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SO₂ Credits
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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. EC-2002-1

CROSS-SURREBUTTAL TESTIMONY

OF

WARNER L. BAXTER

ON

BEHALF OF

UNION ELECTRIC COMPANY

d/b/a AmerenUE

Exhibit No. 124 P
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**** DENOTES PROPRIETARY INFORMATION ****

St. Louis, Missouri
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1 **CROSS-SURREBUTTAL TESTIMONY**

2 **OF**

3 **WARNER L. BAXTER**

4 **CASE NO. EC-2002-1**

5
6 **I. INTRODUCTION AND SUMMARY**

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

8 A. My name is Warner L. Baxter. My business address is One Ameren Plaza,
9 1901 Chouteau Avenue, St. Louis, Missouri, 63101.

10 **Q. Are you the same Warner L. Baxter who previously filed rebuttal**
11 **testimony in this proceeding?**

12 A. Yes.

13 **Q. What is the purpose of your cross-surrebuttal testimony?**

14 A. The purpose of my testimony is to respond to the rebuttal testimonies of
15 (1) Maurice Brubaker, submitted on behalf of the Missouri Industrial Energy Consumers
16 on the subject of comparing AmerenUE's Missouri electric rates with other utilities in the
17 region (2) Michael Gorman, on behalf of the Missouri Industrial Energy Consumers on
18 the subject of the reasonableness of UE's capital structure; and (3) Ryan Kind, submitted
19 on behalf of the Office of the Public Counsel on the subject of SO₂ emission allowance
20 revenue adjustments.

21 **II. MR. BRUBAKER'S RATE COMPARISON**

22 **Q. To which part of Mr. Brubaker's rebuttal testimony are you**
23 **responding?**

1 A. I am responding to Mr. Brubaker's claims about the "competitiveness" of
2 UE's rates as presented on pages 8 through 11 and Schedules 5 and 6 of his rebuttal
3 testimony. Specifically, I take issue with Mr. Brubaker's claims that UE's rates are
4 "substantially above the average for the region" and that UE's rates are the "seventh
5 highest out of the total of 51 service territories in Missouri and surrounding areas." As
6 shown in the cross-surrebuttal testimony of Dr. Lowry, Mr. Brubaker's rate comparison
7 is erroneous, misleading, and at odds with the fact that UE's rates are some of the lowest
8 in the region and country, particularly when considering the higher costs that the
9 Company faces serving a large metropolitan area.

10 **Q. Please explain why Mr. Brubaker's analysis is erroneous and**
11 **misleading.**

12 A. While Mr. Brubaker claims that UE's customers face rates that are
13 substantially above the average for the region, quite the opposite is actually the case. As
14 discussed in greater detail in the cross surrebuttal testimony of Dr. Lowry, Mr.
15 Brubaker's analysis is erroneous and biased for at least four reasons.

16 First, his analysis is highly misleading and biased because his rates for UE
17 include the highest "add-on taxes" (such as gross receipt taxes) in his sample group.
18 Such taxes are excluded from the rate data used for most other utilities in his sample, and
19 for the few other utilities for which Mr. Brubaker did include such taxes, those taxes are
20 much smaller than UE's. Since these add-on taxes clearly are outside the control of UE
21 (and excluded from most of the rates Mr. Brubaker uses in his comparison), these taxes
22 must not be considered for the purpose of assessing the reasonableness of UE's rates. In
23 fact, Mr. Brubaker's own analysis of UE's rates without these taxes—while still

1 inappropriate and biased—shows that UE's rates are approximately in the middle of his
2 sample group, as opposed to his original claims that they are among the highest.

3 Second, Mr. Brubaker's analysis is distorted due to the significant number
4 of very small utilities and jurisdictional parts of individual utilities being included in his
5 sample. For example, 24 of Mr. Brubaker's 51 jurisdictional entities (*i.e.* nearly half of
6 them) serve only 10% of the total load served by these 51 entities. Clearly, a ranking that
7 is based on so many utilities much smaller than UE can hardly be considered a fair
8 comparison of rates. Moreover, the "average rates" calculated by Mr. Brubaker
9 misrepresent what customers in this region are paying simply due to the fact that he
10 attributed an equal weighting to all of his 51 (large or small) entities. As Dr. Lowry
11 shows, the rates paid by UE's Missouri customers are actually approximately 5% to 7%
12 below the rates that customers pay on average in this region of the country. Dr. Lowry's
13 analysis clearly shows that the majority of customers in Mr. Brubaker's sample and the
14 region as a whole pay rates that are higher than UE's Missouri retail rates.

15 Third, Mr. Brubaker's analysis simply is not an appropriate "apples-to-
16 apples" comparison. Dr. Lowry's analysis shows that, compared to other utilities in the
17 region, UE faces substantially more challenging business conditions (*i.e.*, higher costs) in
18 its service territory. For example, labor costs in UE's service territory are 12% higher
19 than the average of the labor costs faced by other utilities in the region. When UE's rates
20 are compared to utilities with similar business conditions in their service territories—such
21 as the group of utilities serving large metropolitan areas in the region—UE's Missouri
22 rates are more than 10% below the regional average.

1 Finally, all of the above rate comparisons do not even fully reflect how
2 well UE's *effective* retail rates compare to the other utilities. This is because the data Mr.
3 Brubaker used for these "typical rates" analyses do not reflect any of the sharing credits
4 that UE's customers received under the EARPs. Factoring these sharing credits into the
5 analysis means that UE's *effective* rates are even lower than the rates shown in the
6 discussed analyses.

7 **Q. What does this evidence mean with respect to Mr. Brubaker's rate**
8 **comparison?**

9 A. Despite Mr. Brubaker's attempt to show otherwise, this evidence clearly
10 shows that UE's rates are well below regional averages—particularly when compared to
11 utilities facing similar business conditions. This finding is also consistent with Dr.
12 Lowry's analysis, as presented in his rebuttal testimony, that UE's cost efficiency has
13 increased significantly during the EARPs and have been about 14% better than the
14 industry standard in recent years. It is also consistent with the rate comparisons in
15 Professor Weisman's rebuttal testimony which, based on consumer price data collected
16 by the U.S. Bureau of Labor Statistics, showed that (1) UE's rates are among the lowest
17 of any major metropolitan area in the country; (2) UE's rates also are below average rates
18 for both large and mid-sized metropolitan areas in the Midwestern U.S.; and (3) during
19 the EARP, UE's rates have decreased relative to the rates of other Midwestern utilities.
20 As I previously pointed out in Section IV of my rebuttal testimony, credit rating agencies
21 have similarly recognized that UE's "average retail rate is competitive regionally and
22 nationally" and "among the lowest in the region." This evidence of low rates and

1 superior cost efficiency again confirms the benefits that alternative regulation has
2 provided to UE and its customers alike.

3 **III. UE'S CAPITAL STRUCTURE IS REASONABLE**

4 **Q. Do you agree with Mr. Gorman's testimony that AmerenUE's**
5 **common equity ratio is unreasonably high?**

6 **A.** Absolutely not. AmerenUE's capital structure is clearly consistent with
7 the Company's credit rating, and is reasonable in light of the Company's business risks,
8 regulatory risks, and the need for substantial energy infrastructure investments over the
9 course of the next several years. Further, our capital structure is necessary in order for
10 the Company to maintain its credit ratings. AmerenUE currently has a A+ credit rating
11 from Standard & Poors, a AA rating from Fitch and Aa3 rating by Moody's.
12 AmerenUE's current capital structure is well within the range of capital structures for
13 comparably-rated utilities. This is also shown clearly in Schedule 8 of Ms. McShane's
14 cross surrebuttal testimony. Ms. McShane's cross surrebuttal testimony also presents a
15 number of additional analyses showing that AmerenUE's capital structure is reasonable.
16 Moreover, UE's actual capital structure as of September 30, 2001, has been
17 recommended by Staff witness Bible in his March 2002 testimony in this case. Further,
18 OPC witness Burdette specifically noted in his May 2002 rebuttal testimony that he finds
19 that this capital structure is appropriate. Importantly, AmerenUE's capital structure is
20 necessary in order for the Company to maintain its current credit ratings.

21 **Q. But isn't it also true that UE's capital structure contains more equity**
22 **than the average utility with comparably-rated debt?**

1 A. That might well be the case. However, as all the credit rating agencies
2 explain very clearly, there are many quantitative and qualitative factors that they consider
3 when assigning a particular credit rating to a company. Capital structure is just one of
4 them. Some companies, such as AmerenUE, simply will need more equity in their
5 capital structure to maintain the same credit rating because of their unique business and
6 financial conditions. If Mr. Gorman were right in his claim that AmerenUE's capital
7 structure contains too much equity relative to UE's credit rating, AmerenUE presumably
8 would have a higher credit rating. But that is obviously not the case.

9 **Q. What are the reasons why UE's equity ratio would need to be higher**
10 **than the average for the utilities in the same rating category?**

11 A. There are several important factors why AmerenUE's capital structure is
12 necessary to maintain its credit rating. First, Ameren will need to fund significant
13 infrastructure investments over the next several years. These funding requirements
14 clearly are monitored carefully by the credit rating agencies because of the additional
15 strain they impose on the Company's cash flow ratios and other credit risk fundamentals.
16 Second, AmerenUE faces unique business risks. For example, the fact that AmerenUE's
17 Callaway nuclear plant represents a significant portion of the Company's assets and
18 generation output has been noted as such an additional risk factor. The lack of a fuel
19 adjustment clause, particularly in combination with the Company's nuclear
20 concentration, also exposes UE to significant risks faced by few other companies.
21 Without a fuel adjustment clause, any disruption to the Company's production would
22 substantially increase the Company's need to purchase power at prevailing market prices.
23 However, unlike many electric utilities, AmerenUE cannot recover these increased costs

1 from its customers through a fuel adjustment clause. While this provides significant
2 benefits to customers by reducing the risks they face, it does shift the risk to AmerenUE
3 and exposes the Company to additional financing requirements which may pressure its
4 credit ratings.

5 And, finally, AmerenUE also faces significant regulatory risks that put
6 additional pressure on the company's credit ratings. As I pointed out in my rebuttal
7 testimony, one of the qualitative factors considered by credit rating agencies is the
8 regulatory environment that a company operates within. Given the positions taken by the
9 Staff in this case, coupled with other regulatory positions and Commission orders
10 currently in place for other utilities, Missouri is considered a higher risk regulatory
11 jurisdiction. This factor also requires a stronger capital structure by the ratings agencies
12 in order to maintain current credit ratings.

13 **Q. What would be the likely effect on AmerenUE if the Commission**
14 **chose to impose Mr. Gorman's hypothetical capital structure?**

15 **A.** Imposition of Mr. Gorman's hypothetical capital structure would likely
16 result in the downgrading of AmerenUE's credit ratings. As I have already pointed out in
17 Section V.A of my rebuttal testimony, Staff's original July 2001 recommendation to
18 reduce rates between \$214 million and \$250 million has lead all major credit rating
19 agencies to change the Company' rating outlook from stable to negative.¹ Indeed,

¹ Moody's put Ameren Corporation on negative outlook fearing that the rate reduction would significantly reduce the company's free cash flow for any additional working capital and capital expenditure needs as well as for dividends to parent Ameren Corporation. (Moody's Investors Service, "Fundamental Credit Research Rating Action", July 12, 2002). Standard and Poor's and Fitch similarly put Ameren Corporation on negative outlook, citing concerns over the impact of the potential rate reduction ("Ameren Corp. Outlook Revised to Negative," Standard & Poor's, *Credit Profile*, Oct. 5, 2001; Rebuttal Testimony of Steven M. Fetter pp. 6-7).

1 Moody's have threatened to downgrade Ameren's debt by up to three notches (close to
2 below investment grade). If the Commission were to adopt Staff's original proposal, the
3 downgrading of AmerenUE's credit ratings would be virtually certain. Downgrades
4 would be even more severe at the Staff's current \$245 million to \$285 million rate
5 reduction proposal. If the Commission were to adopt Mr. Gorman's capital structure in
6 addition to the Staff's proposal, the potential downgrade would be even more severe.

7 **Q. Why is it important that the Company be able to maintain strong**
8 **credit ratings?**

9 **A.** Maintaining strong credit ratings is important to preserve the Company's
10 ability to raise capital on favorable terms and sustain the financial flexibility needed to
11 make required energy infrastructure investments in a timely and efficient manner. It is
12 also needed to maintain the Company's ability to operate effectively and efficiently in
13 what has proved to be a challenging environment for energy companies today. Due to the
14 many challenges and issues facing energy companies today, credit ratings' analysts and
15 lenders look very closely at a company's overall financial strength and flexibility. A
16 strong capital structure, including strong credit ratings, is an important factor in analysts'
17 assessments of a company's financial well-being, and ultimately in a lender's assessment
18 as to whether they should provide funds in the capital markets for infrastructure and
19 operating needs. UE's current capital structure and credit ratings ultimately lead to lower
20 costs to UE and its customers, as well as provide the Company with the financial
21 flexibility to make timely infrastructure investments and meet operating needs. Further,
22 as I have also explained in Sections IV and V of my rebuttal testimony, I believe a

1 financially strong utility in Missouri simply is good public policy and is in the best
2 interest of the utilities, their customers and the State as a whole.

3 **IV. SO₂ EMISSION ALLOWANCE REVENUES**

4 **Q. What is the purpose of this portion of your testimony?**

5 A. The purpose is to respond to the testimony of Office of Public Counsel
6 witness, Ryan Kind.

7 **Q. Mr. Kind recommends imputing over \$23 million to the Company's**
8 **test year revenues, based upon his analysis of the company's handling of SO₂**
9 **allowances. He also recommends severely restricting the Company's ability to**
10 **manage its allowances in the future. Do you agree with these recommendations?**

11 A. I certainly do not.

12 **Q. Why do you disagree with his recommendations?**

13 A. Mr. Kind has made some very serious allegations against the Company, its
14 officers and employees, based only upon his superficial analysis of four documents
15 provided during discovery in this case and his review of allowance transactions. His
16 analysis is wrong and misleading. As documented in the cross-surrebuttal testimony of
17 Company witness Moore and my testimony that follows, there is no evidence of
18 wrongdoing.

19 **Q. Mr. Kind spends 38 pages of testimony and six schedules to support**
20 **his conclusions. How can this be "superficial?"**

21 A. A careful examination of Mr. Kind's testimony shows that it is based
22 mostly on his suppositions, guesses and inaccurate assumptions of what he thinks he
23 "found" in the documents and transaction history he cites.

1 **Q. Please explain.**

2 A. The charges leveled at the Company can be found repeated throughout the
3 testimony, starting with the summary, on page 3, but first appear in their complete form
4 on page 5. There he states that Ameren's documents show that Ameren gave "extensive
5 consideration" to "inappropriate factors" in determining how to manage the Company's
6 allowance bank. In addition, he charges that these documents show that the Company
7 "changed the quantity, magnitude, structure and timing" of SO₂ transactions during the
8 test year. Moreover, he charges that "Ameren's internal documents show" that the
9 Company "gave extensive consideration" to how allowances could be transferred to the
10 Company's unregulated generation affiliate. He claims that the Company gave
11 "extensive consideration" as to how to transfer allowances to the benefit of Ameren
12 (UE's parent) as opposed to a manner "that would provide the greatest financial benefit to
13 UE." And again, he charges that the Company changed "the structure and timing" of the
14 transaction with the Company's unregulated generation affiliate (AmerenEGC or AEG or
15 GENCO) for the financial interest of Ameren and AEG, "rather than UE." He also
16 defines this as "manipulation of earnings."

17 **Q. Why do you say that the charges are not based on substantial**
18 **evidence?**

19 A. I will address the "evidence" Mr. Kind believes he has found in a moment.
20 First, however, it should be noted that the vast majority of Mr. Kind's testimony is
21 nothing more than the repetition of his claims and suppositions. In both his questions and
22 answers he repeats these claims over and over. But it appears that it is mostly an attempt
23 to add weight to these charges. The constant restatement of the charges, rather than a

1 careful analysis of the evidence, has resulted in testimony that looks substantial, but
2 which is in fact little more than repeated opinion.

3 **Q. You said you would address the "evidence" Mr. Kind cites.**

4 **A.** Yes, I will. The evidence that Mr. Kind claims shows "extensive
5 consideration" and which he describes as compelling is nothing more than his inaccurate
6 interpretation of the Company's SO₂ allowance transactions, the Company's strategy in
7 managing these allowances and four separate internal memos from lower or mid-level
8 management employees of the Company.

9 **Q. Mr. Kind states that the Company gave "extensive" and**
10 **"inappropriate consideration" to "ratemaking implications" of allowance**
11 **transactions. Don't the documents he cites prove that claim?**

12 **A.** No, they do not. But first let's carefully examine Mr. Kind's claims.
13
14

15 **A. "Extensive consideration"**
16
17

18 **Q. What evidence of "extensive consideration" does Mr. Kind provide to**
19 **prove his allegation that the Company considered possible ratemaking treatment of**
20 **allowance transactions?**

21 **A.** The alleged "evidence" does not appear until page 19 of Mr. Kind's
22 testimony. There he says that he will divide the documents into two types. One are
23 documents that describe and analyze the trading strategies that Ameren could use. Based
24 upon my reading of Mr. Kind's testimony, it is not clear that he addresses this matter.
25 The second type are documents that "document and summarize the transactions that took
26 place over the last few years." (page 19, lines 11-18) From that introduction, one

1 assumes an avalanche of incriminating documents would follow to support his claim of
2 "extensive consideration". However, he has supplied only four documents, and as I will
3 discuss later, they are hardly incriminating.

4 **Q. What documents did Mr. Kind describe to support his claim?**

5 A. The first is an excerpt from the minutes of the Ameren Risk Management
6 Steering Committee meeting of December 15, 2000. Mr. Kind quotes two sentences
7 from those minutes. Those sentences noted that the Company's current strategy related
8 to the management of SO₂ allowances will not prevent a fall in value over time of the
9 allowance portfolio from around **\$75 million** to an expected **\$28 million** in
10 2010. The next sentence states: " Suggested establishing a lower sharing number with
11 ratepayers via legislature or regulators or getting credits as deregulated asset before 2005:
12 Risk Management was unsure of the feasibility of these solutions." (emphasis added)

13 **Q. Doesn't this indicate that the Company considered the ratemaking**
14 **implications of transactions?**

15 A. It proves that one employee, whose job it was to point out his personal
16 view of **all** of the risks and implications of doing or not doing various business
17 transactions had an idea about how to address what he viewed as a potential problem.

18 **Q. Do you know what was done with this suggestion?**

19 A. Yes, I do. It was rejected. While it was certainly not inappropriate to
20 discuss all of the possible risks associated with strategies for dealing with SO₂
21 allowances, there was no support for this employee's suggestion. Even the minutes of the
22 meeting noted that Risk Management questioned its feasibility when it was brought up.

1 **Q. Mr. Kind claims that this document shows that UE failed to “monetize**
2 **the value of a substantial portion of its allowances through sales or other**
3 **transactions even though the market value of these allowances was generally**
4 **expected to fall sharply between 2005 and 2010.” (page 20, lines 9-12) Is that not**
5 **true?**

6 A. No, it is not. It was simply the opinion of one person. The statement
7 indicates that the speaker anticipated a decline in the value of allowances. The fact of the
8 matter is that this person was not intimately familiar with the Company’s overall
9 compliance strategy and overall market conditions for SO₂ allowances. Of course,
10 blindly following this view would lead to panic sales, as Mr. Kind suggests, to
11 “maximize its monetary value” (page 20, lines 25-26) but that would not have been a
12 good business decision – for the Company or for our ratepayers. And as discussed by
13 Company witness Moore in his cross-surrebuttal testimony, our strategy in managing SO₂
14 allowances considers our overall long-term compliance strategy, including consideration
15 of environmental laws and operating conditions, as well as market conditions.

16 **Q. What about Mr. Kind’s statement that the reference to legislative**
17 **action was “probably” a reference to the GENCO bill that Ameren supported in the**
18 **Missouri legislature?**

19 A. First, his statement was nothing more than a guess. In addition, there was
20 nothing in that legislation that called for a “lower sharing number” as suggested by Mr.
21 Kind. The legislation may or may not have made credits a “deregulated asset” if had
22 been finally passed. It is not clear to me that the person making the suggestion had any

1 specific knowledge of the GENCO bill. In any event, as I have said, the suggestion was
2 rejected.

3 **Q. Mr. Kind claims that these two sentences prove that Ameren “believes**
4 **that structure (sic) of the second EARP provided a dis-incentive (sic) for Ameren to**
5 **manage UE’s SO₂ allowance inventory in the manner that Ameren believed would**
6 **maximize its monetary value.” (page 20, lines 23-26) Is this true?**

7 A. First, it is not clear that the Company is under any requirement (except in
8 Mr. Kind’s view) to “maximize” the “monetary value” of these allowances. The
9 Company’s first concern is to assure that its generation plants – both existing and future –
10 have enough allowances to operate without either having to go to an uncertain market
11 someday in the future to purchase allowances, or being required to make extensive capital
12 expenditures for compliance purposes. Other than that, the Company is required to
13 “prudently” manage its allowances. That certainly does not require, or even allow, the
14 maximization of their monetary value, as Mr. Kind seems to interpret that term.

15 Secondly, since the quoted section of the committee minutes were only
16 one person’s suggestion and that suggestion was rejected by the committee, it proves
17 nothing.

18 **Q. What is the next document that Mr. Kind cites as evidence of**
19 **“extensive” consideration to ratemaking implications of allowance transactions?**

20 A. The second document is a memo, dated December 20, 1999 from
21 Dan Lidisky to Mike Mueller. Although Mr. Mueller is identified accurately as the
22 current Vice President of Ameren Energy Fuels and Services, the more relevant
23 information is that at the time of this memo, Mr. Mueller was the Manager of the Fossil

1 Fuels Department of AmerenUE and Mr. Lidisky reported to him. The memo is attached
2 to Mr. Kind's testimony and is quoted at some length as well.

3 **Q. Mr. Kind highlights (page 21, lines 26-29) two sentences in the third**
4 **paragraph that refer to the "regulated" nature of the allowances. One sentence**
5 **states that, "the incentive to sell or trade them is reduced." The other, that "with**
6 **the AmerenUE incentive plan shareholders will only at best will (sic) be receiving**
7 **half of the earnings." Doesn't this show that the Company considered the**
8 **ratemaking implications of these transactions?**

9 **A.** Again, this is a memo between mid-level management employees,
10 discussing the author's understanding of the potential ratemaking implications of SO₂
11 allowance sales, as they began the responsibility of managing some of the allowances.
12 He merely states his belief that, if the Company would want to sell allowances, half of the
13 proceeds would go to shareholders and half to customers.

14 **Q. Is Mr. Lidisky's statement correct?**

15 **A.** Not necessarily. Under the old EARP, proceeds from the sale of SO₂
16 allowances might not be shared at all with ratepayers, or maybe 50%, or maybe 90%, or
17 maybe 100% of those revenues would be shared. Mr. Lidisky was in no position to know
18 where on the sharing grid the Company would fall and therefore how much, if any, of the
19 SO₂ allowance revenues would be shared with ratepayers.

20 **Q. Mr. Kind states that this memo shows that "possible PSC ratemaking**
21 **treatment of UE allowances had an impact on Ameren's decisions about the**
22 **magnitude, type, and timing of UE's SO₂ transactions (page 22, lines 7-9). In**
23 **addition, he goes on to state that the quoted paragraph indicates that Ameren "was**

1 **going to move forward with additional SO₂ allowance transactions while keeping**
2 **ratemaking considerations in mind as it chose the type and structure of SO₂**
3 **allowance transactions that it would pursue.” (page 22, lines 10-13) Do you agree?**

4 A. No. I do not. The memo simply discusses what one middle management
5 person viewed as the regulatory facts of life. Nothing in the memo, however, indicates
6 that ratemaking treatment “had an impact on Ameren’s decision about the magnitude,
7 type and timing of such transactions.” Nor does the memo indicate that such ratemaking
8 considerations would have an impact on the types of transactions the company would
9 pursue. In fact, the memo merely notes what transactions have occurred, that Fossil
10 Fuels would now have responsibility to manage part of the allowance bank, and a revised
11 risk management policy would be developed to address this change which would allow
12 for a “more active roll in the hedging and trading of” the allowances.

13 In addition, the memo goes on to state that “No one knows what rules we
14 will be dealt in the future and what impact they will have on the value of SO₂ credits
15 going forward.” (Kind Schedule RK-1, page 2)

16 Therefore, although Mr. Kind leaps to the wrong conclusion after reading
17 this memo – that the Company’s decisions were driven by “possible ratemaking treatment
18 of UE allowances” – the memo is clear that the recommendation was that the Company
19 consider selling allowances, and to be aware of the possible changes in the value of SO₂
20 allowances, due to changes in Washington and the EPA.

21 Q. **Does this second document rise to the level of “extensive”**
22 **consideration of ratemaking implications of SO₂ transactions?**

1 A. No, it does not. It is merely a memo suggesting that the Company
2 consider increasing its sales of allowances in the coming year, as apparently Mr. Kind
3 would want. The suggested level of sales did not occur due to market conditions at that
4 time.

5 **Q. What is the third document Mr. Kind cites?**

6 A. The third document is a memo from Mr. James Moore, which addresses a
7 vintage swap of allowances with AmerenEGC. Mr. Moore addresses his memo in his
8 testimony.

9 **Q. Mr. Kind again highlights a few sentences, claiming that they show**
10 **more of the “substantial evidence” that the Company was being guided by**
11 **“inappropriate” considerations. Is that your reading of the memo?**

12 A. No, it is not. I read it as a memo that suggests three alternatives for
13 addressing a need for allowances for AmerenEGC – the former AmerenCIPS generating
14 units. As mentioned elsewhere in my testimony, it is basic business practice to consider
15 all implications of a decision – which could include regulatory implications.

16 **Q. Do you agree that this memo “describes the strong regulatory**
17 **disincentives that Ameren perceived for pursuing the “Allowance Sale” option ...”**
18 **(emphasis added) (p. 23, line 32 – p. 24, line 4)?**

19 A. No. The only suggestion in the memo about a regulatory disincentive is
20 one sentence that references the sharing plan. Perhaps to make the memo sound more
21 ominous, Mr. Kind adds the reference to “as much as 90% of the earnings would have to
22 be returned to ratepayers ...” wording. Those words do not appear in the memo.

1 **Q. Does the fact that the decision was made to do a “vintage swap”**
2 **indicate that earnings were “manipulated” as charged by Mr. Kind, or that**
3 **inappropriate ratemaking considerations drove the decision-making process?**

4 A. No. The reason we decided on that option was that this alternative was
5 consistent with our strategy of building the allowance banks at favorable market terms as
6 part of our overall compliance strategy, as well as give us potential future flexibility to
7 monetize these options should operating and market conditions warrant. It is simply not
8 correct to draw the inferences that Mr. Kind attempts to draw from his reading of this
9 memo.

10 **Q. On page 25, lines 2-3 of his testimony, Mr. Kind claims that proceeds**
11 **from a sale were “pushed forward to a date beyond the sharing period.” What is**
12 **your response to that charge?**

13 A. Mr. Moore gives some specific details about that sale in his cross-
14 surrebuttal testimony. However, I will add that at the time this transaction was entered
15 into, the Company was actively seeking to extend the EARP beyond June 30, 2001.
16 Consequently, there would have been no financial incentives to push sales beyond the
17 sharing period, as Mr. Kind asserts. Those revenues could have been shared with
18 customers, but the Company’s proposal for extending the EARP was flatly rejected by
19 the MPSC Staff, OPC and others.

20 **Q. What is the fourth document?**

21 A. Mr. Kind does not seem to include the fourth document as evidence of
22 “extensive” consideration to ratemaking implications. He cites this document in relation

1 to the charge that the Company inappropriately considered the needs of its unregulated
2 generation subsidiary in the management of its allowance inventory. (pages 25-26)

3 **Q. Is that the extent, then, of what Mr. Kind claimed was evidence of**
4 **“extensive consideration to inappropriate factors including the ratemaking**
5 **implications of making SO₂ allowances sales and other transactions during the final**
6 **two years of the EARP...”? (page 5, lines 6-9)**

7 **A.** That is the extent of the documents presented by Mr. Kind to support his
8 claim. In addition, he claims that the actual sales activity is further proof of his charges.
9 Mr. Moore addressed in some detail why certain sales and other transactions were or
10 were not made during this time frame. It should be clear, however, that the excerpts cited
11 by Mr. Kind from the three documents prove nothing of substance. They were all from
12 mid-level management employees. Their suggestions were either rejected or were merely
13 noted as simple facts. There is no evidence that the Company's management of its SO₂
14 allowances was driven by ratemaking implications. Certainly, there can be no claim that
15 the brief references cited by Mr. Kind shows that the Company gave “extensive”
16 consideration to ratemaking implications. A fair reading might be that a few employees
17 “noted” the ratemaking implications. This can hardly be considered inappropriate in any
18 way.

19

20 **B. “Inappropriate consideration”**

21 **Q. In addition to the claim that the Company gave “extensive”**
22 **consideration, Mr. Kind characterizes that consideration as “inappropriate.” (page**
23 **5, line 7) Do you agree?**

1 A. I disagree that taking ratemaking implications into account is always
2 “inappropriate.” Mr. Kind assumes an evil intent is involved even if the ratemaking
3 treatment of certain actions are merely noted. Mr. Kind may not understand that in the
4 business world, all relevant factors should be considered when making business
5 decisions. Just as the tax implications of a particular deal must be considered, so must
6 the implications of the regulatory treatment that will or will not follow a particular
7 decision. As Mr. Moore explains in some detail, the Company had very good reasons for
8 selling, swapping, doing forward sales, and for not doing transactions at particular times,
9 irrespective of the regulatory treatment. The magnitude of Mr. Kind’s adjustments means
10 that the Company will be penalized because it did not “maximize the monetization” of
11 allowances during the EARP, no matter what other good business reasons existed for not
12 doing so. I hope the Commission will not adopt his shortsighted approach.

13 **Q. Mr. Kind alleges (page 18, line 19 -- page 19, line 2) that “Ameren**
14 **considered the potential for using UE’s large bank of excess allowances to cover**
15 **ongoing or future deficits in the amount of allowances needed at Ameren’s non-**
16 **regulated power plants in its decisions about the magnitude, type, or timing of SO₂**
17 **transactions that it would make.” How do you respond to this charge?**

18 A. First, the Company was given the authority to make allowance
19 transactions with its affiliate, AmerenCIPS, in the Order approving the Stipulation and
20 Agreement in EO-98-401, which authorized the management of SO₂ allowances.
21 Secondly, Mr. Kind finds normal and appropriate business decision-making to have some
22 sinister motive. Of course, it appears that Mr. Kind believes that allowances should be
23 “monetized” to the maximum extent possible. (I assume he agrees that we should keep

1 enough to cover the minimum needs of UE's regulated plants.) However, he apparently
2 believes that if Ameren employees give any consideration to how other Ameren power
3 plants' needs might be met through mutually beneficial transactions, this is a violation of
4 some regulatory standard. In fact, such a shortsighted approach would probably end up
5 costing UE and its customers money in the long run.

6 **Q. Please explain.**

7 A. Ameren's unregulated generating units run also for the benefit of Union
8 Electric customers. If those units need to obtain allowances, and can do so from Union
9 Electric at a fair market price, and through a perfectly legal transaction that avoids
10 significant tax consequences, those deals should be made. Why should Union Electric
11 sell allowances on the market and pay taxes, or swap with others, and leave AmerenEGC
12 to seek allowances in the market? If the deals are at arm's length, there is no harm to
13 Union Electric's customers.

14 **Q. You have reviewed the "evidence" that Mr. Kind believed proved his**
15 **charges. What about the charges themselves?**

16 A. It is difficult to know where to start. As I mentioned above, virtually
17 every page of Mr. Kind's testimony includes an allegation of wrongdoing. It is clear that
18 his evidence fails to support any claim. I believe that I have responded to the main
19 charges that Mr. Kind repeats throughout his testimony. He changes the words
20 sometimes; or puts a different spin on the claim; or uses additional pejorative phrases,
21 such as "sweetheart" deals (page 6, line 4); but the thrust of his claims are the same. The
22 failure to address each of them should not be viewed as agreement.

1 **Q. On page 8 Mr. Kind states that UE manipulated the earnings related**
2 **to its SO₂ allowance transactions. Is this true?**

3 A. No. The sale of AmerenUE allowances were based on our view of
4 whether enough allowances were available for sale, based on our overall compliance
5 strategy, operating conditions and whether market conditions were appropriate to transact
6 such sales.

7 **Q. Is it true that the Company has recently been making more sales of**
8 **allowances?**

9 A. Yes, it is. Due to our analysis of our overall compliance position,
10 operating conditions and market conditions, we have sold SO₂ allowances in 2002.
11 Looking ahead, and based upon my discussions with Mr. Moore and others, I believe it is
12 not unreasonable to assume that the Company could continue to monetize approximately
13 ****65,000 to 75,000**** allowances per year over the next several years. Under reasonable
14 market conditions, that would approximate ****\$10 million to \$15 million**** of SO₂
15 revenues per year (or ****\$6 million to \$9 million**** after income taxes). Of course,
16 changing market conditions, operating conditions, environmental regulations and other
17 factors could change the Company's current view on this matter in the future.

18 **Q. Is this a change in the Company's compliance strategy?**

19 A. No. It is not a change in our strategy. We are still focused primarily on
20 assuring environmental compliance and monetizing excess allowances when operating
21 conditions and market conditions are appropriate.

22 **Q. One series of claims by Mr. Kind concerns Ameren's holding**
23 **company structure. Would you comment on that portion of his testimony?**

1 A. Mr. Kind's statements concerning the holding company structure are
2 simply confusing. It appears that he is implying that it is in the best interest of Ameren
3 (the holding company) for UE to achieve sub-par operating results. Or, stated another
4 way, he seems to be saying that the fiduciary responsibility of Ameren's officers to
5 maximize performance at the holding company level will require that actions be taken
6 which result in the regulated company achieving inferior financial results. If this is an
7 accurate reading of his testimony, it is simply ridiculous. In fact, the vast majority of
8 Ameren's operating results, or earnings, come from UE, and in particular, the electric
9 operations at UE. To state that we are not focused on superior performance at UE is
10 simply mind-boggling. The fact of the matter is that we have achieved superior operating
11 and financial performance at UE, as Drs. Lowry and Weisman address at some length and
12 in significant detail in their testimony. UE has been able to achieve this superior
13 performance which has resulted in keeping rates low, customer satisfaction high, and has
14 permitted UE to make making timely infrastructure investments. And at the same time,
15 this superior performance has resulted in solid returns on our shareholders' investments.

16 **Q. Mr. Kind also recommends that the Commission modify the authority**
17 **that the Commission gave to UE in MPSC Case No. EO-98-401, to manage its SO₂**
18 **allowance inventory. Do you agree with those recommendations?**

19 A. As I have stated previously, I strongly disagree with Mr. Kind's assertions.
20 The Company has effectively managed its SO₂ allowance inventory, balancing its
21 consideration of compliance strategy, environmental laws and regulations, operating
22 conditions and market conditions. UE's ratepayers have been well served by the MPSC's
23 December 1998 order and that order should be permitted to stay in place.

Cross-Surrebuttal Testimony of
Warner L. Baxter

1 **Q. Does this conclude your testimony?**

2 **A. Yes it does.**

DEBBY ANZALONE
Notary Public - Notary Seal
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St. Louis County
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