

FILED²

DEC 11 2009

Missouri Public
Service Commission

Exhibit No.:
Issue(s): Interim Rates
Witness: Warner L. Baxter
Sponsoring Party: Union Electric Company
Type of Exhibit: Surrebuttal Testimony
Case No.: ER-2010-0036
Date Testimony Prepared: November 24, 2009

MISSOURI PUBLIC SERVICE COMMISSION

Case No. ER-2010-0036

SURREBUTTAL TESTIMONY ON INTERIM RATES

OF

WARNER L. BAXTER

ON

BEHALF OF

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

St. Louis, Missouri
November, 2009

AmerenUE Exhibit No. C
Case No(s) ER-2010-0036
Date 12-07-09 Rptr VS

1 **SURREBUTTAL TESTIMONY ON INTERIM RATES**

2 **OF**

3 **WARNER L. BAXTER**

4 **CASE NO. ER-2010-0036**

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

6 A. My name is Warner L. Baxter. My business address is 1901 Chouteau
7 Avenue, Saint Louis, Missouri 63103.

8 **Q. Are you the same Warner L. Baxter who filed direct and rebuttal**
9 **testimony on interim rates in this case?**

10 A. Yes, I am.

11 **Q. What is the purpose of your surrebuttal testimony on interim rates?**

12 A. The purpose of my surrebuttal testimony is to respond to certain matters in the
13 rebuttal testimony filed by Steven M. Rackers and David Murray on behalf of the
14 Commission Staff, and Russell W. Trippensee on behalf of the Office of the Public Counsel
15 addressing AmerenUE's request for interim rate relief.

16 **Q. What issues does Mr. Rackers raise in his rebuttal testimony on the**
17 **calculation of interim rates?**

18 A. Mr. Rackers proposes a number of adjustments to AmerenUE witness Gary
19 Weiss' calculation of the revenue requirement associated with new plant additions for the
20 period October 1, 2008 through May 31, 2009.¹ For example, Mr. Rackers argues that an
21 adjustment to the Company's accumulated deferred income tax (ADIT) should be

¹ As described in our initial interim rate request and Mr. Weiss' direct testimony on interim rates, these plant additions reflect investments that have been placed in service since the end of the true-up cutoff date in our last rate case, and which are serving customers today.

1 recognized, that plant additions to serve new customers should be excluded, and that cost
2 savings associated with plant additions that improve efficiency should also be accounted for.

3 **Q. What is your response to this argument?**

4 A. In the context of setting the permanent rates that will arise from this case, Mr.
5 Rackers' adjustments would be legitimate, just as would be any number of additional
6 adjustments going the other way which would increase the Company's revenue requirement
7 and that will also be taken into account as part of the final resolution of this case. For
8 example, higher operations and maintenance costs associated with the new plant additions
9 will be taken into account when permanent rates are set. A different rate of return applicable
10 to the investment will be taken into account. Different tax rates, where applicable, will be
11 taken into account. The problem with taking all these factors into account in connection with
12 an interim rate request is that you quickly reach the point where interim rates could only be
13 implemented after a full-blown rate case that considers "all relevant factors." In other words,
14 if all these factors must be considered it becomes impossible to set interim rates at all, even
15 in an emergency situation.

16 In proposing its interim rate increase, AmerenUE requested that a relatively small
17 part of its overall rate increase (less than 10%) be placed into effect early, subject to refund,
18 to help mitigate the persistent regulatory lag it has experienced over many months. We
19 calculated this amount based on costs of plant already in service, which we believe produced
20 a very conservative request, which is very likely to be exceeded when permanent rates are
21 ultimately established. We could have asked that 10 or 20 percent (or some other fraction) of
22 the permanent rate request be implemented on an interim basis, subject to refund, but we
23 chose to provide a straightforward, easily verifiable basis for the calculation. And again, the

1 interim increase will be refunded with interest in the very unlikely event that the permanent
2 rates awarded after the Commission considers all relevant factors do not exceed the interim
3 increase. Consequently, there is no need to adjust the Company's interim rate increase as
4 Mr. Rackers proposes.

5 **Q. Does Mr. Rackers make any other arguments that would, if adopted,**
6 **effectively prevent a utility from ever implementing interim rates?**

7 A. Yes. On page 3 of his rebuttal testimony on interim rates, Mr. Rackers argues
8 that it would be theoretically possible for AmerenUE to be over-earning and still be entitled
9 to interim rate relief, according to the Company's methodology. Of course this is true. If it
10 were not true, then there would be no reason to make the interim rates subject to refund. So
11 while it is true that there may be no way to know with 100 percent certainty whether a utility
12 is over- or under-earning until a full rate case is completed, it is also true that this lack of 100
13 percent certainty is no bar to interim rate relief. If 100 percent certainty were the standard,
14 no interim rate relief could ever be afforded to any utility. In this case, however, where
15 AmerenUE has made substantial investments in its system since its last rate case to construct
16 plant that is already serving customers and where the Company can show that it has
17 persistently been unable to earn anywhere close to its authorized return, it is reasonable to
18 expect that the permanent rate increase, when finally calculated, will exceed the amount of
19 the proposed interim increase. And again, in the unlikely event that does not prove to be the
20 case after a full-blown rate proceeding, customers will receive refunds with interest.

21 **Q. Do you have any other response to Mr. Rackers' rebuttal testimony on**
22 **interim rates?**

1 A. Yes. On page 8 of his testimony, Mr. Rackers argues that AmerenUE has not
2 lost any of the cost of its investment in plant since the true-up cut-off date from the last rate
3 case because UE has “recovered its operating costs and earned positive returns on equity.”
4 Mr. Trippensee makes a similar point in his rebuttal testimony on interim rates. Specifically,
5 on page 9 of his testimony he argues that AmerenUE is inaccurate when it argues that it is
6 not recovering the cost of its investment in its system. He states: “To reiterate, a positive
7 return on equity means adequate revenues exist to cover all expenses for that period.
8 Therefore Mr. Weiss’s [sic] assertion that taxes and depreciation related to plant-in-service
9 will be ‘lost forever’ is disingenuous.” Apparently Mr. Rackers and Mr. Trippensee believe
10 that so long as AmerenUE is earning even one-tenth of one percent of positive return, its
11 costs are being covered by its rates.

12 This argument is wrong or at least misleading, on several levels. First of all, the
13 return provided to shareholders *is* a part of the cost of service – it is the cost of the equity
14 used by the utility to provide utility services that has been provided by the investment of the
15 utility’s shareholders. If a utility does not have a reasonable opportunity to earn a fair return
16 for its shareholders, it is not recovering its cost of service. AmerenUE’s current rates do not
17 reflect its considerable investment in its system and cost increases the Company has absorbed
18 since the cut-off date for known and measurable changes in its last rate case. Because these
19 costs are not reflected in rates, AmerenUE has had to pay them out of the earnings its
20 shareholders would otherwise have been entitled to keep. Just because the Company is still
21 able to earn some level of positive return (albeit far below its authorized rate of return) does
22 not negate the fact that it is not recovering its cost of equity because its rates are failing to
23 generate enough revenue to cover the costs associated with plant additions and expense

1 increases since rates were last set. In other words, just because AmerenUE can earn one
2 tenth of one percent of return does not mean its rates are sufficient to recover its costs. To
3 the contrary, persistent under-earnings (as AmerenUE has experienced) suggests that its rates
4 are far from keeping up with its costs. Both Mr. Rackers and Mr. Trippensee ignore this
5 obvious fact.

6 **Q. Do you have any response to other parts of Mr. Trippensee's rebuttal**
7 **testimony on interim rates?**

8 A. Yes. On page 5 of his testimony, Mr. Trippensee argues that persistent
9 negative cash flow is the norm for the utility industry. He states: "This has been the utility
10 business model for decades and is not a recent phenomenon and certainly does not justify an
11 interim rate increase." Apparently Mr. Trippensee believes that utilities can endure any level
12 of negative free cash flow without suffering adverse consequences. That one dollar, \$500
13 million, \$1 billion, or \$2 billion of negative free cash flow have the same financial
14 consequences to a utility and we need not worry about reducing these levels. Of course, this
15 is not true. Significant levels of negative free cash flow cannot be sustained indefinitely
16 without adverse consequences to all stakeholders. Interim rate relief is one regulatory tool
17 we are seeking to reduce the level of negative free cash flow.

18 **Q. Do you have any response to Staff witness David Murray's rebuttal**
19 **testimony on interim rates?**

20 A. Yes, I do. In his surrebuttal testimony on interim rates, Mr. Murray takes
21 the position that if AmerenUE's credit ratings or credit quality are not directly impacted by
22 the granting of interim rates, then AmerenUE's request should be denied. As Mr. Nickloy
23 points out in his surrebuttal testimony on interim rates, credit ratings are one important

1 source of information for investors and other creditors when making credit related decisions
2 and decisions about that cost at which they are willing to lend funds to the Company. In
3 addition, another important factor is an entity's credit quality, which is driven by both
4 quantitative and qualitative factors that they independently assess for themselves. Due to the
5 relatively small magnitude of our interim rate request, we do not expect our credit ratings to
6 immediately improve should the Commission grant our request. However, in terms of credit
7 quality, the granting of AmerenUE's request for interim rates would be an important, positive
8 step towards enhancing our credit quality. It would clearly signal that the Commission is
9 using one available tool to reduce the excessive regulatory lag we are experiencing in
10 Missouri, improve AmerenUE's cash flows and related borrowing needs, and strengthen its
11 financial condition. These factors sum up to a more credit supportive regulatory
12 environment, and consequently, provide a meaningful enhancement to AmerenUE's overall
13 credit quality.

14 **Q. Do you have any other response to the rebuttal testimonies filed by Staff**
15 **and the Office of the Public Counsel?**

16 A. Yes. I think the most significant aspect of the Staff and Public Counsel
17 testimony is what it does not say.

- 18 • Their testimony does not deny the fact that AmerenUE has been chronically unable to
19 earn anywhere close to its Commission authorized return on equity over the past
20 several years, despite having received two rate increases since June 2007.
- 21 • Their testimony does not deny the fact that as long as the Company's investment
22 levels remain high or are significantly increasing, it will be very unlikely that we will
23 be able to earn anywhere close to our authorized return in the future.

- 1 • They do not deny that the hundreds of millions of dollars in lost return AmerenUE
2 has absorbed as a result of regulatory lag can never be recovered—that regulatory lag
3 is not just a delay in the recovery of costs, but a permanent loss of those costs.
- 4 • Finally, and perhaps most critically, they do not deny that the inability of utilities to
5 recover their costs, and recover them on a timely basis, creates a powerful
6 disincentive to make new investments in energy infrastructure. In fact, under
7 Missouri’s current regulatory framework, every dollar that is invested between rate
8 cases incrementally reduces shareholder earnings and deprives the utility of the
9 ability to recover the legitimate cost of the common equity shareholders provide to
10 fund the utility’s operations.

11 The bottom line is that it is important that we not lose sight of the issue and the
12 related policy implications we are trying to address with our interim rate request (and in
13 many respects, through our entire general rate case filing). We are not seeking to eliminate
14 regulatory lag. We accept some level of regulatory lag as inherent in the regulatory
15 framework. We also accept our responsibility to manage our operations efficiently on behalf
16 of our customers, as well as to address certain levels of regulatory lag. There is no doubt that
17 we have done that in the past, are doing so presently, and will continue to do so in the future.
18 Instead, what we are seeking to address with this interim rate request and in the remainder of
19 our general rate case is the excessive regulatory lag we are experiencing in Missouri. This
20 excessive regulatory lag is being driven by several factors, including the economy, the need
21 for significant investment in energy infrastructure now and in the foreseeable future, and
22 current regulatory policies and frameworks that are not adequately addressing these
23 circumstances. The excessive regulatory lag has several policy implications, including that it

1 is materially affecting AmerenUE's cash flows and related financing costs, and is preventing
2 AmerenUE from recovering its cost of equity by systematically preventing AmerenUE from
3 having a reasonable opportunity to earn a fair return on its investment. In addition, the
4 existing regulatory framework creates a strong disincentive to pursue new investments to
5 meet increasing customer expectations and/or strongly support state and federal policies and
6 initiatives.

7 Missouri is at a crossroads with regard to utility investment. The needs of the state
8 are substantial—we need investment to improve reliability of the existing electric utility
9 system to meet rising customer needs in the digital age, we need investment in energy
10 efficiency, we need investment in “smart grid” infrastructure, we need investment in
11 transmission facilities to integrate renewable sources of energy into the grid, and we may
12 ultimately need investment in traditional forms of baseload generation to preserve our state's
13 energy independence. These investments not only benefit utilities and their customers, but
14 they create jobs in this state and make the state a more attractive location for businesses to
15 locate.

16 But if electric utilities are not permitted to timely recover their cost of service,
17 including a reasonable opportunity to earn a fair return on their investment in infrastructure,
18 these investments will likely be meaningfully deferred, or they simply won't be made.
19 Missouri will fall further behind other states, where full and timely cost recovery is provided,
20 in these important areas. The Staff and Office of the Public Counsel ignore this important
21 and over-arching policy consideration.

22 **Q. Will the approval of interim rates in this case completely solve the**
23 **problem of excessive regulatory lag?**

1 A. No, but implementing interim rates would be a small, but important step in the
2 direction of mitigating excessive regulatory lag. Consequently, we are requesting that the
3 Commission simply use the discretion it has in establishing regulatory policies to address this
4 significant issue.

5 **Q. Does this conclude your surrebuttal testimony on interim rates?**

6 A. Yes it does.

In the Matter of Union Electric Company) Case No. ER-2010-0036
d/b/a AmerenUE's Tariffs to Increase its)
Annual Revenues for Electric Service.)

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

1. My name is Warner L. Baxter. I am employed by Union Electric Company d/b/a AmerenUE as President and Chief Executive Officer.

2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony on Interim Rates on behalf of AmerenUE, consisting of ___⁹ pages, which has been prepared in written form for introduction into evidence in the above-referenced docket.

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

Warner L. Baxter

Subscribed and sworn to before me this 24th day of November, 2009.

Notary Public

My commission expires: 4-1-2010

