt of
75 interest payments on an unsecured note from a below investment grade entity. The
76 unsecured note is roughly equivalent to Illinois Power's entire common equity.

77 How Illinois Power got to its current financial condition is unimportant. What is
78 important is that Ameren is here today with a plan to provide a long-term solution for
79 Illinois Power's situation. Ameren would recapitalize Illinois Power and right-size its
80 balance sheet in a way that provides an immediate or near-immediate restoration of an
81 investment grade credit rating. Ameren would also ensure that capital expenditures
82 continued at Illinois Power at necessary and appropriate levels. Finally, Ameren would
83 provide management of Illinois Power's electric and gas systems by an experienced
84 operator of such systems that is already serving hundreds of thousands of electric and gas
85 customers in Illinois as well as in the adjoining state of Missouri.

86 Ameren fully understands that the Commission must decide whether the Ameren
87 plan meets the applicable statutory criteria. However, in doing so, the Commission
88 should not view the regulatory conditions as "extras" or "options". They establish
89 fundamental boundaries on the costs and risks that Ameren is willing to accept in
90 acquiring Illinois Power and taking on the responsibility to achieve the results I just
91 described. Ameren is confident that the evidence will show that Ameren's acquisition of
92 Illinois Power on the terms set forth in the SPA, including the regulatory conditions,
93 satisfies the applicable statutory criteria.

94 **Q. Please explain why the HMAC rider should be approved in this proceeding rather**
95 **than in a separate proceeding.**

96 A. As I stated earlier, the SPA sets forth certain regulatory approvals that are required as a
97 condition to consummation of the transaction. Specifically, Section 8.2(b) requires a
98 final order from this Commission with respect to the rider identified on Schedule 8.2(b),
99 Item I(vii). This is the HMAC Rider that is proposed in the Application and included as
100 an exhibit to Mr. Jon Carls' testimony.

101 Hence, as part of the transaction that is before the Commission, a Commission
102 order is required concerning the proposed HMAC rider. As I explained above, the
103 regulatory conditions are boundaries on the costs and risks that Ameren is willing to
104 accept. It is entirely consistent and logical for the Commission to consider this aspect of
105 the transaction in this proceeding. Not only is it a critical component to the overall
106 transaction but as a matter of contract, an order on the HMAC rider is required in order
107 for the acquisition to proceed.

108 It would make no sense for the Applicants to seek, in a separate proceeding,
109 regulatory approval of a condition that must be met for the transaction to close. If the
110 HMAC rider were litigated in a separate proceeding, there is the risk that its adjudication
111 or final determination would take place sometime after this proceeding is completed. This
112 delay would only serve to put on hold the closing of the transaction. On the other hand, if
113 there was some guarantee that the separate proceeding to consider the HMAC rider
114 would be completed at the same time this proceeding is concluded, then I question the
115 need for the separate proceeding. Presumably the same parties in this proceeding would
116 participate in the separate proceeding. I can foresee conflicting schedules but more
117 importantly, an unwarranted duplication of the parties' time and resources.

118 **Q. Why is it necessary for the Commission to approve the HMAC rider in order for the**
119 **Applicants to effectuate the reorganization?**

120 A. Commission approval of the HMAC rider was a negotiated component of the overall
121 transaction and is a required condition to be met in order for the Applicants to proceed
122 forward with the transaction, unless the absence of the HMAC rider would not have
123 material adverse impact on Illinois Power or Ameren after closing. Ameren, of course, is
124 concerned that non-approval of the HMAC rider would have a material adverse impact
125 on Illinois Power and Ameren.

126 Applicants' initial filing addressed the reasoning behind the HMAC rider from
127 Ameren Corporation's perspective, but I would like to elaborate. Upon considering the
128 acquisition of Illinois Power, we took into account not only the benefits to be realized by
129 our shareholders, current customers and Illinois Power customers, but also the risks
130 involved. There are many different types of risk -- regulatory, business, financial, legal
131 to name a few, and these risks vary in degree. Some risks are known and measurable,
132 while others cannot be quantified or their magnitude cannot be reasonably ascertained.
133 For those whose magnitude can be reasonably ascertained, the assumption of the risk by
134 the buyer can be captured through the negotiated acquisition price. But if the magnitude
135 of a known risk cannot be reasonably estimated or quantified, then it is difficult if not
136 impossible for the parties to come to agreement on how that risk should be reflected in
137 the acquisition price. The liability risk associated with asbestos claims against Illinois
138 Power falls into the latter category.

139 I know from ongoing personal dealings with the financial community, including
140 the rating agencies, that they are very much concerned with the exposure that Ameren
141 would be taking on by acquiring Illinois Power as a result of the actual and potential
142 asbestos claims against Illinois Power. The financial community understands rate

143 making and its relation to cost recovery, and they see the risks facing Ameren in
144 acquiring Illinois Power. The financial and regulatory risks associated with taking on
145 Illinois Power's asbestos liability bear upon the costs that Ameren will incur in its debt
146 issuances and other financings, including those that may occur as part of recapitalizing
147 Illinois Power.

148 In our judgment, it is a prudent and justifiable request to seek approval of the
149 HMAC rider as part of this transaction. In the end, the risk associated with being unable
150 to recover the costs related to Illinois Power's asbestos litigation through normal
151 ratemaking processes -- either non-recovery (because damages and defense costs exceed
152 the amounts, if any, built into base rates) or delayed recovery -- was not acceptable.

153 Recent history has suggested that asbestos litigation against electric utilities of the type
154 faced by both Illinois Power and the current Ameren utilities will continue, and that the
155 resulting costs and exposure are unknown and unpredictable. We know this from our
156 own experience with regard to the asbestos-related claims against the current Ameren
157 utilities. Based on our due diligence inquiries with regard to Illinois Power, the same
158 concerns are applicable to Illinois Power.

159 Q. So, is it your view that a rider is appropriate in this instance?

160 A. Yes. As indicated above the costs and expenses associated with asbestos related
161 claims are not easily predicted, can be volatile, and their magnitude is uncertain.

162 **Q. Can you provide more background on the nature of the asbestos-related claims and**
163 **explain what it is about them that makes the ultimate amount of the claims**
164 **unpredictable and appropriate for rider recovery?**

165 A. Yes. Many lawsuits to date have been filed by or on behalf of present or former
166 employees of third-party contracting firms that did maintenance or construction work at

one of the fossil power stations, and were allegedly exposed to asbestos in the course of that work. These can include not only employees of contractors that contracted directly with the utility but also employees of sub-contractors of the prime contractor. This aspect of the lawsuits makes the ultimate number difficult to predict because the utilities have little if any records of the numbers or identities of employees of third-party contractors who worked at the fossil stations, especially many years ago. Thus, Illinois Power and Ameren have no way to estimate the potential numbers of plaintiffs. Finally, although many of the lawsuits to date have been filed by contractor employees who did work at the power plants, it is expected that in the future, lawsuits will be increasingly filed by family members of workers who did work on the power plants, and may also be filed by persons (or their family members) who worked at facilities other than power stations that may have involved alleged exposure to asbestos.

Another factor that makes it difficult to estimate Illinois Power's ultimate exposure from asbestos-related claims is that every case is unique in terms of the health-related impacts claimed by the plaintiffs. Illinois Power has paid wide ranging amounts to settle asbestos-related claims. Ameren has had a similar experience. Because of the nature of the alleged damages, typically health related, it is nearly impossible to predict an average amount per claim. The plaintiff's age, extent of alleged exposure, and number of dependents, among other things, are also factors. Each case, when filed, has to be evaluated on its own merits and potential exposure.

Q. You mentioned "recent history" regarding the numbers of asbestos lawsuits or claims. Can you provide this information?

A. Yes. In 2001 Illinois Power was served with nine lawsuits; in 2002 46 lawsuits were filed; and in 2003, 36 lawsuits were filed. Ameren has also experienced a similar

191 volatility in such claims. In 2001, 23 claims were served on its utilities—AmerenUE and
192 AmerenCIPS; in 2002, 104 claims were served; and in 2003, 62 claims were served. As
193 the total number of claims continues to increase, so do the costs of settling or paying
194 judgments, and defending these claims. However, while we expect the number of claims
195 to be filed to increase, we cannot know how many will be filed, or when they will be
196 filed. That information simply cannot be known. Of course, since the ultimate number of
197 claims cannot be reasonably predicted, and (as I explained earlier) it is difficult to predict
198 an amount of settlement or judgment per claim, it is also impossible to predict with any
199 certainty the ultimate total exposure to settlements and judgments as well as the ultimate
200 total defense costs.

201 **Q. Do you have any further comments regarding the propriety of the HMAC rider as a**
202 **part of this transaction?**

203 A. Yes. In designing the rider we wanted to ensure that Illinois Power would only recover
204 prudently incurred costs. As the rider is designed, Illinois Power will have the burden of
205 substantiating the justness and reasonableness of the incurred costs and, ultimately, the
206 Commission will be the decision maker in terms of the recovery of these costs. Further,
207 we intend to vigorously defend these claims—the mere fact that a rider is in place will
208 not deter Illinois Power in this regard. Finally, Mr. Jon Carls who filed direct testimony
209 in support of the rider, will be able to respond to any questions about the mechanics of
210 the rider.

211 **Q. Does this conclude your supplemental direct testimony?**

212 A. Yes, it does.