

Exhibit No.:

*Issues: CIPSCO Merger Savings; Generic
UE Criticisms of Staff Case;
Injuries and Damages;
Uncollectibles*

Witness: MARK OLIGSCHLAEGER

Sponsoring Party: MoPSC Staff

Type of Exhibit: Surrebuttal Testimony

Case No.: EC-2002-1

Date Testimony Prepared: June 24, 2002

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

MARK OLIGSCHLAEGER

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

CASE NO. EC-2002-1

**Jefferson City, Missouri
April 2002**

****Denotes Proprietary Information****

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UNION ELECTRIC COMPANY
d/b/a AMERENUE
CASE NO. EC-2002-01

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

The Staff of the Missouri Public Service Commission,)
Complainant,) Case No. EC-2002-1
vs.)
Union Electric Company, d/b/a AmerenUE,)
Respondent.)

AFFIDAVIT OF MARK OLIGSCHLAEGER

STATE OF MISSOURI)
COUNTY OF COLE) ss.

Mark Oligschlaeger, is, of lawful age, and on his oath states: that he has participated in the preparation of the following Surrebuttal Testimony in question and answer form, consisting of 52 pages to be presented in the above case; that the answers in the following Surrebuttal 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.

Mark O. Oligschlaeger
Mark Oligschlaeger

Subscribed and sworn to before me this 24th day of June, 2002.



Toni M. Charlton
Notary Public

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

SURREBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

UNION ELECTRIC COMPANY

d/b/a AMERENUE

CASE NO. EC-2002-01

Q. Please state your name and business address.

A. Mark L. Oligschlaeger, P.O. Box 360, Suite 440, Jefferson City, MO 65102.

Q. Please describe your educational background and work experience.

A. I attended Rockhurst College in Kansas City, MO, and received a Bachelor of

Science degree in Business Administration with a major in Accounting in 1981. I have been employed by the Missouri Public Service Commission (Commission) since September 1981 within the Accounting Department. In November 1981, I passed the Uniform Certified Public Accountant (CPA) examination and, since February 1989, have been licensed in the state of Missouri as a CPA.

Q. Have you previously filed testimony before this Commission?

A. Yes, numerous times. A listing of the cases in which I have previously filed testimony before this Commission is given in Schedule 1, attached to this surrebuttal testimony.

Q. With reference to Case No. EC-2002-1, the Staff's filed earnings complaint against Union Electric Company, d/b/a AmerenUE (UE or Company), have you made an investigation of the books and records of UE?

A. Yes, with the assistance of other members of the Commission Staff (Staff).

1 Q. What is the purpose of your surrebuttal testimony?

2 A. The purpose of this testimony is to address the arguments made by certain
3 Company witnesses in their rebuttal testimony concerning the issues of injuries and damages,
4 and uncollectibles expense. I will also address the matter of UE's 1997 merger with
5 CIPSCO, Inc., and its relationship to this complaint proceeding. Further, I will comment
6 upon certain overall criticisms made of the Staff's complaint filing by UE witnesses, as well
7 as address some of the deficiencies in the Company's filed cost of service/revenue
8 requirement calculation.

9 Q. Are you adopting any of the direct testimony sponsored by the Staff in this
10 proceeding?

11 A. Yes, I am. Due to his unavailability as a result of surgery, I am adopting the
12 portions of the direct testimony of Staff Accounting witness Doyle L. Gibbs that concern the
13 issues of injuries and damages expense, and uncollectibles expense. Other Staff witnesses
14 will be adopting other portions of Mr. Gibbs' direct testimony.

15 **SUMMARY/CONCLUSIONS**

16 Q. Please summarize the overall conclusions and recommendations presented in
17 this testimony.

18 A. In its rebuttal testimony, the Company continually refers to the Staff's
19 recommendation that UE's rates be reduced as penalizing or "punishing" UE. To the
20 contrary, a rate reduction passing on to ratepayers the benefits of past UE productivity and
21 efficiency savings is a matter of elemental fairness and equity, especially when it is
22 considered that UE customers have effectively paid for the upfront costs associated with

1 certain productivity/efficiency gains. I will illustrate this point using the 1997 UE/CIPSCO,
2 Inc. merger as an example.

3 Contrary to the representations in the Company's rebuttal testimony, the Staff's
4 recommended revenue requirement for UE in this proceeding is conceptually sound and
5 based upon appropriate and consistent ratemaking standards that have long been applied by
6 this Commission. The Staff's proposed adjustments to UE's book test year financial results
7 are forward-looking in nature, matched at an appropriate point of time, and reflect
8 recommendations for the recovery of all ongoing known and measurable costs incurred by
9 UE that are beneficial to its customers and necessary in providing them safe and adequate
10 service. In contrast, the Company's cost of service calculation suffers from serious
11 deficiencies, including the failure to sponsor appropriate normalization and annualization
12 adjustments, and the failure to consistently match elements of revenues, expense and rate
13 base within the test year and update period.

14 The Company's expressed belief that generally accepted accounting principles
15 (GAAP) should largely be applied by the Commission in determining rate levels for
16 regulated services is fundamentally flawed, because the purpose of GAAP in setting
17 standards for financial reporting and the purpose of the Commission in determining the costs
18 to include in the ratemaking process in Missouri are different in significant respects.

19 In regard to the issues of injuries and damages expense, and uncollectibles expense,
20 the Staff continues to take the position that both items are best reflected in the rate setting
21 process on a cash basis, and that injuries and damages expense should be adjusted from its
22 test year level to reflect a reasonable ongoing level of such costs.

CIPSCO MERGER COST IMPACTS

Q. Have you reviewed the rebuttal testimony of UE witness Gary L. Rainwater?

A. Yes, I have.

Q. In that testimony, how does Mr. Rainwater characterize the Staff's recommendation that UE's Missouri electric rates be reduced?

A. Mr. Rainwater characterizes this proposal as "Staff is proposing to punish our Company for its good performance" (Rebuttal, page 3).

Q. To what is Mr. Rainwater referring to when he cites the Company's "good performance?"

A. He is discussing UE's performance in achieving cost reductions and in the area of service improvement. Mr. Rainwater states, also on page 3 of his rebuttal testimony, "I believe that our record of cost reduction and service improvement is unmatched in the utility industry and should be commended rather than punished."

Q. Does the Staff agree with Mr. Rainwater's characterization of the Staff's earnings complaint case against UE?

A. Of course not. To recommend that a utility's rates be reduced so that the utility can prospectively have the opportunity to earn a reasonable, not an excessive, rate of return is no more "punishing" the utility than increasing a utility's rates so that it can prospectively have the opportunity to earn a reasonable rate of return would be "punishing" the utility's customers.

More specifically, though, Mr. Rainwater's discussion of the Staff's complaint case as it relates to UE's past cost savings does not discuss all of the relevant aspects of that matter. The aspect Mr. Rainwater does not choose to discuss is how the costs associated with

1 ongoing expense reductions were treated in the context of the Experimental Alternative
2 Regulatory Plan (EARP). To illustrate my point, I will use the costs and savings associated
3 with the 1997 merger of UE and CIPSCO, Inc. as an example of how both sides of the
4 costs/savings relationship have been handled in Missouri under the EARP.

5 Q. Please describe the UE/CIPSCO, Inc. merger.

6 A. In August 1995, UE and CIPSCO, Inc. (CIPSCO) announced that an
7 agreement to merge the two companies had been reached. CIPSCO primarily consisted of a
8 regulated electric and gas utility in the state of Illinois. A holding company would be formed
9 (later named Ameren) as a result of the merger, and UE and CIPSCO would operate as
10 separate divisions, AmerenUE and AmerenCIPS, respectively, under the holding company
11 structure.

12 After all required regulatory approvals were received, the UE/CIPSCO merger was
13 closed at the end of December 1997.

14 Q. Did UE and CIPSCO present estimates of merger savings and costs in the UE
15 application to merge before this Commission in Case No. EM-96-149?

16 A. Yes. In Mr. Rainwater's direct testimony in that proceeding, he sponsored an
17 estimate of total merger savings over the ten years following the merger of \$590 million.
18 Total merger costs, in the form of merger transaction and transition costs, were estimated at a
19 ten-year level of \$41 million.

20 Later in that proceeding, in the surrebuttal testimony of UE witness Craig D. Nelson,
21 those amounts were updated to the following ten-year levels: merger savings -- \$759 million;
22 merger costs -- \$73 million.

23 Q. What are merger "transaction costs" and merger "transition costs?"

1 A. “Transaction costs” are costs of putting a merger deal together in advance of
2 actual consummation of the transaction. These costs include items such as legal fees and
3 investment banker fees.

4 “Transition costs” are costs to integrate the two merging companies after the merger
5 is approved and closed. These costs include items such as severance costs for employees
6 losing their jobs as a result of the merger and costs to integrate the utilities’ computer and
7 telephone systems.

8 Q. What was the approximate amount of UE’s estimated merger and cost figures
9 that were estimated to apply to UE’s Missouri retail electric operations?

10 A. According to Mr. Rainwater’s direct testimony in Case No. EM-96-149, the
11 expected percentage of the CIPSCO merger savings and costs that should flow to or be
12 assigned to the Missouri retail electric operations of UE was 58.7 percent (page 21).

13 Q. Was there an acquisition adjustment associated with the UE/CIPSCO
14 transaction?

15 A. No. This transaction was structured as an exchange of stock. As such, it
16 qualified as a “pooling” transaction, allowable under the financial accounting rules at the
17 time. Under the pooling method of accounting for mergers and acquisitions, no acquisition
18 adjustment or merger premium amount was required to be booked as an asset, and no annual
19 amortization to expense of premium costs was required, either.

20 Q. How was the UE/CIPSCO merger application resolved in Missouri?

21 A. A Stipulation And Agreement in Case No. EM-96-149 (Stipulation) was
22 reached among the parties recommending that the Commission approve the merger. Among
23 the terms of the Stipulation was a provision calling for a ten-year amortization to expense of

1 the combined transaction and transition costs of the merger, with no rate base treatment
2 allowed for the unamortized balance. (The amount to be amortized excluded executive
3 severance packages.) Under the terms of the Stipulation, both the merger costs and merger
4 savings would flow into the sharing grid of the EARP, which was already in existence at the
5 time of the CIPSCO merger. Neither the Commission nor the Staff had been advised of the
6 possible CIPSCO merger when the first EARP (Stipulation And Agreement in Case
7 No. ER-95-411) was before the Commission for determination.

8 Q. Is it possible at this point to quantify what the actual merger savings were that
9 resulted from the CIPSCO transaction?

10 A. No. Because merger savings estimates compare the actual financial results of
11 two combined utilities with the hypothetical results if the two companies had each remained
12 on a stand-alone basis, the actual amount of savings from any merger transaction can never
13 be quantified or “tracked.”

14 The Staff in this testimony is not endorsing the estimates of merger savings included
15 in UE’s testimony in Case No. EM-96-149, because neither the Staff nor the Company can
16 verify them. However, for purposes of this testimony, the Staff is assuming that the amount
17 of merger savings resulting from the CIPSCO merger was significant, and those savings
18 exceeded the merger costs associated with that transaction.

19 Q. Briefly describe the operation of UE’s EARP.

20 A. In the first EARP, which was in effect from July 1995 to June 1998,
21 UE retained all earnings up to a 12.61% return on equity (ROE); earnings between a 12.61%
22 and 14.00% ROE were shared 50/50 between the Company and its customers; and earnings
23 above a 14.00% ROE were credited 100% to customers.

1 In the second EARP, which was in effect from July 1998 to June 2001, earnings up to
2 a 14% ROE were treated as in the first EARP. However, for earnings from a 14.00%
3 to 16.00% ROE, customers received the benefit of 90% of that tier, with UE retaining 10%.
4 All earnings above a 16.00% level were credited 100% to customers.

5 Q. What were the practical results of flowing through merger savings and costs
6 into the EARP earnings sharing grid?

7 A. If one assumes that merger savings were greater than merger costs for the
8 annual credit periods under the EARP, then the merger had the impact of increasing customer
9 credits under the EARP (as long as the resulting ROE exceeded 12.61%). However, the
10 EARP mechanism served to give UE dollar for dollar recovery of merger costs before any
11 amount of merger savings in excess of the costs could be shared with customers.

12 For example, assume that in an EARP credit year, \$5 million of merger costs were
13 amortized and \$20 million of merger savings were realized. The first \$ 5 million of merger
14 savings would have the impact of offsetting the detrimental financial impact of the merger
15 cost amortization. It is only the remaining \$15 million of merger savings that would be
16 potentially shared with customers. This illustrates the point that an earnings sharing
17 mechanism such as the EARP does not cause sharing of costs between the Company and its
18 customers; the customers remain responsible for the cost of service in entirety. It is only cost
19 savings that can be shared between utilities and customers.

20 Q. Under the provisions of the EARP, is it accurate to state that customers paid
21 for all merger costs, and shared in the resulting merger savings?

22 A. Yes.

1 Q. Have there been any problems with how the merger cost amortization was
2 handled in the context of the EARP?

3 A. Yes. The Staff believes an error may have occurred in the EARP credit
4 calculations, causing an excessive amount of merger transaction and transition costs to be
5 reflected as a reduction to UE's earnings in the EARP sharing grid. The Staff believes an
6 AmerenUE Missouri jurisdictional retail electric factor (approximately 85-86%) may have
7 been applied to the total Ameren merger costs for EARP credit calculation purposes, while
8 an Ameren Missouri jurisdictional electric factor should have been applied
9 (approximately 58-60%). This would cause the assignment to Missouri of the portion of
10 merger costs that should have been the responsibility of the AmerenCIPS division in Illinois.
11 For any credit calculation in which this error occurred, the impact would have been UE's to
12 over-collection of merger costs in Missouri by approximately \$1.5 to \$2 million for the credit
13 year. The Staff is continuing to investigate this matter.

14 Q. Have UE Missouri electric customers received the benefit of any CIPSCO
15 merger savings through a permanent rate reduction?

16 A. If they have, it is only to a very minor degree. In 2000, UE customers
17 received a belated rate reduction that was called for in the Stipulation of Case
18 No. EM-96-149 recommending approval of the CIPSCO merger. This rate reduction was
19 calculated as the average customer credit received during the first three years of the EARP
20 (i.e., through June 1998), after weather normalizing the credit amounts. As the CIPSCO
21 merger was not closed until the last day of 1997, that negotiated rate reduction could only
22 reflect a portion of the savings created in the first six months of the merger.

23 Q. What is the status of merger savings and costs in current UE rate levels?

1 A. Customers have paid for a large portion of UE's merger costs under the EARP
2 through a stipulated amortization method; as previously discussed, Missouri customers may
3 well have overpaid through the EARP for these costs. In contrast, UE's current rate levels
4 reflect the retention of a large portion of whatever merger savings have been achieved to-date
5 from the CIPSCO merger for the benefit of shareholders. Whatever portion of merger
6 savings was passed on to customers through credits under the EARP is now retained entirely
7 by UE through its current excessive earnings level.

8 UE's current rates reflect a mismatch between assignment of CIPSCO merger costs
9 and the related merger savings, to customer detriment.

10 Q. What actions does the Staff recommend be taken by the Commission in regard
11 to CIPSCO merger savings at this time?

12 A. The Staff recommends that fairness and equity require that any such merger
13 savings be passed on in entirety to UE's customers at this point. This can only be done by
14 reducing the Company's rates to end its current excess earnings, and allow UE an
15 opportunity through new rates to earn a reasonable, not excessive, rate of return.

16 Q. Does the discrepancy in how UE's merger-related costs and cost savings have
17 been treated under the EARP also apply to non-merger costs and cost savings?

18 A. Yes. Many utility cost reduction initiatives, such as renegotiation of fuel
19 contracts and formal programs to downsize the number of employees, also involve upfront
20 costs and potential long-term savings. Under the EARP, again, customers have paid for any
21 such upfront costs booked as expenses during the term of the EARP in the same way
22 CIPSCO merger costs have been. Any resulting savings from those initiatives during the
23 duration of the EARP were shared, at best, between the Company and its customers. The

1 Staff would again assert that a rate reduction is now in order, so that the customers that have
2 paid for these initiatives under the EARP can reap the full benefit of them.

3 Q. In this testimony, are you intending to indicate that all of UE's current excess
4 earnings are a result of its efforts to be more productive and efficient before and during the
5 EARPs?

6 A. No. There is no way to measure exactly what factors have contributed to
7 UE's current excess earnings situation. Some of the excess earnings undoubtedly relate to
8 factors outside UE's control, such as general economic conditions. However, some of the
9 excess earnings no doubt relate to UE's efforts to cut costs and improve its productivity in
10 the past.

11 Q. Wouldn't passing along merger and non-merger savings to customers at this
12 time reduce UE's incentives to undertake steps to reduce costs in the future?

13 A. No. The Staff would agree that any policy that would have the effect of
14 immediately passing on to customers the benefits of productivity initiatives would be ill-
15 conceived, as it would blunt the utilities' incentives to strive to cut costs by denying them
16 any practical benefit from their efforts. For this reason, the Staff has consistently taken the
17 position that utilities should have a reasonable opportunity to benefit from efforts to be more
18 efficient through the mechanism of regulatory lag or similar means.

19 However, a reasonable opportunity to benefit from cost reduction efforts by utilities
20 does not mean perpetual retention of the benefits. In regard to the CIPSCO merger, the
21 Company will have retained the benefit of most of any resulting merger savings for up to five
22 years at a minimum, by the time new rates from this proceeding go into effect. The Staff
23 believes UE has had more than an adequate opportunity to benefit from CIPSCO merger

1 savings, particularly considering that customers in Missouri have been responsible for paying
2 merger costs.

3 For any non-merger cost savings for which UE maintains the benefit in current rates,
4 which may pre-date the EARP, the situation is even more inequitable. This is because UE
5 last had its rates adjusted to match its actual cost of service in 1987-1988.

6 Q. Would a rate reduction at this time hurt UE's efforts to become more efficient
7 and to prepare for potentially greater competition in the future?

8 A. No. It is ironic that UE is using potential competition as a reason to urge the
9 Commission to take steps that would be anti-competitive.

10 In a theoretical competitive marketplace, firms can obtain a competitive advantage
11 through greater innovation and cost cutting efforts, thus increasing its profits. But economic
12 theory holds that the firm's competitors will eventually erode the leading firm's profit levels
13 by copying its efforts or finding ways to otherwise offset the former competitive advantage.
14 Then, the formerly leading firm must continually find new ways to dominate the competitive
15 market for whatever product or service is produced.

16 In contrast, UE is essentially advocating that it be allowed to retain benefits of cost
17 cutting efforts for an unlimited period of time. Competitive companies could not do that;
18 only monopolies have this ability. The purpose of regulation, of course, is to interpose the
19 effects of competition as best as it can in setting the prices regulated utilities can charge.

20 Periodically returning utilities to rates based upon their cost of service may be
21 characterized as harsh and punitive by UE. But this process best reflects the environment
22 that competitive businesses actually must operate in.

1 Q. If merger and non-merger related cost savings are passed on to customers by
2 the actions of the Commission in this case, will UE have the opportunity to create additional
3 cost savings?

4 A. Yes. UE recently announced it was planning to merge with Cilcorp, another
5 Illinois utility. While all of the details of the merger are not available to the Staff, it is
6 reasonable to assume that one reason that UE is planning this merger is to create additional
7 cost savings.

8 **OVERVIEW: UE CRITICISMS OF STAFF CASE**

9 Q. Please summarize the main criticisms offered in UE's rebuttal testimony
10 concerning the Staff's determination of the Company's revenue requirement.

11 A. General criticisms of the Staff's revenue requirement calculations are offered
12 in a number of UE rebuttal witnesses' testimony, but the most in-depth treatment of this topic
13 can be found in the rebuttal testimony of UE witnesses Martin J. Lyons (pages 4-26) and
14 Warner L. Baxter (pages 43-60). A summary of the major points of their critiques follows:

15 ?? The Staff's adjustments to the Company's test year results are alleged to be
16 arbitrary in nature, and are offered with little or no support. Taken as a whole,
17 UE depicts the Staff's case as "standardless" (Lyons rebuttal, pages 11,15-18);

18 ?? The Staff is accused of being opportunistic and inconsistent in its selection of
19 normalization approaches, appearing to select the specific approach used for a
20 given area on the basis that the method would result in the lowest revenue
21 requirement for the Company (Lyons rebuttal, pages 15-18);

22 ?? The Staff is depicted as ignoring the requirements of GAAP in formulating its
23 adjustments, and failing to propose an alternative accounting regime to GAAP as

1 the foundation of its revenue requirement calculation (Lyons rebuttal,
2 pages 11-14);

3 ?? As part of its overall hostility to the use of GAAP for ratemaking purposes, the
4 Staff is accused of inappropriately using “cash” basis accounting for several of
5 its adjustments rather than the accrual accounting techniques normally used for
6 financial reporting purposes (Lyons rebuttal, pages 18-22; Baxter, page 55);

7 ?? The Staff is alleged to violate the Commission’s ordered test year in several of its
8 adjustments (Lyons rebuttal, pages 37, 39-41); and

9 ?? These witnesses believe that the Staff improperly proposed to eliminate “non-
10 recurring” costs from the test year, denying the Company recovery of prudently
11 incurred expenses (Lyons rebuttal, pages 22-25; Baxter rebuttal, pages 53-54).

12 I will be offering an overall response to these critiques in this testimony. I, as well as
13 other Staff witnesses, will also address some of these points as they are applicable to each of
14 the issues in the case.

15 Q. One of the major criticisms of the Staff by UE is that the Staff’s proposed
16 adjustments do not appear to be proposed in a consistent manner under an overall
17 philosophy. Does the Staff’s revenue requirement reflect an overall approach and philosophy
18 regarding how rates should be set for regulated utilities in Missouri when traditional cost of
19 service regulation methods are used?

20 A. Yes. The approach used in this complaint case to develop UE’s revenue
21 requirement is consistent with the approach the Staff has used in all proceedings during my
22 tenure at the Commission. In fact, the Staff’s revenue requirement approach and philosophy
23 in this proceeding is consistent with the approach used in rate filings by the vast majority of

1 the State's utilities and other participants in the rate case process. Perhaps because of the
2 pervasiveness of this approach in Missouri, it frequently is implicitly assumed in rate
3 proceedings and not directly articulated as a philosophy as such. Because of the unique
4 nature of UE's attack on this approach in this rate proceeding, it needs to be explicitly
5 articulated by the Staff, or else the basis for the Staff's revenue requirement formulation will
6 not be fully understood or appreciated.

7 Q. What is the overall approach and philosophy that underlies the Staff's revenue
8 requirement recommendation for UE in this proceeding and in general?

9 A. Simply stated, if a traditional cost of service regulation approach is used to set
10 UE's rates in this proceeding, rates should be set to allow the Company a reasonable
11 opportunity to recover its prudently incurred and ongoing level of prospective costs of
12 providing service to its customers.

13 More specifically, this approach entails:

- 14 1) Consideration of whether historic measures of the utility's revenues, expenses
15 and rate base, as expressed on the Company's books and records in the test
16 year, should be adjusted to reflect ongoing, prospective levels of these
17 revenue requirement components;
- 18 2) An appropriate "matching" of all major elements of revenue requirement at a
19 consistent point, so that a valid going-forward relationship between the
20 Company's revenues, expenses and rate base is established; and
- 21 3) Rates based upon "known and measurable" events, not speculation as to the
22 future.

1 Referring back to these “first principles” adequately addresses all of UE’s criticisms
2 of the Staff’s approach to calculating revenue requirement in this proceeding.

3 Q. By what means does the Staff propose to adjust historic test year results to
4 restate them to levels consistent with a utility’s ongoing and prospective level of cost of
5 service?

6 A. This is done primarily through use of annualization and normalization
7 adjustments.

8 Q. What are annualization adjustments?

9 A. Annualization adjustments pertain to costs associated with events that have
10 occurred within the test year and will continue to occur subsequent to the test year.
11 Annualization adjustments reflect the forward-looking dollar impact of recurring test year
12 events. They are generally used whenever the data for a revenue or expense component
13 show a definite trend upward or downward within a test year. In that situation, an
14 annualization adjustment would normally be proposed to reflect the most recent values
15 within the test year for that revenue or expense component for inclusion in rates.

16 Q. What are some typical examples of annualization adjustments proposed by the
17 Staff?

18 A. These examples include revenue annualizations to reflect customer growth,
19 and expense annualizations for depreciation and payroll.

20 A utility’s test year revenue levels should reflect changing levels of customers on the
21 utility’s system throughout the period. To adjust historical revenue levels to an appropriate
22 forward-looking basis, revenues are customarily adjusted to reflect an entire year’s usage by

1 the number of customers on the utility's system as of the end of the test year or update
2 period.

3 A utility's test year booked depreciation expense should reflect application of
4 approved depreciation rates to changing levels of plant investment throughout the 12-month
5 period. To adjust historical depreciation expense levels to an appropriate forward-looking
6 basis, depreciation expense is customarily adjusted to reflect an entire year's application of
7 the depreciation rates advocated by the particular party to the test year-end or update period-
8 end level of plant investment.

9 A utility's test year payroll expense should reflect the payment of changing salary
10 amounts over time to a changing number of individuals employed by the company. To adjust
11 historical payroll expense levels to an appropriate forward-looking basis, payroll expense is
12 customarily adjusted to reflect the wage/salary rates in effect at the end of the test year or
13 update period, applied to the number of employees at the end of the test year or update
14 period.

15 Q. Has the Staff sponsored adjustments in this proceeding concerning all of these
16 common annualization adjustments?

17 A. Yes.

18 Q. Do all of these Staff adjustments have the impact of reducing UE's revenue
19 requirement?

20 A. No. The Staff's payroll expense annualization for UE increases the levels of
21 this expense above the test year levels. The Staff's depreciation expense annualization
22 adjustment overall decreases UE's test year expense, but only because the Staff is proposing
23 new, lower depreciation rates in this proceeding. The Staff's revenue customer growth

1 annualization increases forward-looking revenue levels above test year amounts for UE, thus
2 reducing revenue requirement.

3 Q. Do these types of annualizations violate the test year concept?

4 A. No, not when the adjustments are based upon the last known values within the
5 test year and update period for customer numbers, plant balances, salary/wage rates and
6 employee numbers, as is true for all Staff annualization adjustments proposed in this
7 proceeding.

8 Q. Are all of these annualization adjustments standard in rate proceedings?

9 A. Yes, both the Staff and the utility normally propose them in rate proceedings.

10 Q. Has UE sponsored all of these annualizations as part of its revenue
11 requirement calculation?

12 A. No. While UE is proposing annualization adjustments for depreciation
13 expense and payroll expense to increase its revenue requirement, UE has neglected to reflect
14 an annualization adjustment in revenues for customer growth, which can be expected to
15 reduce its revenue requirement.

16 Q. What is the impact of UE's failure to annualize its revenue levels in its case
17 through a customer growth adjustment?

18 A. Such treatment creates an artificial revenue requirement for the Company, by
19 increasing the calculation of the amount of revenues that purportedly need to be recovered
20 through rate relief, but for which in actuality a portion can be expected to be recovered by
21 UE at existing rates from the level of customers on the system at the end of the test year
22 update period. The customer growth issue is addressed in detail in the surrebuttal testimony
23 of Staff Accounting witness Greg R. Meyer.

1 Q. What are normalization adjustments?

2 A. Normalization adjustments reflect the removal of costs associated with events
3 or items within the test year that are non-recurring, or exhibit a fluctuation from the level that
4 would be normally expected to occur. Normalization adjustments need to be made to test
5 year results to achieve an appropriate forward-looking focus of the revenue/expense/rate base
6 relationship.

7 Q. Please give examples of normalization adjustments the Staff has proposed to
8 items that tend to fluctuate over time.

9 A. In electric regulation, a predominant example is weather normalization. For
10 electric utilities, the test year level of revenues and associated expenses (such as fuel
11 expense) reflect the impact of the weather patterns in effect during that 12-month test year
12 period. It is standard for parties in rate cases to propose revenue and expense adjustments
13 that serve to restate these items as if “normal” weather patterns had been in effect during the
14 test year.

15 For other types of costs, the booked expense in any one year may show variations or
16 fluctuations from year-to-year. If, in comparison to past years, the test year amount for a
17 particular cost shows a trend upward or downward, and the reason for the trend would appear
18 to be ongoing, it would probably be appropriate not to adjust the test year result. However, if
19 there are fluctuations in value from year-to-year, but there is no discernable trend from
20 year-to-year (i.e., either upward or downward), adjustment of the test year expense using a
21 multi-year average should be considered, if there is no indication that any particular annual
22 result is indicative of likely future levels of that cost.

23 Q. Are normalization adjustments standard in the ratemaking process?

1 A. Yes. Both the Staff and utilities in rate proceedings commonly propose
2 normalization adjustments.

3 Q. In its revenue requirement calculation, has UE incorporated any normalization
4 adjustments to its test year results?

5 A. UE has incorporated some normalization adjustments, for items such as the
6 impact of weather on sales and to spread the impact of the Callaway generating unit refueling
7 outage over 18 months. However, there are certain expenses that UE acknowledges in its
8 rebuttal testimony have fluctuated greatly in recent years, but for which UE has not proposed
9 to restate test year levels of the expense to normal ongoing levels. UE has chosen to leave
10 the level of these expenses at “abnormal” levels.

11 Q. What specific expenses are you referring to?

12 A. UE’s rebuttal testimony itself sets out a basis for normalization adjustments
13 for tree trimming and injuries and damages.

14 Regarding tree trimming, Mr. Lyons’ rebuttal testimony at page 16 indicates that the
15 Staff has provided “legitimate reasoning” for the need for an adjustment, and that an
16 adjustment “may well be appropriate.” However, UE witness Thomas R. Voss criticizes the
17 Staff for deviating from the test year level of tree trimming expense by proposing an
18 adjustment. The Company’s case reflects no adjustment to normalize tree trimming
19 expenses. The Staff’s treatment of tree trimming expenses is addressed in the direct and
20 surrebuttal testimony of Staff Accounting witness Paul R. Harrison.

21 For injuries and damages expense, UE witness Lyons states at page 44 of his rebuttal
22 testimony “...injuries and damages expense has fluctuated significantly from year to year in
23 the five years ended September 30, 2001.” However, UE failed to sponsor a normalization

1 adjustment for this item to “smooth out” the above-mentioned fluctuations for purposes of
2 setting ongoing rates. I will address this issue in more detail later in this testimony.

3 Q. What is the impact of UE’s failure to adjust “abnormal” levels of expense
4 from the test year?

5 A. UE’s failure to propose reasonable normalization adjustments means that
6 certain significant expenses are proposed for inclusion in rates at abnormally high, non-
7 recurring levels. More broadly, this failure to sponsor appropriate normalization adjustments
8 will result in UE recovering its past unadjusted test year cost of service in rates on a going
9 forward basis in this proceeding, rather than a reasonable level of ongoing costs.

10 Q. Has the Staff sponsored normalization adjustments to eliminate the impact of
11 non-recurring costs from the test year?

12 A. Yes, in at least three areas. The Staff has proposed to remove from cost of
13 service a one-time payment made in the test year for UE to leave the Midwest Independent
14 System Operator (MISO), the costs of an expired capacity purchase, and certain non-
15 recurring costs paid by UE in the test year associated with automated meter reading systems.

16 Q. Is total elimination from cost of service appropriate for non-recurring items?

17 A. Yes, if the costs are truly non-recurring (i.e., of the nature that it is highly
18 unlikely that the utility will ever incur the particular costs again).

19 Some costs will not recur on an annual basis, but may be incurred again in the future
20 on an irregular basis. If this type of cost is included in a test year, and the costs otherwise
21 meet the criteria for inclusion in rates, then the Staff would normally propose their inclusion
22 in cost of service through a multi-year amortization.

1 Another type of non-recurring cost is “extraordinary” costs. These costs are unusual
2 and non-recurring costs that are outside the normal business activities of a utility. These
3 costs are usually associated with “acts of God” (floods, ice storms, etc.) and other truly major
4 events outside the control of the utility. When such events occur and costs are incurred, the
5 normal process in Missouri is to defer the costs on the utility’s books and amortize them to
6 expense.

7 Contrary to the implication in Mr. Lyons’ rebuttal testimony at pages 22-23,
8 extraordinary costs are not the only type of non-recurring costs that utilities experience.

9 Q. What is the justification for making adjustments to eliminate true non-
10 recurring costs from the test year, if there are no allegations of imprudence associated with
11 the costs?

12 A. The justification for these adjustments is that they are necessary to restate
13 historical cost data to properly reflect the expected future operations of the utility. To state it
14 another way, because it is not expected that the utility will incur these costs during the period
15 rates will be in effect, it would be inappropriate to allow the company revenues to cover such
16 non-existent costs during that period.

17 Q. Company witnesses argue in rebuttal testimony that the Staff’s adjustments to
18 non-recurring costs in this proceeding ignore the fact that utilities will always incur a certain
19 level of non-recurring costs (Baxter rebuttal, pages 53-54; Lyons rebuttal, page 23). What is
20 your opinion?

21 A. Having raised the unique concept of “recurring” non-recurring costs in its
22 testimony, UE has not followed through by providing meaningful manifestation that such
23 costs exist for UE, and at what level. Without such tangible manifestation, UE appears to be

1 trying to rebut the Staff's position that certain costs in the test year will not recur by citing
2 "conceptual" or "hypothetical" non-recurring costs that UE allegedly will incur in the period
3 new rates will be in effect as a result of this proceeding. Of course, it is always possible to
4 argue against adjustments that reduce real test year costs by alleging that other unidentified
5 costs will occur or recur at increased levels in the future.

6 Q. At page 15 of his rebuttal testimony, Mr. Lyons has presented a list of varying
7 approaches the Staff has used in normalizing various UE costs, leading to his statement that
8 "the Staff was opportunistically picking and choosing normalization techniques" (Lyons
9 rebuttal, page 18). Is this conclusion correct?

10 A. No. Mr. Lyons and other UE witnesses would have the Commission believe
11 that the fact that the Staff proposes normalization methods that may vary from item-to-item is
12 evidence of the Staff's selective search for ways to unfairly and inappropriately reduce UE's
13 revenue requirement. The simple truth is that this is not the case. The Staff examines all
14 major elements of cost of service individually, among other reasons, to determine the need
15 for potential normalization adjustments. The situation usually differs from cost-to-cost,
16 which in turn calls for different types of adjustments depending upon the cost and the
17 situation. As discussed above, items in the test year which show a trend upward or
18 downward over a period of time probably either will be annualized or will not be adjusted at
19 all by the Staff. The Staff will probably normalize items that fluctuate up and down over a
20 period of time by use of a multi-year average. While five years is a common period for
21 multi-year average normalization adjustments, factors such as the availability and the
22 consistency of data over time, and the length of time the particular cost has been incurred,
23 may lead to use of a greater or lesser number of years for normalization purposes than five

1 years. Depending upon the nature of the item, non-recurring costs may be either adjusted out
2 of the test year or amortized over a period of years.

3 The undeniable fact that the Company has been more “consistent” in its adjustment
4 approaches than the Staff (mostly by failing to propose adjustments to test year data) reveals
5 that rote consistency is not a virtue in the ratemaking process.

6 Q. When should consistency be a concern in the formulation of adjustments?

7 A. Consistency is a valid concern when a party proposes different treatments for
8 elements of cost of service when the underlying facts and circumstances are identical or
9 highly similar for the elements. UE’s criticisms of the Staff in rebuttal testimony for
10 “inconsistency” and “opportunism” are vague and general. They do not reach the level of
11 specificity necessary for any real analysis of the Staff’s adjustments.

12 Q. UE witness Lyons presents at page 26 of his rebuttal testimony a belief that
13 adjustments to alter or disallow test year costs are not appropriate unless there is an
14 allegation of utility imprudence. Do you agree?

15 A. No. To the extent that UE’s position, as expressed in Mr. Lyons’ rebuttal
16 testimony, is based upon legal grounds, I will not address such contentions.

17 However, from a ratemaking perspective, UE’s argument is incorrect. In rate
18 proceedings in Missouri, proposed adjustments premised upon allegations of imprudence are
19 actually relatively rare. Most adjustments to test year results are instead premised upon
20 either the need to normalize or annualize test year costs to reflect future conditions (which
21 does not normally involve imprudence), or are intended to assign certain costs to
22 shareholders for reasons other than imprudence, such as the costs are not necessary and do
23 not benefit customers.

1 Q. Why should utility costs be assigned to shareholders through the rate process,
2 if there are no allegations of imprudence concerning the costs?

3 A. The Staff asserts that certain costs frequently incurred by utilities are either
4 not strictly necessary for provision of service to regulated customers, or are intended to
5 benefit shareholder interests as opposed to customer interests. These types of costs include
6 charitable contributions, certain organizational dues, lobbying costs, institutional advertising
7 expense, incentive compensation costs, and others. Adjustments to the test year for these
8 types of costs are normally not premised upon an allegation that the utility acted imprudently
9 in incurring the expenses. Rather, these adjustments are based upon a belief that the costs in
10 question are simply not appropriate to include in customer rates.

11 Q. Has UE proposed any adjustments in this case that would fall into this
12 category?

13 A. Yes. UE has proposed an adjustment to test year expense that would result in
14 the disallowance of \$1 million in institutional advertising expense. While UE's rebuttal
15 testimony does not go into detail as to why this adjustment is appropriate, I believe it is safe
16 to assume that UE in proposing this adjustment is not intending to admit that this cost was
17 imprudently incurred.

18 Q. In the context of several proposed Staff adjustments, UE has accused the Staff
19 of violating the ordered test year in this proceeding. Are these accusations valid?

20 A. No. Other Staff witnesses will be addressing the Company's test year
21 allegations as they pertain to their assigned issues. Taking an overall perspective, however,
22 UE's claims are groundless. The Staff has not violated in any way the letter or the spirit of
23 the Commission's Order dated December 6, 2001, regarding test year in this proceeding.

1 The Staff has presented its case in a manner that appropriately matches in time all major
2 elements of the utility's revenue requirement.

3 Q. Please explain the Staff's approach to "matching" of cost of service elements.

4 A. Starting with the ordered test year ending June 30, 2001, the Staff updated all
5 major elements of revenue requirement through the end of the update period,
6 September 30, 2001. Most rate base items are valued at September 30, 2001 levels, as period
7 ending balances have a more relevant relationship to UE's ongoing cost of service than, for
8 example, average balances over the period of the test year or update period. Major elements
9 of expense were also updated through September 30, 2001. All expense categories were
10 examined as well to determine the need for normalization and annualization adjustments to
11 restate those items to better fit the forward-looking perspective of the ratemaking process.
12 Revenues were adjusted to reflect the level of customers on UE's electric system at the end
13 of the update period. The Staff believes the cost of service it has calculated produces a
14 reasonable revenue/expense/rate base relationship based upon an appropriate matching of all
15 major revenue requirement components, all of which is consistent with the Commission's
16 test year directives.

17 Q. Are out-of-period adjustments allowable in the ratemaking process?

18 A. Yes, on a very limited basis. The Commission has indicated it will consider
19 reflection of out-of-period, or isolated, adjustments in utility revenue requirements if such
20 adjustments are based upon known and measurable information and a proper matching of all
21 elements of cost of service is preserved. In most cases, when the Commission has accepted
22 isolated adjustments in setting rates, the adjustments concerned either contractual wage
23 increases or changes in government-mandated costs (such as changes in postage rates).

1 Q. Has the Staff reflected any out-of-period adjustments in its case?

2 A. From some perspectives, the Staff's inclusion of certain insurance
3 reimbursements relating to UE's Venice power plant fire is out-of-period, since the exact
4 amount of the reimbursements was not known until after the test year and update period.
5 However, if these reimbursements are considered to be out-of-period, the Staff believes
6 Commission adoption of these adjustments would be appropriate because they are based
7 upon known and measurable information, and they do not violate any matching concerns. In
8 fact, the insurance reimbursements should be reflected in this proceeding precisely because
9 their inclusion is needed to appropriately "match" other expenses relating to the Venice
10 Power Plant fire that were booked as being within the test year and update period.

11 Venice Power Plant fire issues are also discussed in the direct and surrebuttal
12 testimony of Staff witness Harrison.

13 Q. Aside from the Venice insurance reimbursements, has UE accused the Staff of
14 violating the Commission test year Orders with any of its other proposed adjustments?

15 A. Yes. In at least two other instances (adjustment to revenues for customer
16 growth; annualization adjustment for the Commission annual assessment), the Company has
17 accused the Staff of disregarding the Commission's directives concerning the test year.

18 Q. Are these allegations accurate?

19 A. No. Both the customer growth adjustment and the Commission assessment
20 adjustment are annualizations based upon known and measurable data points within the test
21 year update period. Both adjustments are standard in rate case proceedings and are normally
22 sponsored by both the utility and the Staff.

1 Q. You earlier indicated that the Staff's revenue requirement recommendation in
2 this case is appropriately prospective in nature, and internally consistent in that it is matched
3 at a point in time consistent with the Commission's test year practices. Are these statements
4 true concerning the Company's sponsored revenue requirement recommendation?

5 A. No. The Company's case is neither forward-looking nor appropriately
6 matched.

7 The Company's case is not forward-looking because, as previously discussed, UE has
8 not proposed that normalization and annualization adjustments be applied to test year data,
9 except for some, not all, "standard" rate case adjustments. With minor exceptions, all of the
10 "standard" adjustments that UE has proposed increase revenue requirement.

11 Related to the above concern, UE's case is not appropriately "matched" because UE
12 has failed to update items that would decrease revenue requirement, such as customer
13 growth, to the same point in time as other elements, like depreciation and payroll expense,
14 that increase UE's revenue requirement.

15 Because of these fundamental flaws, UE's revenue requirement calculation is not an
16 appropriate base for the Commission to make a determination of the sufficiency of the
17 Company's current rate levels.

18 Q. In his rebuttal testimony, Mr. Baxter references the small number of
19 adjustments sponsored by UE to its test year results. Is its lack of adjustments a point in
20 favor of UE's revenue requirement calculation?

21 A. No. At pages 63-64 of his rebuttal testimony, Mr. Baxter states, "...the
22 number of adjustments that were made to test-year expenses are very modest. Simply put,

1 aside from the standard normalization of certain revenues and expenses, our cost of service
2 largely reflects our actual costs incurred by the Company during the test-year.”

3 Apparently, these statements are intended as supporting UE’s approach to
4 determining revenue requirement. However, they miss the relevant point. More adjustments
5 or less adjustments is not the issue; the issue is whether a party has proposed appropriate
6 adjustments to restate past historic cost information into forward-looking, prospective cost
7 information suitable for inclusion in rates. Mr. Baxter supports UE’s implicit belief that the
8 purpose of the ratemaking process is largely to verify that UE’s numbers have been recorded
9 and added, subtracted, multiplied and divided accurately in order for UE to recover its
10 booked level of past, historic costs. The Commission should reject this view of regulation.

11 Q. Please summarize the Company’s beliefs regarding the relationship of
12 generally accepted accounting principles (GAAP) in ratemaking.

13 A. Much space in UE’s rebuttal testimony is spent on decrying the Staff’s failure
14 to utilize GAAP approaches in formulating its revenue requirement. The Company alleges
15 that GAAP is generally appropriate for purposes of setting rates, and goes so far as to state
16 that parties opposing the use of GAAP for a particular rate element should have a special
17 burden to justify the non-GAAP treatment (Lyons rebuttal, pages 8-9). Further, UE implies
18 that parties that reject GAAP approaches in ratemaking have an obligation to present some
19 alternative system of accounting to support their rate case adjustments and positions (Lyons
20 rebuttal, pages 13-14). In particular, UE asserts that the accrual approach to calculating
21 expenses incorporated within GAAP is appropriate for ratemaking and, accordingly, the
22 Staff’s recommendation to use a cash basis for setting rates for selected elements of expense
23 is both contrary to GAAP and to appropriate ratemaking (Lyons rebuttal, pages 9-11, 18-22).

1 Q. Please define GAAP.

2 A. I generally concur with Mr. Lyons' description, at pages 5-6 of his rebuttal
3 testimony, of GAAP and the process by which it is developed by financial accounting
4 authorities. Simply stated, GAAP are the rules business entities must follow in reporting to
5 the public their financial results.

6 Q. Are utilities required to follow GAAP for financial reporting purposes?

7 A. Yes.

8 Q. What rules govern how electric utilities in Missouri account for costs for
9 regulatory accounting purposes?

10 A. Electric utilities in Missouri are required to follow the instructions in the
11 Federal Energy Regulatory Commission (FERC) Uniform System of Accounts (USOA) in
12 reporting their financial results to the Commission. The Commission has adopted by rule the
13 FERC USOA. 4 CSR 240-20.030 and 4 CSR 240-40.040. It should be noted that the
14 requirements of the USOA, while generally consistent with GAAP, are in some instances
15 different from the financial reporting requirements of non-regulated companies.

16 Q. Is the Commission in any manner required to follow the accounting standards
17 in the USOA in setting rates?

18 A. No. The text of the Commission rule adopting the USOA states that nothing
19 within the USOA shall be considered binding for ratemaking purposes. 4 CSR 240-20.030(4)
20 and 4 CSR 240-40.040(4).

21 Q. Does the Commission ever deviate from the accounting provisions of the
22 USOA in its rate decisions?

1 A. Yes. In some recent cases, the Commission has ordered that net salvage costs
2 related to assets should be treated as current costs on a cash basis, and not follow the more
3 traditional approach of accruing the estimated net salvage values over the estimated lives of
4 the assets as a component of depreciation expense. The Commission took this position
5 notwithstanding the fact that the rule adopting the FERC electric USOA calls for the booking
6 of net salvage costs in an accrual fashion consistent with its traditional inclusion in
7 depreciation expense. 4 CSR 240-20.030 (3)(H).

8 The Staff is recommending in this case that net salvage costs be treated as a current
9 expense on a cash basis.

10 Q. In this proceeding, if the Commission orders a rate methodology for an item
11 that conflicts with an accounting treatment prescribed within the Commission rules, are there
12 any actions the Commission can take to reconcile the difference in rate and accounting
13 treatment?

14 A. Yes. In that circumstance, the Staff recommends that the Commission's
15 Order state that the Company is not expected to comply for accounting purposes with the
16 specific rule or section of a rule for which different ratemaking has been ordered. This
17 would be equivalent to granting the Company a waiver from the rule or rule section in
18 question.

19 Q. Is the Commission in any manner required to follow GAAP in setting rates?

20 A. No. In fact, GAAP itself recognizes that there are many instances in which
21 regulatory commissions may set rates on a different basis than GAAP. In 1982, the Financial
22 Accounting Standards Board issued Financial Accounting Standard No. 71 (FAS 71),
23 "Accounting for the Effects of Regulation." FAS 71 sets out the circumstances under which

1 regulated utilities can account for certain costs for financial reporting purposes consistent
2 with how their regulatory commissions treat the costs for ratemaking purposes, if the rate
3 treatment is not consistent with financial reporting GAAP. A copy of FAS 71 is attached to
4 this testimony as Schedule 2.

5 By totally ignoring the existence of FAS 71 in their rebuttal testimony, Mr. Baxter
6 and Mr. Lyons have attempted to provide an incomplete and misleading depiction of the
7 relationship of GAAP and utility ratemaking.

8 Q. What is “accrual accounting?”

9 A. Accrual accounting involves the reporting of revenues when they are earned,
10 not when they are received, and the reporting of expenses when they are incurred, not when
11 they are paid. In general, accrual accounting focuses on the economic substance of business
12 transactions, not on cash receipts and outlays, as cash basis accounting does.

13 Q. Is accrual accounting standard in GAAP?

14 A. Yes.

15 Q. Is accrual accounting used within the USOA?

16 A. Yes. It is a requirement of the USOA that utilities keep their books and
17 records on an accrual basis.

18 Q. Is the calculation of costs under GAAP for financial reporting purposes and
19 the calculation of costs in the ratemaking process equivalent in nature?

20 A. No. The fundamental error UE makes throughout all of its discussion of
21 GAAP and its relationship to the rate process is that the Company conflates the purpose of
22 GAAP in calculating the financial results of utilities with the purposes and goals of the
23 Commission in setting rate levels for utilities. This relationship simply does not hold.

1 Q. Why isn't the level of utility costs developed under the provisions of GAAP
2 automatically transferable to the rate process as the amount of the costs to include in rates?

3 A. GAAP is intended to govern how businesses report to the public the financial
4 results of their past business operations. It guides how utilities and non-regulated businesses
5 report past levels of expenses and revenues, assets and liabilities. In contrast, as previously
6 discussed, the rate process intends to set rates equal to the utility's expected prospective level
7 of costs. GAAP, as used for financial reporting purposes is unavoidably backward-looking.
8 The rate process is, or should be, forward-looking. For this reason, the concepts of
9 annualization and normalization of expenses, so important in ratemaking, are not generally
10 applicable in financial accounting and GAAP.

11 Q. Are there other differences between GAAP and the normal practices of
12 ratemaking?

13 A. Yes. Under traditional ratemaking approaches, a utility's rates are directly
14 based upon a calculation of its costs. Non-regulated entities presumably base the prices they
15 charge on market forces, not directly on the costs of the enterprise. The regulator's concerns
16 in directly setting rates for utility services cannot be assumed to be the same as the concerns
17 of those bodies formulating GAAP in establishing how costs are accounted for.

18 Also, GAAP is developed by organizations that are not directly involved in or overly
19 concerned with the world of utility regulation. The particular needs and interests of utilities,
20 utility customers and utility regulators are not, and for all practical purposes cannot be, a
21 primary concern of financial reporting authorities in the development of GAAP.

22 Q. Is the use of GAAP approaches in the ratemaking process ever appropriate?

1 A. Yes. When use of GAAP in ratemaking fosters a calculation of a rate
2 component at an appropriate prospective level, that is based upon “known and measurable”
3 information, and is stated at a level matched in time with other revenue requirement
4 components, there is no inherent concern with incorporating GAAP into the rate process.

5 Q. Having failed to endorse blanket application of GAAP to utility ratemaking, is
6 the Staff now obligated to propose a different financial reporting system to use for
7 ratemaking for this proceeding, as suggested by Mr. Lyons at page 11 of his rebuttal
8 testimony?

9 A. No. The ratemaking standard proposed by the Staff, and used by it in this
10 proceeding, has already been discussed in this testimony. It is not clear what purpose is
11 served by the Staff proposing alternative financial reporting systems that are not applicable to
12 the rate process.

13 Q. Is the use of accrual approaches justified in ratemaking?

14 A. Yes, when appropriate. Accrual approaches in setting rates are appropriate
15 when their use best fosters an appropriate balance between the need for timely recognition of
16 expenses and the need for accurate quantification of expenses. It should be noted that while
17 GAAP utilizes accrual accounting, this does not automatically mean that all accruals are
18 appropriate or accurately calculated.

19 Q. Please explain.

20 A. There are occasions in both financial accounting and ratemaking when it is
21 clearer that an expense exists than what the ultimate amount of the expense will be. Some
22 examples of these situations are embodied in the issues facing the Commission in this
23 proceeding (injuries and damages claims, legal costs, environmental clean-up costs). Current

1 GAAP, using an accrual approach, emphasizes the need for timely recognition of the expense
2 (once it could be reasonably estimated) over the need for a high level of confidence in the
3 quantification of the payout.

4 Q. Why is the interest in timely recognition of expenses important in GAAP?

5 A. For financial reporting purposes, this desire is tied to the need for proper
6 matching of revenues to expenses; i.e., that all of the expenses incurred by the business in
7 providing its product or service be booked in the same period as the revenues earned from the
8 product/service. GAAP recognizes that appropriate matching will not be achieved in all
9 instances by delaying recognition of expenses until they are capable of final and accurate
10 quantification.

11 For ratemaking purposes, the interest in timely recognition of expenses lies in the
12 concept of “intergenerational equity”; i.e., trying to ensure that the right costs are charged to
13 the right customers (those benefiting from the utility’s incurrence of those costs).

14 Q. Please provide an example of how intergenerational equity concerns leads to
15 the use of accrual accounting for rate purposes.

16 A. The charging of depreciation expense in rates is an excellent example of
17 intergenerational equity concerns.

18 When an electric utility constructs a generating unit, it is fundamental that the
19 customers receiving power from the unit over its life share in paying for the costs of the unit.
20 If the assumed life of the unit is 40 years, then the ratemaking process will incorporate the
21 recovery of the unit’s cost from customers through depreciation expense over a 40-year
22 period. But the estimate of the unit’s life used in setting the applicable depreciation rate

1 cannot be exact. The generating unit's actual life may ultimately be less or more than 40
2 years.

3 The perceived demands of intergenerational equity call for an attempt to recover the
4 cost of the unit from customers over its estimated life, even if the correct amount of annual
5 depreciation expense to be charged each year cannot be known in advance of knowledge of
6 when the unit will stop operating.

7 Q. Should the demands of intergenerational equity always outweigh a concern for
8 accurate quantification of costs?

9 A. No. Equity concerns run both ways. Reflecting costs in rates before an
10 accurate quantification of the costs can be made runs the risk of charging customers far more
11 or far less in rates for certain items than the actual costs to the utility. This result, depending
12 upon the specific situation, would be grossly unfair to the customers or the utility.

13 Q. In this proceeding, for those items for which the Staff is advocating cash
14 treatment rather than accrual treatment for rate purposes (environmental costs, legal costs,
15 and injuries and damages), why does the Staff take this position?

16 A. For these items, the Staff believes that the potential inequity of charging
17 customers in rates for these costs in advance of the opportunity for an accurate quantification
18 of the costs, outweighs intergenerational equity concerns, and justifies waiting until a cash
19 outlay is made for these items before recognizing them in rates.

20 Q. Wouldn't that recommendation, if adopted by the Commission, be in
21 opposition to GAAP practices?

1 A. No. Again, FAS 71 allows in most instances for a utility to account for costs
2 for financial reporting purposes in a consistent with their regulatory commission's rate
3 directives.

4 Q. Has the Commission previously considered the proper relationship between
5 GAAP and its rate setting processes?

6 A. Yes. Examples of the Commission's past statements in regard to rate
7 treatment of post-retirement employee benefits (OPEBs) in comparison to GAAP treatment
8 of such costs can be found in the surrebuttal testimony of Staff Accounting witness John P.
9 Cassidy.

10 Q. In the Staff's opinion, are the Company positions in this case on the "cash vs.
11 accrual" issues based upon valid intergenerational equity concerns?

12 A. No. Mr. Lyons, at page 18 of his rebuttal testimony, states that the cash basis
13 "divorces costs from the ratepayers who benefited from the services that generated them."
14 At page 55 of his rebuttal testimony, Mr. Baxter opines that accrual accounting is "designed
15 to accurately match revenues with the costs incurred to produce those revenues." However,
16 the rhetoric employed by these witnesses on the "cash vs. accrual" issues does not match the
17 reality of what the Company is actually advocating.

18 For most of the costs involved in the "cash vs. accrual" issues, UE is relying upon the
19 provisions of Financial Accounting Standard No. 5 (FAS 5), "Accounting for
20 Contingencies." FAS 5 calls for the booking of liabilities when company management
21 believes that a future cash outlay from the event in question is "probable," and when the
22 amount of the future cash outlay can be "reasonably estimated." Please note that the standard
23 employed by UE under FAS 5 is quite different from that implicit in the intergenerational

1 equity theory; it leads to assignment of costs to customers when a liability is probable and
2 can be reasonably estimated, not when the event that caused the liability occurred. As the
3 provisions of FAS 5 may not be met until long after the event triggering the liability
4 occurred, the “right” customers will not be charged the costs of the event even under the
5 accrual accounting championed by UE. This is especially true of injuries and damages
6 expenses and environmental liabilities. This aspect of the “cash vs. accrual” issue will be
7 addressed later in this testimony as it concerns injuries and damages, and in the surrebuttal
8 testimony of Staff Accounting witness Cassidy concerning environmental costs.

9 Q. Under GAAP, who would be responsible for determining whether certain
10 future cash outlays are probable to occur and capable of reasonable estimation?

11 A. For utility companies, their management would be responsible for these
12 decisions.

13 Q. What is the “known and measurable” test in Missouri regulation?

14 A. The Commission has for many years taken the stance that the impact of only
15 known and measurable events should be included in the rate process. “Known” means an
16 event has occurred. “Measurable” means the financial impact of the event can be accurately
17 quantified.

18 Q. In the Staff’s opinion, does the reflection in rates of events that are “probable”
19 of occurring in the future and are capable of being “reasonably estimated” meet the definition
20 of “known and measurable?”

21 A. No.

1 Q. At pages 21-22 of his rebuttal testimony, Mr. Lyons asserts that the Staff's use
2 of cash accounting is another example of "opportunism," or the Staff only selecting
3 ratemaking approaches that serve to reduce UE's revenue requirement. Is this true?

4 A. No. In fact, the Staff's advocacy of a cash approach for determining the
5 ratemaking allowance for uncollectibles expense, if adopted, would result in a significant
6 increase in the expense above UE's accrual recommendation for this item.

7 Q. On page 21 of his rebuttal testimony, Mr. Lyons' states that the accrual
8 treatment of such items as injuries and damages, and environmental costs is more forward-
9 looking than the cash approach. Do you agree?

10 A. No. If the price of being forward-looking is the inclusion of highly
11 speculative costs in rates, then that is too high of a price to pay.

12 The Staff finds it interesting that it is only in the "cash vs. accrual" context that UE
13 ever addresses the need for ratemaking to be forward-looking in nature. In all of UE's other
14 arguments for its revenue requirement approach, the emphasis is on recovery of its past test
15 year costs.

16 Q. At page 20 of his rebuttal testimony, Mr. Lyons opines that the cash basis of
17 accounting is "readily subject to self-interested manipulation." Do you agree?

18 A. No. I strongly disagree that the cash basis of accounting is any more subject
19 to manipulation than accrual accounting.

20 To respond to the specific example given in Mr. Lyons' testimony concerning injuries
21 and damages, an unusually large amount of cash settlements in a test year would likely
22 trigger the Staff's interest in obtaining an explanation for this matter. In addition, to the
23 extent these cash payouts caused expense to increase above previous years' levels, injuries

1 and damages would probably be handled for rate purposes through a multi-year
2 normalization adjustment, thereby causing a cash flow shortfall to the utility engaging in this
3 practice.

4 On the accrual side of the equation, there is a real incentive for utility management to
5 err on the side of maximizing future estimates of liabilities, if those estimates are used in the
6 ratemaking process. Higher estimates will inflate both a utility's rates and its cash flow, if
7 the Commission accepts the utility's estimates. This incentive would seem to be at least
8 equal to any incentive under cash basis accounting for improper conduct.

9 As the Commission is aware, recent events in the energy industry have shown
10 multiple instances of improper accounting practices and ineffective, at best, independent
11 auditor review at certain business entities. All of these abuses took place in the context of
12 GAAP and accrual accounting practices. Ultimately, of course, abuses are possible under
13 either the cash or accrual system of accounting, if strong ethics are not important to a
14 business's management.

15 Q. Are there other pitfalls with wholesale adoption of GAAP for ratemaking
16 purposes?

17 A. Yes. Quite frankly, blanket adoption of GAAP for ratemaking purposes can
18 lead to absurd results, because GAAP is simply not designed specifically for the rate process.
19 There is an excellent illustration of this point in this proceeding.

20 Q. Please explain.

21 A. The Venice Power Plant repair and replacement costs, discussed earlier in this
22 surrebuttal testimony, illustrate the problems associated with applying GAAP standards to
23 ratemaking, regardless of the circumstances.

1 Within the test year, UE booked over \$20 million of costs, both of an expense and
2 capital nature, related to the repairs necessary to restore the Venice station to service after a
3 fire in 2000. At the same time, UE applied to its insurance carriers for reimbursement of its
4 repair and replacement costs. At the conclusion of the update period, UE had not booked an
5 accrual for its probable insurance recovery for the Venice Power Plant repair and
6 replacement costs because, under UE's GAAP interpretation, the amount of the
7 reimbursement was not certain. Subsequent to the test year and update period, UE received
8 from its insurance carriers amounts sufficient to offset most of the repair and replacement
9 costs booked within the test year.

10 Q. What is UE's position on Venice Power Plant repair and replacement costs in
11 this proceeding?

12 A. UE seeks recovery from its customers of all Venice Power Plant repair and
13 replacement costs booked within the test year, unadjusted for any insurance reimbursement
14 from its carriers.

15 Q. Under its recommended approach, has UE proposed to normalize the costs of
16 the Venice Power Plant fire?

17 A. No. Unless UE has evidence that that major power plant fires will be an
18 annual event in the future, failing to normalize this item is totally inappropriate.

19 Q. What would be the result if UE prevails on this issue?

20 A. The Company could potentially gain triple recovery of most of its Venice
21 Power Plant repair and replacement costs, once from customers in rates, twice through the
22 EARP credit calculation for the sixth credit period, and a third time from its insurance
23 carriers.

1 Q. What is the theoretical justification for UE's position on this issue?

2 A. I am not sure that there is a "justification" for this position except for the
3 assertion that GAAP principles dictate this particular result and the Commission should just
4 accept it.

5 Q. What is the Staff's position on this issue?

6 A. The Staff's position is that the costs for repair and replacement respecting the
7 Venice Power Plant should be normalized and should not be reflected in rates without some
8 reasonable treatment of the applicable insurance proceeds. Because the amount of the
9 proceeds are now known, the Staff advocates offsetting the proceeds against the test year
10 costs for purposes of setting rates. If the Commission accepts the Company's argument that
11 this treatment would violate the test year, then the Staff would suggest two potential
12 alternative approaches. One, eliminate the test year Venice Power Plant repair and
13 replacement costs from cost of service in entirety, so that neither the repair and replacement
14 costs nor the insurance reimbursements are reflected in rates. Second, use the total amount
15 of UE's request for reimbursement from the insurance carriers for the Venice Power Plant
16 fire as an offset to the booked test year costs. Either alternative approach would ensure that
17 both parts of the equation, the repair/replacement costs and the insurance reimbursements,
18 are treated in a consistent and equitable manner.

19 **INJURIES AND DAMAGES**

20 Q. Have you reviewed the rebuttal testimony of the UE witness addressing this
21 issue?

22 A. Yes, I have. UE witness Lyons addresses the injuries and damages issue in
23 his rebuttal testimony at pages 43-46.

1 Q. Based upon Mr. Lyons' testimony, what are the important differences between
2 the Staff and the Company on this issue?

3 A. There is two fundamental differences. First, should rates be set using a cash
4 basis for this item (Staff), or an accrual basis (UE)? Second, should rates be set using an
5 adjusted level of injuries and damages expense utilizing a multi-year average (Staff), or
6 should rates reflect the unadjusted test year level for this item (UE)? In this testimony, I will
7 address both issues in turn.

8 Q. Why does the Staff believe that injuries and damages expense is best handled
9 for ratemaking purposes using a cash basis?

10 A. I have discussed the generic issue of "cash vs. accrual" ratemaking earlier in
11 this testimony. As this discussion applies to the issue of injuries and damages, the Staff
12 believes that the process of attempting to estimate future claims payouts from lawsuits is
13 inherently and necessarily speculative in nature, and potentially subject to high levels of
14 inaccuracy. Also, use of estimates for this item in rates would not meet the Commission's
15 "known and measurable" standard. Additionally, the accrual approach is potentially quite
16 subject to manipulation for this item of expense. It is possible to estimate high levels of
17 future claim payouts in a given period to achieve a specific result for rate purposes, and then
18 simply reverse the estimate in a period where the high estimate no longer serves the desired
19 purpose. For these reasons, the Staff asserts that the best policy for treatment of injuries and
20 damages expense is that it only be included in rates when actual claims payout information is
21 known and measurable.

1 Q. Mr. Lyons argues that the Staff's cash approach to this issue will lead to the
2 wrong group of customers paying for this cost if rate recovery is delayed to the time cash
3 payouts are made. Is this argument valid?

4 A. Mr. Lyons states at page 45 of his rebuttal testimony that "...if the cash basis
5 is allowed for injuries and damages, future ratepayers receiving service a long time after the
6 events giving rise to the injuries and damages payments will be forced to pay for such costs."
7 The Staff believes Mr. Lyons' point would be more valid if injuries and damages expense
8 could be assigned to customers on an accrual basis with a high degree of accuracy. As
9 previously discussed, they cannot. Charging customers in rates for estimated costs that may
10 differ significantly from actual cash payouts does not seem to be either fair or equitable in
11 any meaningful sense. Furthermore, the Company's proposed method of reflecting injuries
12 and damages costs in rates also will not result in those particular customers receiving service
13 at the time the events giving rise to the damage claims occurred being charged in rates for
14 those costs, contrary to Mr. Lyons' implication.

15 Q. Please explain.

16 A. As previously discussed, UE's position on this issue is based upon application
17 of FAS 5. This financial accounting standard requires business entities to book liabilities
18 only when a reasonable determination can be made that a future payout is "probable" and the
19 amount of the future payout can be "reasonably estimated," not when the event giving rise to
20 the claim occurs. The determination that a future payout is probable of occurring and that a
21 reasonable estimate can be made of that amount may only be possible years after the event
22 giving rise to the potential payout actually took place.

1 As an example, an incident that gives rise to a lawsuit may take place in Year X, a
2 lawsuit may be filed in Year X+1, the utility may not book a liability amount for the claim
3 until Year X+3, and a cash payout may not occur until Year X+4. Under the theory of
4 intergenerational equity espoused by Mr. Lyons, customers receiving service in Year X
5 (or, perhaps, X+1) should pay for the expense associated with the incident. However, under
6 the Company's proposed rate treatment of injuries and damages, customers in Year X+3
7 would be charged the estimated expense. Under the Staff's proposal, customers in Year X+4
8 would pay the actual expense at the time it is known and measurable.

9 Q. Is the estimated liability associated with a specific lawsuit subject to change?

10 A. Yes. Based upon review of data provided by UE in this proceeding,
11 frequently an initial estimate of the liability is made and booked to expense for a particular
12 case. The estimate of the probable cash payout may be changed in later years as more
13 information becomes available about the court proceeding. These changes in the liability
14 estimates, and the current impact on expense of these changes, have nothing to do in an
15 intergenerational equity sense with service to current customers of the utility.

16 Q. Are you aware of actual claims situations involving UE that illustrate the
17 difference between the timing when the Company proposes to charge customers for injuries
18 and damages expense and true intergenerational equity?

19 A. Yes. In one claim against UE, the incident giving rise to the lawsuit occurred
20 in 1993, but no amount was booked to the injuries and damages reserve until 1998. The
21 Company made no payout until 2001. In another case, the event triggering a lawsuit
22 occurred in 1992, but no liability amount was booked by UE until 2000. No payout on that
23 claim has occurred as of the end of the update period.

1 In the Staff's view, the crucial factor that appears to currently govern financial
2 reporting of estimated injuries and damages claims is not a theoretical appropriate matching
3 of related expenses with revenues, but is rather the timing when the Company believes it is
4 capable of assessing the likely outcome of a particular case and making a reasonable estimate
5 of the future loss.

6 Q. Are you aware of any information that calls into question the accuracy of
7 UE's estimates of its liability for injuries and damages during the test year and update
8 period?

9 A. Yes. The Staff's review of UE's booking of injuries and damages claims in
10 the post-test year update period showed that UE booked monthly expense accruals for this
11 item of ** P-----
12 P-----.
13 P-----
14 P-----
15 P-----**

16 Q. ** P-----
17 P-----**

18 A. ** P-----
19 P-----
20 P-----
21 P-----
22 P-----
23 P-----**

Surrebuttal Testimony of
Mark L. Oligschlaeger

1 Q. ** P-----

2 P-----**

3 A. ** P-----

4 P-----

5 P-----** This data request response is attached
6 to this surrebuttal testimony as Schedule 3 (Proprietary).

7 Q. Turning to the question of whether an adjustment is appropriate for injuries
8 and damages in this case, please re-state the Staff's position on this matter.

9 A. Because both the annual cash payouts and the booked accrual expense for
10 injuries and damages has widely fluctuated over the last five years, without an apparent
11 upward or downward trend, the Staff believes that it is clearly more appropriate to use a
12 five-year average of injuries and damages data to normalize test year data than to rely on
13 unrepresentative test year amounts.

14 The following table presents the last five years' history, as stated on both a 12-months
15 ending June 2001 and September 2001 basis, for both the accrued expense and for cash
16 payouts:

	<u>Accruals</u>	<u>Cash</u>
17 June 1997	** P-----	P-----**
18 1998	** P-----	P-----**
19 1999	** P-----	P-----**
20 2000	** P-----	P-----**
21 2001	** P-----	P-----**
22		
23		

Surrebuttal Testimony of
Mark L. Oligschlaeger

1 Sept. 1997 ** P----- P-----**
2 1998 ** P----- P-----**
3 1999 ** P----- P-----**
4 2000 ** P----- P-----**
5 2001 ** P----- P-----**

6 The Company is advocating that the unadjusted June 30, 2001 balance of
7 ** P-----** for the Injuries and Damages Reserve (which is equal to the balance at
8 September 30) be used to set rates. This amount is **P-----e
9 P-----
10 P-----
11 P-----**

12 I have attached, as Schedule 4 (Proprietary), to this surrebuttal testimony, the
13 response to Staff Data Request No. 222. This response shows, by month, the amounts of
14 accrued expense booked to the injuries and damages reserve, the amounts charged against the
15 reserve as a result of claims paid, and the resulting reserve balance for each month from
16 December 1997 to December 2001.

17 Q. Does the Company agree with the Staff's characterization that injuries and
18 damages expense has fluctuated up and down in recent years?

19 A. Yes. UE witness Lyons, at page 44 of his rebuttal testimony, states, "injuries
20 and damages expense has fluctuated significantly from year to year during the five years
21 ended September 30, 2001." Given this belief, it is inexplicable that the Company has failed
22 to acknowledge the need for a normalization adjustment for this item.

1 Q. Do the financial results for injuries and damages expense post-
2 September 2001 in any way support the Company's position that \$17,800,000 is a reasonable
3 level of ongoing expense for this item?

4 A. ** P-----
5 P-----
6 P-----**

7 Q. Mr. Lyons' criticizes the Staff's selection of a five-year average to normalize
8 injuries and damages expense as being "arbitrary and opportunistic," and states use of either
9 a three-year or four-year average by the Staff would have resulted in a higher recommended
10 rate allowance. Please comment.

11 A. In most instances where the Staff utilizes a multi-year average normalization
12 approach, a five-year average is selected. This is because use of five years of data often is a
13 reasonable compromise between the need to have enough data points to create a
14 representative average, and the need to avoid use of old data that may reflect conditions no
15 longer present at the utility. The Staff believes use of a five-year average in this instance is
16 appropriate in setting injuries and damages expense at an appropriate ongoing level, and that
17 more evidence is required than merely citing that a different average would have produced a
18 higher (or lower) number to invalidate the approach.

19 **UNCOLLECTIBLES EXPENSE**

20 Q. Have you reviewed the rebuttal testimony of UE concerning the issue of
21 uncollectibles expense?

22 A. Yes, I have. UE witness Lyons addresses this issue on pages 52-54 of his
23 rebuttal testimony.

1 Q. Before addressing the conceptual differences between the Company and the
2 Staff on this matter, has the Staff made any corrections to its proposed adjustment to
3 uncollectibles filed with its direct testimony?

4 A. Yes. In his testimony, Mr. Lyons stated his belief that the Staff calculated its
5 proposed uncollectibles adjustment in its direct case using the wrong per-book test year
6 amount for this item. This assertion was correct. The Staff has modified its proposed
7 adjustment in this area to now increase test year expense by \$5,253,214, the difference
8 between the test year amount of uncollectibles expense of \$3,752,000 and the Staff's
9 proposed rate allowance for this item of \$9,005,214 (the level of actual bad debt write-offs
10 for the twelve months ended September 30, 2001).

11 Q. What are the conceptual issues between UE and the Staff in the area of
12 uncollectibles expense?

13 A. The primary difference is the Staff's advocacy of a "cash" approach (use of
14 net write-offs) for rate treatment of uncollectibles, while the Company proposes to use the
15 accrual expense for bad debts reflected on its books. There is also a minor difference in
16 timing. The Staff's allowance is based upon the test year update period for this case, the
17 twelve-month period ending September 30, 2001, while UE's proposed rate amount is taken
18 from the test year for this proceeding, the twelve months ended June 30, 2001.

19 Q. Please provide the amount of booked accrual uncollectibles expense for the
20 years 1997 to 2001, ending in June, as well as the net write-offs for the same period. Also
21 provide the same amounts for the years 1997 to 2001, ending in September.

1 A. These amounts for the one-year periods ending in June are as follows:

2		Accrued Bad Debt Expense	Net Bad Debt Write-offs
3	1997	** P-----	P-----**
4	1998	** P-----	P-----**
5	1999	** P-----	P-----**
6	2000	** P-----	P-----**
7	2001	** P-----	P-----**

8 The numbers for the one-year periods ending in September are:

9		Accrued Bad Debt Expense	Net Bad Debt Write-offs
10	1997	** P-----	P-----**
11	1998	** P-----	P-----**
12	1999	** P-----	P-----**
13	2000	** P-----	P-----**
14	2001	** P-----	P-----**

15 As this data shows, there have been fluctuations in both the amount of the booked
16 expense and the amount of the write-offs over this five-year period, but with an upward trend
17 apparent in the test year and update period. The Staff has chosen to recommend the amount
18 of actual net write-offs for the update period, because this amount is almost equal to the
19 five-year average of net write-offs for the twelve-month periods ending September for the
20 years 1997-2001 (\$9,113,568). This approach also appropriately recognizes the upward
21 trend in uncollectibles for UE. The Company, in contrast, is proposing the unadjusted
22 accrued test year level of this item, \$3,752,000. As can be seen by a review of the last five
23 years' history of uncollectibles expense, the test year uncollectibles accrual appears to be an

1 anomaly, in that it is by far the lowest amount of expense booked by UE in this period. The
2 Staff does not believe that the Company's rate recommendation in this case for uncollectibles
3 is representative of an ongoing level of expense for this item.

4 Q. Why is the Staff's "cash" approach to this item conceptually superior to the
5 Company's proposed "accrual" approach?

6 A. The Company's "intergenerational equity" argument does not really apply
7 here, as a utility's accruals for bad debts are largely based upon an estimate of future write-
8 offs for a period of months, not years, into the future. Therefore, whether an accrual or cash
9 approach is used for uncollectibles is irrelevant, for all practical purposes, since it is basically
10 the same group of customers that would be charged the expense under either approach. For
11 this reason, it is not evident why the Commission should be asked to conclude that use of
12 estimated expenses is better suited for ratemaking for bad debts than the actual costs, except
13 for a blind and unthinking adherence to GAAP.

14 Q. Does this conclude your surrebuttal testimony?

15 A. Yes, it does.

COMPANY	<u>CASE NO.</u>
Kansas City Power and Light Company	ER-82-66
Kansas City Power and Light Company	HR-82-67
Southwestern Bell Telephone Company	TR-82-199
Missouri Public Service Company	ER-83-40
Kansas City Power and Light Company	ER-83-49
Southwestern Bell Telephone Company	TR-83-253
Kansas City Power and Light Company	EO-84-4
Kansas City Power and Light Company	ER-85-128 & EO-85-185
KPL Gas Service Company	GR-86-76
Kansas City Power and Light Company	HO-86-139
Southwestern Bell Telephone Company	TC-89-14
Western Resources	GR-90-40 & GR-91-149
Missouri-American Water Company	WR-91-211
UtiliCorp United Inc. / Missouri Public Service	EO-91-358 & EO-91-360
Generic: Expanded Calling Scopes	TO-92-306
Generic: Energy Policy Act of 1992	EO-93-218
Western Resources, Inc./Southern Union Company	GM-94-40
St. Louis County Water Company	WR-95-145
Union Electric Company	EM-96-149
St. Louis County Water Company	WR-96-263
Missouri Gas Energy	GR-96-285
The Empire District Electric Company	ER-97-82
UtiliCorp United, Inc./Missouri Public Service	ER-97-394
Western Resources, Inc./Kansas City Power & Light Company	EM-97-515
United Water Missouri, Inc.	WA-98-187
Missouri-American Water Company	WM-2000-222
UtiliCorp United Inc. / St. Joseph Light & Power Company	EM-2000-292

MARK L. OLIGSCHLAEGER

COMPANY	<u>CASE NO.</u>
UtiliCorp United Inc. / The Empire District Electric Company	EM-2000-369
Green Hills Telephone Corporation	TT-2001-115
IAMO Telephone Company	TT-2001-116
Ozark Telephone Company	TT-2001-117
Peace Valley Telephone Company, Inc.	TT-2001-118
Holway Telephone Company	TT-2001-119
KLM Telephone Company	TT-2001-120
Missouri Gas Energy	GR-2001-292
The Empire District Electric Company	ER-2001-299
Oregon Farmers Mutual Telephone Company	TT-2001-328
Ozark Telephone Company	TC-2001-402
Gateway Pipeline Company, Inc.	GM-2001-585