

Exhibit No.: _____

Issue(s):

Deferred Income Taxes, OPEB Liability

Rate Base:

Operating Income:

Revenue, Outage Expense,
Nuclear S&E Expense, A&G Salaries,
Outside Services, Incentive Comp.

Witness // Type of Exhibit:

Effron/Rebuttal

Sponsoring Party:

Public Counsel

Case No.:

EC-2002-1

REBUTTAL TESTIMONY

OF

DAVID J. EFFRON

Submitted on Behalf of the Office of the Public Counsel

Staff of the Missouri Public Service Commission

v.

Union Electric Company d/b/a AmerenUE

Case No. EC-2002-1

May 10, 2002

NP

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

| | | |
|----------------------------|---|--------------------|
| STAFF OF THE MISSOURI |) | |
| PUBLIC SERVICE COMMISSION, |) | |
| Complainant, |) | |
| |) | |
| vs. |) | Case No. EC-2002-1 |
| |) | |
| UNION ELECTRIC COMPANY, |) | |
| d/b/a AmerenUE, |) | |
| Respondent. |) | |


AFFIDAVIT OF DAVID J. EFFRON

STATE OF CONNECTICUT)

COUNTY OF Fairfield) ^{ss} Ridgelyfield

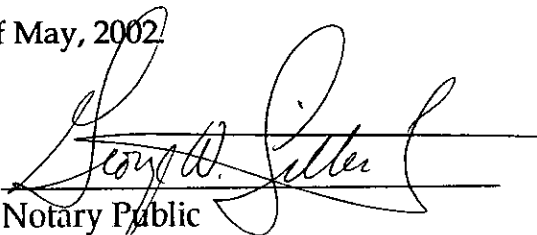
David J. Effron, of lawful age and being first duly sworn, deposes and states:

1. My name is David J. Effron. I am a consultant with Berkshire Consulting Services. I am presenting testimony on behalf of the Missouri Office of the Public Counsel.
2. Attached, hereto and made a part hereof for all purposes, is my rebuttal testimony consisting of pages 1 through 28 and Schedules DJE-1 through DJE-3.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.



David J. Effron

Subscribed and sworn to me this 9th day of May, 2002



Notary Public

My Commission expires 3/31/07.

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DIRECT TESTIMONY

OF

DAVID J. EFFRON

STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION

V.

UNION ELECTRIC COMPANY D/B/A AMERENUE

CASE NO. EC-2002-1

1 **I. STATEMENT OF QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is David J. Effron. My business address is 386 Main Street, Ridgefield, Connecticut.

4 **Q. WHAT IS YOUR PRESENT OCCUPATION?**

5 A. I am a consultant specializing in utility regulation.

6 **Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.**

7 A. My professional career includes over twenty years as a regulatory consultant, two years as a
8 supervisor of capital investment analysis and controls at Gulf & Western Industries and two years
9 at Touche Ross & Co. as a consultant and staff auditor. I am a Certified Public Accountant, and I
10 have served as an instructor in the business program at Western Connecticut State College.

11 **Q. WHAT EXPERIENCE DO YOU HAVE IN THE AREA OF UTILITY RATE**
12 **SETTING PROCEEDINGS?**

1 A. I have analyzed numerous electric, telephone, gas and water rate filings in different jurisdictions.
2 Pursuant to those analyses, I have prepared testimony, assisted attorneys in rate case preparation,
3 and provided assistance during settlement negotiations with various utility companies.

4 I have testified in approximately two hundred cases before regulatory commissions in
5 Alabama, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky, Maryland,
6 Massachusetts, Missouri, New Jersey, New York, North Dakota, Ohio, Pennsylvania, Rhode Island,
7 South Carolina, Texas, Vermont, and Virginia.

8 **Q. PLEASE DESCRIBE YOUR OTHER WORK EXPERIENCE.**

9 A. As a supervisor of capital investment analysis at Gulf & Western Industries, I was responsible for
10 reports and analyses concerning capital spending programs, including project analysis, formulation
11 of capital budgets, establishment of accounting procedures, monitoring capital spending and
12 administration of the leasing program. At Touche Ross & Co., I was an associate consultant in
13 management services for one year and a staff auditor for one year.

14 **Q. HAVE YOU EARNED ANY DISTINCTIONS AS A CERTIFIED PUBLIC**
15 **ACCOUNTANT?**

16 A. Yes. I received the Gold Charles Waldo Haskins Memorial Award for the highest scores in the
17 May 1974 certified public accounting examination in New York State.

18 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

19 A. I have a Bachelor's degree in Economics (with distinction) from Dartmouth College and a Masters
20 of Business Administration Degree from Columbia University.

II. PURPOSE OF TESTIMONY

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of the Missouri Office of the Public Counsel.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. On March 1, 2002, the Public Service Commission Staff ("Staff") presented testimony and exhibits on the excess revenue presently being produced by the rates charged by Union Electric Company d/b/a AmerenUE ("UE" or "the Company"). The calculation of the revenue excess was calculated based on a test year consisting of the twelve months ended June 30, 2001, adjusted for known and measurable changes through September 30, 2001. The purpose of this testimony is to address certain issues in the determination of the rate base and operating income components of the appropriate revenue requirement.

Q. WHAT ISSUES DO YOU ADDRESS IN THIS TESTIMONY?

A. In the area of rate base, I address accumulated deferred income taxes and the postretirement benefits ("OPEB") liability. In the area of operating income, I address revenue, nuclear outage expense, nuclear operation supervision and engineering expense, administrative and general salaries, outside services expense, and incentive compensation. At the time of the preparation of this testimony, there were still outstanding data requests for which responses had not been received. I reserve the right to modify or amend this testimony based on responses to those requests.

III. RATE BASE

A. ACCUMULATED DEFERRED INCOME TAXES

Q. HOW ARE ACCUMULATED DEFERRED INCOME TAXES TREATED IN THE DETERMINATION OF THE TEST YEAR RATE BASE?

A. Accumulated deferred income taxes (or "ADIT") are deducted from plant in service in the determination of rate base. Certain items of ADIT are credit balances, representing the cumulative effect of timing differences where deductions are taken for tax purposes in advance of when the expenses are recognized for book purposes, and certain items are debit balances, representing the cumulative effect of timing differences where deductions are taken for tax purposes in arrears of when the expenses are recognized for book purposes. The debit balances have the effect of reducing the net rate base deduction for ADIT, thereby increasing rate base.

Q. ARE YOU PROPOSING ANY ADJUSTMENTS TO THE ADIT DEDUCTED FROM PLANT IN SERVICE IN STAFF'S DETERMINATION OF RATE BASE?

A. Yes. I am proposing to eliminate certain deferred tax debit balances from the ADIT deducted from plant in service.

Q. HAVE YOU SUMMARIZED THE DEFERRED TAX DEBIT BALANCES THAT ARE YOU PROPOSING TO REMOVE FROM THE ADIT DEDUCTED FROM PLANT IN SERVICE?

1 A. Yes. On Schedule DJE-1, Page 1, I have identified three items of deferred tax debit balances that
2 should be eliminated from the calculation of the net ADIT deducted from plant in service in the
3 determination of rate base.

4 **Q. PLEASE DESCRIBE THE FIRST ITEM, AND EXPLAIN WHY IT SHOULD BE**
5 **REMOVED FROM THE ADIT THAT GO INTO THE DETERMINATION OF THE**
6 **COMPANY'S RATE BASE.**

7 A. The first item is the net deferred tax balance related to the **
8
9
10
11

12 ** Staff has not
13 deducted the accrued provision for deferred compensation itself from rate base. Therefore, the
14 deferred tax debit balance related to the accrued deferred compensation costs should be eliminated
15 from the ADIT that goes into the calculation of rate base.

16 **Q. WHAT IS THE NEXT ITEM THAT YOU ARE PROPOSING TO REMOVE FROM**
17 **THE NET BALANCE OF ADIT?**

18 A. The next item is the deferred tax balance related to **
19
20

21 ** (response to OPC Data Request 4036,
attached as Schedule DJE-3, Page 1). From the description in that response, it does not appear that

1 the tax effect of this item should be included in the utility cost of service. Therefore, I am proposing
2 to eliminate this item from the ADIT balance that goes into the determination of rate base.

3 **Q. WHAT IS THE THIRD ITEM OF ADIT THAT YOU ARE PROPOSING TO**
4 **ELIMINATE?**

5 A. The third item is deferred tax debit balance related to certain reserve accounts, such as the injuries
6 and damages reserve and accrued legal reserve. Again, this deferred tax debit balance relates to
7 expenses that the Company accrues on its books of account before the actual expenditures are
8 deducted for income tax purposes. The ADIT on this item represent the taxes on the cumulative
9 accruals in excess of costs that have been deducted for income tax purposes. Staff has not deducted
10 the accrued reserves themselves from rate base. Therefore, the deferred tax debit balance related to
11 the accrued reserves should be eliminated from the ADIT that go into the calculation of rate base.

12 **Q. PLEASE SUMMARIZE THE EFFECT OF YOUR PROPOSES ADJUSTMENTS TO**
13 **ADIT.**

14 A. As can be seen on my Schedule DJE-1, Page 1, I am proposing to remove ** ** of
15 deferred tax debit balances from the determination of the ADIT deducted from plant in service in
16 the determination of rate base. This adjustment has the effect of increasing the net deduction for
17 ADIT by ** ** and reducing rate base by the same amount. On Missouri jurisdictional
18 basis, the effect is to reduce rate base by ** **.

19 **B. POSTRETIREMENT BENEFIT LIABILITY**

20 **Q. WHAT ARE POSTRETIREMENT BENEFIT COSTS?**

1 A. Postretirement benefits costs, other than pensions, are costs of employee benefits, such as medical
2 insurance, that the Company is obligated to pay for employees after the employees retire. Pursuant
3 to relevant accounting standards, the Company is required to accrue this obligation while the
4 employees are still working and to treat the obligation to continue these payments after retirement
5 as an expense of current employee service.

6 **Q. HOW IS THE POSTRETIREMENT BENEFITS EXPENSE INCLUDED IN THE UE**
7 **COST OF SERVICE DETERMINED?**

8 A. The postretirement benefits expense (or "OPEB") is based on Statement of Financial Accounting
9 Standards 106 ("FAS 106"). Staff makes certain adjustments to normalize this cost, but the
10 expense included in the cost of service is derived from the periodic cost pursuant to FAS 106.

11 **Q. DOES UE FUND THE FAS 106 OBLIGATION?**

12 A. Yes. It is my understanding that the recovery of OPEB in rates is allowed only to the extent that
13 such costs are funded.

14 **Q. IF UE FUNDS THE OPEB COSTS TO THE EXTENT THAT THE OPEB ARE**
15 **RECOVERED IN RATES AND IF THE OPEB COST IS BASED ON FAS 106,**
16 **SHOULD A LIABILITY FOR THIS OBLIGATION ACCUMULATE ON THE COMPANY'S**
17 **BOOKS?**

18 A. No. While there might be a short-term liability on the Company's books from time to time based
19 on a lag between when the expense is recorded and when the contributions are actually made, the
20 accrued liability should be relatively modest in relation to the annual expense and should not

1 accumulate and grow over time. By definition, if the costs are funded based on the amount
2 recovered, there should not be a large liability for unfunded costs. Only if the amount funded is
3 less than the amount recognized as an expense would a significant liability accumulate.

4 **Q. IS THERE, IN FACT, A LIABILITY FOR UNFUNDED OPEB ON THE**
5 **COMPANY'S BOOKS OF ACCOUNT?**

6 A. Yes. As of June 30, 2000 the accrued OPEB liability was ** .** By June 30, 2001,
7 the liability had grown to ** **, and as September 30, 2001, the liability was **
8 ** (Response to OPC Data Request 4041 – attached as Schedule DJE-3, Page 2). By
9 definition, this liability represents the OPEB costs recognized on the Company's books of account
10 in excess of amounts actually disbursed to fund the OPEB costs.

11 **Q. IF THE ACCRUED LIABILITY REPRESENTS COSTS INCLUDED IN THE**
12 **REVENUE REQUIREMENT IN EXCESS OF ACTUAL EXPENDITURES TO FUND OPEB**
13 **COSTS, WHAT DO YOU RECOMMEND?**

14 A. As, I explained above, this should not happen if the Company is only allowed to recover OPEB
15 costs to the extent that such costs are actually funded. There is still a data request outstanding
16 requesting an explanation of this accrued liability. However, if the accrued liability does represents
17 costs included in the revenue requirement in excess of actual expenditures, then there should be a
18 rate base deduction for the accrued liability, as the liability would then represent customer supplied
19 funds. I have calculated that on a Missouri jurisdictional basis, the rate base deduction would be **

20 ** (Schedule DJE-1, Page 2) as of September 30, 2001.

IV. OPERATING INCOME

A. REVENUE

Q. HAVE YOU REVIEWED STAFF'S DETERMINATION OF PRO FORMA OPERATING REVENUE UNDER PRESENT RATES?

A. Yes. Among other adjustments, Staff has annualized sales based on the number of customers as of September 30, 2001 and has adjusted sales to reflect normal weather for the test year.

Q. ARE YOU PROPOSING ANY ADJUSTMENTS TO STAFF'S CALCULATION OF PRO FORMA OPERATING REVENUE UNDER PRESENT RATES?

A. Yes. I am proposing an adjustment to Staff's annualization of sales based on the number of customers as of September 30, 2001. In addition, I address one element of Staff's weather normalization adjustment to revenue, although I have not quantified a specific adjustment at this time.

Q. PLEASE DESCRIBE HOW STAFF ANNUALIZED SALES BASED ON THE NUMBER OF CUSTOMERS AS OF SEPTEMBER 30, 2001.

A. For the residential, small general, large general, and small primary service classes, Staff subtracted the number of customers in each month of the test year from the actual number of customers as of September 30, 2001 and multiplied the difference by the average revenue per customer for each month.

Q. IS IT POSSIBLE FOR SEASONAL DISTORTIONS OR OTHER TEMPORARY FLUCTUATIONS TO AFFECT THIS METHOD OF ANNUALIZING CUSTOMER GROWTH?

1 A. Yes. If the number of customers fluctuates seasonally, and if the point at which the customer
2 growth is annualized (in this case September 30) is at or near a seasonal low or high, then the
3 annualization will be seasonally distorted and will not be representative of the normal level of
4 customers being served. Similarly, if the number of customers in a class fluctuates, by annualizing
5 the sales based on one month, there is a possibility of distortion from using a month that might not
6 be representative of the normal number of customers.

7 **Q. IS THE NUMBER OF CUSTOMERS FOR ANY OF THE CLASSES FOR WHICH**
8 **STAFF ANNUALIZED SALES AFFECTED BY SEASONAL PATTERNS?**

9 A. Yes. **
10
11
12
13
14
15

16 **

17 **Q. SHOULD THE NUMBER OF CUSTOMERS USED BY STAFF BE ADJUSTED TO**
18 **REFLECT NORMAL CONDITIONS?**

19 A. Yes. The number of customers as of September 30 appears to be affected by seasonal conditions
20 that will not continue through the year. Thus, the number of customers as of that date appears to

1 understate the normal number of customers. The number of customers used by Staff to annualize
2 sales should be adjusted.

3 **Q. AS A GENERAL MATTER, IF REVENUES OR EXPENSES ARE AFFECTED BY**
4 **ABNORMALITIES, IS IT APPROPRIATE TO ADJUST THOSE REVENUES OR**
5 **EXPENSES TO REFLECT NORMAL CONDITIONS?**

6 A. Yes. The determination of the Company's revenue and expenses for the purpose of calculating the
7 revenue deficiency or excess and the prospective rates for electric service should reflect normal
8 conditions. For example, Staff adjusts sales and revenue to reflect normal weather conditions. In
9 the area of expenses, Staff adjusts tree trimming expense to reflect the normal level of expense that
10 the Company can be expected to incur on an ongoing basis prospectively under normal conditions.
11 Similarly, later in this testimony, I address certain adjustments to normalize what appear to be
12 certain abnormal expenses incurred in the twelve months ended June 30, 2001.

13 The underlying theory for these adjustments is that the determination of the Company's
14 revenue requirement and rates should reflect normal conditions. If there are abnormalities in
15 revenues or expenses in the chosen test year, the development of the revenue requirement should
16 not incorporate those abnormalities into the development of rates. By definition, the abnormalities
17 will not continue prospectively, and the prospective rates should not be based on abnormal
18 conditions. Rather, any identified abnormalities should be adjusted so that the development of rates
19 reflects normal conditions. It is my understanding that it is the usual Commission practice to
20 normalize revenues and expenses to eliminate the effect of abnormalities that may have existed in
21 the test year used to determine a utility company's revenue requirements.

1 **Q. HOW CAN THE NUMBER OF CUSTOMERS AS OF SEPTEMBER 30 BE**
2 **ADJUSTED TO ELIMINATE THE EFFECT OF ANY SEASONAL DISTORTIONS?**

3 A. Over the five-year period 1995-2000, the average annual growth rate in the number of residential
4 customers has been 0.768%. Customer growth through September 30 can be annualized by
5 multiplying the actual number of customers for each month in the test year by 1 plus 0.768% times
6 the years, or fraction of a year, from that month until September 30, 2001. For example, for July
7 2000 the actual number of customers should be multiplied by 1 plus 0.768% * 14.5/12. For March
8 2001, the actual number of customers should be multiplied by 1 plus 0.768% * 6.5/12. The result
9 will capture the growth in the number of residential customers through September 30, 2001 on a
10 normal, "deseasonalized" basis.

11 **Q. HAVE YOU PERFORMED SUCH A CALCULATION?**

12 A. Yes. My adjustment to Staff's annualization of sales and revenue is shown on Schedule DJE-2,
13 Page 1. My proposed modification to the number of residential customers as of September 30,
14 2001 results in an increase to adjusted test year revenue of ** .** Fuel expense must
15 also be adjusted, consistent with the increase to kWh sales.

16 **Q. DOES THE NUMBER OF CUSTOMERS IN ANY OF THE CUSTOMER CLASSES**
17 **FLUCTUATE FROM MONTH TO MONTH?**

18 A. Yes. **
19
20

1
2 .** There did not appear to be a seasonal pattern to these fluctuations.

3 **Q. SHOULD THE NUMBER OF CUSTOMERS USED TO ANNUALIZE THE SALES TO**
4 **THESE CUSTOMER CLASSES BE MODIFIED?**

5 A. Yes. Staff used the number of customers as of September 30, 2001. If this one month is not
6 representative of the normal number of customers as of that time, then the annualization is
7 distorted. I recommend that the average number of customers for the six months ended December
8 2001 be used for the purpose of annualizing sales to the **

9 .** The mid-point of this six-month period is September 30, 2001. Thus use of this six-
10 month average recognizes growth in the number of customers through September 30, 2001,
11 consistent with Staff's adjustments to rate base and certain expenses through that date, without
12 relying on a single month to quantify the necessary annualization adjustments.

13 On Schedule DJE-2, Page 1, I show that annualizing sales to the ** **
14 based on the average number of customers for the last six months of 2001 would increase revenue
15 by ** ** compared to the revenue calculated by Staff. Annualizing sales to the **
16 ** class based on the average number of customers for the last six months of 2001 would
17 decrease revenue by ** ** compared to the revenue calculated by Staff. This schedule
18 also shows the adjustments to kWh sales associated with each of these adjustments.

1 **Q. HAVE YOU REVIEWED STAFF'S WEATHER NORMALIZATION TO REVENUE?**

2 A. Yes. I believe that certain modifications to the method by which Staff prices out its weather
3 normalization adjustment should be considered.

4 **Q. WHY SHOULD MODIFICATIONS TO THE METHOD OF PRICING OUT THE**
5 **WEATHER NORMALIZATION ADJUSTMENT BE CONSIDERED?**

6 A. As explained in the testimony of Staff Witness Pyatte, the revenue adjustment was calculated by
7 applying a single seasonal energy rate to the monthly kWh weather adjustment for each customer
8 class. For example to calculate the revenue adjustment for the residential class in December 2000,
9 the kWh weather adjustment was multiplied by \$0.0577 per kWh, even though some of the sales in
10 December are billed at a rate of \$0.0577 per kWh and some are billed at a rate of \$0.0389 per kWh.

11 This method appears to overstate the revenue adjustment. In December 2000, the average
12 charge per kWh in the residential class was ** ** per kWh. If that rate were used to
13 calculate the revenue adjustment in December 2000, the adjustment would be approximately
14 ** ** less. Because the weather normalization in that month was a decrease, reducing
15 the adjustment by that much would increase the pro forma revenue under present rates by the same
16 amount. For the test year as a whole, the adjustment for the residential class would be less by about
17 ** ,** and the pro forma revenue would be greater by that amount, if the average rate,
18 rather than single season energy rate, were used in those months when the declining block rates
19 were in effect. (It should be noted that even use of the average rate might produce an adjustment
20 that is too great. If weather caused usage to be greater than normal in a given month, then it is
21 likely that a disproportionate share of the incremental abnormal usage would be in the tail block.)

1 Based on my analysis, the weather adjustment to revenue for the small general class would
2 also be somewhat less if the revenue adjustments were priced out at the average rate per kWh rather
3 than the single season energy rate. The weather adjustments to revenue for the large general, small
4 primary, and large primary classes would be somewhat greater, because Staff priced out the
5 adjustments for those customer classes using the tail block rates, which are lower than the average
6 rates.

7 I am not able to calculate a precise adjustment at this time because I do not have the
8 capability to price out the weather adjustments for each customer class based on the appropriate
9 rate per kWh for each month. However, I recommend that an alternative to the use of the single
10 season energy rate, based on the appropriate rate per kWh for each customer class for each month,
11 be used to price out the weather adjustment to kWh in Staff's computer model.

12 **B. OPERATING EXPENSES**

13 **1. CALLAWAY REFUELING OUTAGE**

14 **Q. HAS STAFF NORMALIZED EXPENSES ASSOCIATED WITH EXPENSES**
15 **INCURRED DURING THE REFUELING AND MAINTENANCE OUTAGE AT THE**
16 **CALLAWAY NUCLEAR POWER PLANT IN THE SPRING OF 2001?**

17 A. Yes. The Company refueled the Callaway nuclear power plant in April and May of 2001.
18 Therefore, the expenses associated with the refueling of the plant and the maintenance projects
19 performed during the refueling outage were incurred entirely within the test year in this case, the
20 twelve months ended June 30, 2001. However, the plant does not experience a refueling and
21 maintenance outage every twelve months. The plant is refueled on an eighteen-month cycle. Thus,

1 there will be a refueling and maintenance outage every eighteen months, or year and a half. The
2 "average" twelve-month period will contain two-thirds of a refueling and maintenance outage. To
3 normalize the expected frequency of the outages, Staff removed one-third of expense incurred in
4 the test year.

5 **Q. SHOULD THE REFUELING AND MAINTENANCE OUTAGE EXPENSE BE**
6 **FURTHER ADJUSTED?**

7 A. Yes. The actual expense incurred in the refueling and maintenance outage in April and May of
8 2001 was higher than the normal expense. This can be seen by reference to my Schedule DJE-2,
9 Page 2, where I show the expenses incurred in each of the last five outages, including the outage in
10 2001. The total expense incurred in the 2001 outage was **

11 ** The higher expense incurred in 2001 appears to be associated with the
12 generally longer length of the outage – **

13 ** The outage expense should be further adjusted to
14 normalize the level of expense, as well as to reflect the normalized frequency of the outages.

15 **Q. HOW DO YOU RECOMMEND THE OUTAGE EXPENSE BE NORMALIZED?**

16 A. The outage expense can be normalized by taking the average of the expenses associated with the
17 last five refueling outages. On Schedule DJE-1, Page 2, I have calculated the average of the
18 expenses of the last five refueling outages, including the outage in 2001, with the actual expenses
19 for the outages prior to the test year escalated by 2% per year to state the expenses in test year
20 dollars. I have used an escalation rate of 2% to approximate the average rate of inflation over the
21 years during which the last five refueling outages were experienced.

1 Using the five-outage average, as escalated, I have calculated an adjustment of **

2 .** These adjustments are
3 incremental to the adjustments calculated by Staff. On a Missouri jurisdictional basis, the
4 incremental adjustments are **

5 .**

6 **2. NUCLEAR OPERATION - SUPERVISION AND ENGINEERING**
7 **EXPENSE**
8

9 **Q. WHAT WAS THE EXPENSE CHARGED TO ACCOUNT 517, NUCLEAR**
10 **OPERATION - SUPERVISION AND ENGINEERING IN THE TWELVE MONTHS ENDED**
11 **JUNE 30, 2001?**

12 A. The expense charged to this account in the test year was ** **.

13 **Q. WHAT DOES THIS EXPENSE REPRESENT?**

14 A. This account includes labor and expenses for the general supervision and direction of the operation
15 of the Company's nuclear power plant.

16 **Q. HOW DOES THE EXPENSE CHARGED TO THIS ACCOUNT IN THE TEST YEAR**
17 **COMPARE TO THE EXPENSE CHARGED TO THIS ACCOUNT IN OTHER RECENT**
18 **YEARS?**

19 A. It is generally higher. For example, in 2000 the expense for nuclear operation supervision and
20 engineering expense was ** .** In 1999, the expense was ** .**

1 **Q. HAS THE COMPANY EXPLAINED WHY THE NUCLEAR OPERATION**
2 **SUPERVISION AND ENGINEERING EXPENSE WAS HIGHER IN THE TEST YEAR?**

3 A. OPC Data Request 4055 (attached as Schedule DJE-3, Page 3) asked the Company to explain the
4 reason for the increase in this expense over the level of expense incurred in other recent years. The
5 Company's response is not particularly helpful in explaining the reasons for the increase in this
6 expense account. The response cites **

7 .** Together, these
8 changes account for less than half of the increase over the expense amounts from earlier years.

9 The Company also cited the **

10
11
12 .** The response does not offer a great deal of insight as to why the
13 expenses charged to this account ** ** from 2000 to the test year,
14 even with the six month overlap between 2000 and the test year.

15 **Q. ARE YOU PROPOSING AN ADJUSTMENT TO THE NUCLEAR OPERATION**
16 **SUPERVISION AND ENGINEERING EXPENSE INCURRED IN THE TWELVE MONTHS**
17 **ENDED JUNE 30, 2001?**

18 A. Yes. Referring to Schedule DJE-2, Page 3, it can be seen that the expense charged to this account
19 in the twelve months ended June 30, 2001 **

20 .** The
21 Company has not established that the level of expense charged to this account in the twelve months

ended June 30, 2001 is normal or is indicative of the level of expense that will be incurred prospectively. Therefore, I am proposing to normalize the test year expense.

Q. PLEASE EXPLAIN YOUR PROPOSED ADJUSTMENT TO NUCLEAR OPERATION SUPERVISION AND ENGINEERING EXPENSE.

A. On Schedule DJE-2, Page 3, I have calculated the average of the expenses of over the five-year period 1997 – 2001, with the actual expenses for the years prior to the test year again escalated by 2% per year, again to account for inflation and to state the expenses in test year dollars. Using the five-year average, I have calculated a normalized level of expense of **. This is ** less than the expense incurred in the test year. Accordingly, I am proposing an adjustment of ** to nuclear operation supervision and engineering expense. On a Missouri jurisdictional basis, the adjustment is **.

3. ADMINISTRATIVE AND GENERAL SALARIES

Q. WHAT IS THE AMOUNT OF ADMINISTRATIVE AND GENERAL SALARIES (ACCOUNT 920) INCLUDED IN TEST YEAR OPERATION AND MAINTENANCE EXPENSE?

A. Test year administrative and general ("A&G") salaries were **.

Q. HOW DOES THIS COMPARE TO A&G SALARIES IN RECENT YEARS?

A. It is generally higher. For example, in 2000 A&G salaries were **. In 1999, A&G salaries were **.

1 Q. HAS THE COMPANY EXPLAINED WHY THE A&G SALARIES WERE HIGHER IN
2 THE TEST YEAR?

3 A. In response to OPC Data Request 4052 (attached as Schedule DJE-3, Page 4), UE stated that **

4
5 .** The Company further explained
6 that **

7 .**

8 Q. ARE THE EXPENSES CHARGED TO A&G SALARIES IN THE TEST YEAR
9 NORMAL?

10 A. Based on a comparison of expenses charged to that account in recent years, the expenses charged to
11 A&G salaries for the twelve months ended June 30, 2001 appear to be **

12 .** On Schedule DJE-2, Page 4, I show the expenses charged to Account 920 for each year
13 1997 - 2001. It can be seen that the expenses charged to A&G over this five-year period have
14 indeed fluctuated, **

.**

15 Q. SHOULD THE A&G SALARIES INCURRED IN THE TWELVE MONTHS ENDED
16 JUNE 30, 2001 BE NORMALIZED?

17 A. Yes. As explained above, the expenses charged to this account fluctuate from year to year. While
18 the actual expenses incurred in the twelve months ended June 30, 2001 fall within the extremes of
19 the levels of expenses charged to this account over the last five years, the actual test year expenses
20 appear to be greater than normal. Therefore, the A&G expenses for the test year should be
21 normalized.

1 Q. HAVE YOU QUANTIFIED A NORMALIZATION ADJUSTMENT TO THE
2 EXPENSES CHARGED TO A&G SALARIES IN THE TWELVE MONTHS ENDED JUNE
3 30, 2001?

4 A. Yes. On Schedule DJE-2, Page 4, I have calculated an adjustment to normalize the test year A&G
5 salaries expense. My proposed adjustment is based on the actual A&G salaries expenses for the
6 five years 1997-2001. I have calculated the average A&G salaries expense for that five-year
7 period, with the actual expenses for the years 1997-2000 escalated at a rate of 2.5% per year to re-
8 state the actual level of expenses to test year dollars. The escalation rate of 2.5% is intended to
9 allow for real growth as well as the effect of inflation. I have used a 2.5% escalation factor for this
10 expense to allow for increased expenses that might be experienced as a result of real system growth
11 due to such factors as increasing numbers of customers and a growing balance of utility plant. I
12 believe that this factor is fairly conservative, in that it would not be unreasonable to expect that
13 growth in administrative and general expense would be constrained by economies of scale and
14 productivity.

15 Using this method, I have calculated a normalized level of A&G salaries of
16 ** .** This is ** ** than the actual A&G salaries expense in the twelve
17 months ended June 30, 2001. Accordingly, I recommend that the test year A&G salaries expense
18 be ** ** to normalize the actual expenses incurred in the test year. On a
19 Missouri jurisdictional basis, this adjustment **

20 .**

4. OUTSIDE SERVICES EXPENSE

Q. WHAT IS INCLUDED IN CHARGES TO ACCOUNT 923, OUTSIDE SERVICES?

A. As provided by the Uniform System of Accounts instructions, Account 923 includes fees and expenses for professional services that are not applicable to a particular operating function. For example, this account will include fees for outside auditors, attorneys, actuaries, engineering consultants and management consultants. In the case of UE, the largest part of the charges to Account 923 is billings from Ameren Services.

Q. HAVE YOU REVIEWED THE OUTSIDE SERVICES EXPENSE FOR THE TEST YEAR?

A. Yes. Actual charges to Account 923 for outside services expense in the twelve months ended June 30, 2001 were **. ** Staff eliminated ** ** of over-accrued legal expense from this account. After this adjustment, the outside services expense is **. **

Q. BASED ON THE COMPANY'S EXPERIENCE IN OTHER RECENT YEARS, IS THIS LEVEL OF OUTSIDE SERVICES EXPENSE NORMAL?

A. No. On Schedule DJE-2, Page 5, I show the outside services expense charged to Account 923 for each year 1998 - 2001. I have begun with 1998 because the merger of AmerenUE and AmerenCIPS and the formation of Ameren Services was effective January 1, 1998. Therefore, a comparison of expenses incurred presently to expenses incurred prior to that date might not be meaningful. Referring to this schedule, it can be seen that for 2001, the charges for outside services were **. **, for 2000, the charges were **. **, for 1999, the charges were **. **, and for 1998, the charges were **. **. Thus the charges in the test

1 year, the twelve months ended June 30, 2001, were ** ** for
2 either 2000 or 2001, even though those two years in part overlap the test year. The charges to
3 Account 923 in the test year ** **to Account 923 in either 1998
4 or 1999.

5 **Q. HAS THE COMPANY EXPLAINED THE REASONS FOR THE INCREASE IN THE**
6 **CHARGES TO ACCOUNT 923 IN THE TWELVE MONTHS ENDED JUNE 30, 2001?**

7 A. OPC Data Request 4053 (attached as Schedule DJE-3, Page 5) asked the Company to explain the
8 reasons for the **

9 .** The Company responded that **

10 .** This describes the
11 types of charges to the outside services account, but it does not explain why the charges **

12 .**

13 Another explanation offered by the Company was that **

14
15 .** I find this explanation
16 lacking in two respects. **

. **

The explanation contained in the response to OPC Data Request 4053 concludes with the statement **

** If by "the current level of outside services" the response means the level of outside services expense for the twelve months ended June 30, 2001, this conclusory statement appears to be somewhat questionable.

Q. HAS THE COMPANY PROVIDED ANY INFORMATION THAT WOULD SUPPORT THE LEVEL OF EXPENSE CHARGED TO ACCOUNT 923 IN THE TWELVE MONTHS ENDED JUNE 30, 2001 AS BEING REPRESENTATIVE OF OUTSIDE SERVICES THAT WILL CONTINUE INTO THE FUTURE?

A. No, and available data do not support this conclusion. As noted above, the actual outside services expense for 2000 was ** **, and for 2001 the expense was ** **. Not only were the expenses less in the 2000 and the other years before the test year, the expenses were also less in the year ended six months after the end of the test year. This is an indication that outside services expenses incurred in the test year are not representative of the outside services expenses that will be incurred prospectively.

Q. WHAT DO YOU RECOMMEND?

A. I recommend that the actual outside services expense incurred in the twelve months ended June 30, 2001 be normalized for the purpose of determining the level of outside service expense to be

1 included in the Company's revenue requirement. I have calculated my proposed normalization
2 adjustment on Schedule DJE-2, Page 5.

3 **Q. PLEASE EXPLAIN THIS SCHEDULE.**

4 A. I have based my proposed normalization adjustment on the actual outside services expense incurred
5 in the years 1998 – 2001. I have used this four-year period rather than the five-year period I used to
6 normalize administrative and general salaries because, as noted above, Ameren Services was
7 formed in 1998, and the outside services expense incurred in the years before that might not offer a
8 meaningful comparison. (I should note that in 1997 the outside services expense was
9 ** **, which was less than any of the other years, so the exclusion of this year does not
10 cause any downward bias.) I have calculated the average outside services expense for the four-year
11 period 1998 - 2001, with the actual expenses for the years 1998-2000 escalated at a rate of 2.5% per
12 year to re-state the actual level of expenses to test year dollars. Again, the escalation rate of 2.5% is
13 intended to allow for real system growth as well as the effect of inflation.

14 Using this method, I have calculated a normalized level of outside services expense of
15 ** ** This is ** ** than the actual outside services expense in the
16 twelve months ended June 30, as adjusted by Staff. Accordingly, I recommend that Staff's test
17 year outside services expense be reduced by ** ** to normalize the actual expenses
18 incurred in the test year. On a Missouri jurisdictional basis, this adjustment reduces test year
19 operation and maintenance expense by ** **. **

20 **Q. HAVE YOU PERFORMED A REASONABILITY TEST ON YOUR PROPOSED**
21 **ADJUSTMENT?**

1 A. Yes. The outside services expense for 2001 was ** .** For the first six months of 2001
2 (which is within the test year), the outside services expense was ** .** Thus, for the
3 last six months of 2001, outside services expense was ** ** Doubling the actual
4 outside services expense for the last six months of 2001, the annualized level of expense is
5 ** .** This is actually less than the normalized expense of ** ** that I have
6 calculated on Schedule DJE-2, Schedule 5. Based on this comparison, I believe that the normalized
7 level of expense that I have calculated is reasonable.

8 **5. INCENTIVE COMPENSATION**

9 **Q. HAVE YOU REVIEWED STAFF'S PROPOSED ADJUSTMENT TO ELIMINATE**
10 **INCENTIVE COMPENSATION FROM THE COMPANY'S COST OF SERVICE?**

11 A. Yes. Staff is proposing to eliminate Company's incentive compensation expense from the cost of
12 service on the grounds that **

13 .**

14 **Q. BASED ON YOUR REVIEW, IS STAFF'S ELIMINATION OF INCENTIVE**
15 **COMPENSATION FROM THE COST OF SERVICE APPROPRIATE?**

16 A. Yes. There are three incentive compensation programs – **

17
18
19 .** Because the primary determinant of the incentive compensation is **
20 ** elimination expense of this expense from the cost of service to be paid by
21 ratepayers is appropriate.

1 **Q. WHY IS IT APPROPRIATE TO ELIMINATE INCENTIVE COMPENSATION ON**
2 **THE GROUNDS THAT THE PRIMARY BASIS FOR DETERMINING THE**
3 **COMPENSATION TO BE AWARDED IS ** **?**

4 A. If the primary basis for awarding incentive compensation were safety, reliability, or cost control,
5 then it would be reasonable to include such incentive compensation expenses in the cost of service.
6 These are goals that benefit everybody, including customers.

7 However, ** ** is a shareholder-oriented goal, not a customer-oriented goal. For
8 example, all else equal, higher rates will result in higher revenues, which in turn will result in
9 higher ** **. Thus, including incentive compensation related to EPS in the revenue
10 requirement would, in effect, require customers to reward company management on a contingency
11 basis for getting them to pay higher rates. If the incentive compensation program is successful in
12 increasing ** **, the shareholders should be happy to reward management accordingly and
13 absorb the cost of the program. As shareholders are the primary beneficiaries of increases to
14 ** **, it should be those shareholders, not customers, that bear the cost of the incentive
15 compensation related to ** **. Therefore, the incentive compensation based on ** **
16 should be excluded from the cost of service.

17 **Q. IS IT YOUR UNDERSTANDING THAT THE COMMISSION HAS DISALLOWED**
18 **INCENTIVE COMPENSATION FROM THE COST OF SERVICE IN OTHER CASES?**

19 A. Yes. Staff has cited other cases where the Commission has disallowed incentive compensation,
20 because the utilities had not established that the incentive compensation plans met the
21 Commission's standards for inclusion of the expenses in the cost of service, such as the plan's

1 being primarily in the interest of ratepayers. As UE's incentive compensation plans appears to be
2 based primarily on the interests of investors, the incentive compensation expense should not be
3 included in the cost of service in this case.

4 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

5 **A. Yes.**

SCHEDULE DJE-1

HAS BEEN DEEMED

PROPRIETARY

IN ITS ENTIRETY.

SCHEDULE DJE-2

HAS BEEN DEEMED

PROPRIETARY

IN ITS ENTIRETY.

SCHEDULE DJE-3

HAS BEEN DEEMED

PROPRIETARY

IN ITS ENTIRETY.