Exhibit No.:
Issues: Legal Fees; Midwest ISO; Environmental Expense; Fuel Costs for Coal Inventory; Payroll; Incremental Overtime
Witness: JOHN P. CASSIDY
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

JOHN P. CASSIDY

UNION ELECTRIC COMPANY, d/b/a AMERENUE

CASE NO. EC-2002-1

Jefferson City, Missouri
June 2002

NP

****Denotes Proprietary Information****
****<u>Denotes Highly Confidential Information</u>****

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

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

AFFIDAVIT OF JOHN P. CASSIDY

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

John P. Cassidy, 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 30 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.

John P Cassidy

John P Cassidy

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

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

Toni M Charlton

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

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JOHN P. CASSIDY

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SURREBUTTAL TESTIMONY

OF

JOHN P. CASSIDY

UNION ELECTRIC COMPANY

d/b/a AMERENUE

CASE NO. EC–2002–1

Q. Please state your name and business address.

A. John P. Cassidy, 815 Charter Commons, Suite 100B, Chesterfield, Missouri 63017.

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Public Service Commission (Commission) as a Regulatory Auditor.

Q. Are you the same John P. Cassidy who has previously filed direct testimony in this case?

A. Yes, I am.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of this surrebuttal testimony is to respond to the rebuttal testimony of Company witness Martin J. Lyons regarding legal expense and environmental expense. My surrebuttal testimony will also address the rebuttal testimonies of Company witnesses Warner L. Baxter and David A. Whiteley regarding the issue of the Midwest ISO exit fee. Lastly, this surrebuttal testimony will address Company witness Gary S. Weiss's rebuttal testimony regarding the issues of fuel costs for coal inventory, payroll and the incremental overtime associated with the Callaway refueling.

Q. What is your response to the rebuttal testimony of Company witnesses Baxter, Lyons, Weiss and Whiteley regarding the issues of legal expense, environmental expense, Midwest ISO exit fee, fuel costs for coal inventory, payroll and incremental overtime associated with Callaway refueling?

A. The Staff disagrees with the reasoning stated in the rebuttal testimonies of all of these witnesses regarding their proposed ratemaking treatment of these expenses. The Staff will address the rebuttal testimony of each Company witness and will also respond to some specific comments made by each witness in their respective rebuttal testimony.

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

A. Yes, I am. Due to medical reasons, I am adopting the portions of the direct testimony of Staff Accounting witness Doyle L. Gibbs that concerns the issue of payroll and the related incremental overtime associated with the Callaway refueling.

LEGAL AND ENVIRONMENTAL EXPENSES

Q. In his rebuttal testimony, Company witness Lyons voices his support for the Company's adherence to Generally Accepted Accounting Principles (GAAP) when accounting for legal and environmental expenses for financial accounting purposes. Is the Staff proposing that the Company deviate from GAAP for financial reporting purposes?

A. No. The Staff is not requiring or even suggesting that the Company deviate from GAAP for financial reporting purposes. To be more specific, the Company is allowed to recognize and book an estimate of costs for liabilities it expects to incur in a future period if those amounts can be reasonably estimated, under GAAP. The Staff is not proposing any modifications to the Company's financial reporting procedures. The Staff is noting that the accrued amounts for legal and environmental expenses, which the Company reflected in the test year, are not representative of ongoing levels.

Q. On what basis does the Staff support its adoption of the cash basis approach for legal and environmental expenses which Company witness Lyons represents as a departure from GAAP?

A. The Staff's position is that using a cash basis approach for the expenses is more reasonable than an accrual approach for ratemaking purposes. It should be noted, however, that the Staff's approach is not inconsistent with GAAP, because of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" (FAS 71). FAS 71 is a universally accepted GAAP standard, which is not mentioned in Mr. Lyons' rebuttal testimony. FAS 71 affords that regulatory commissions are not controlled by the other FAS because these standards were not designed to be appropriate for setting rates in the context of ratemaking proceedings. Therefore, the Staff's use of the cash basis of accounting is not "arbitrary and without foundation" as Company witness Lyons suggested in his rebuttal testimony on page 14, line 13, nor is it "some home-cooked methodology" as he indicated on page 15, line 6 in his rebuttal testimony. The Staff uses a cash basis of accounting to establish an objective basis for purposes of determining an ongoing level of expense. The cash basis is less subjective than the Company's approach and it avoids the potential of accruals being used to achieve a predetermined ratemaking result. The actual cash basis provides the data to properly normalize and annualize the cost level included in rates. This process eliminates management discretion to increase or decrease an accrual for future unknown events.

Q. Does the Staff agree with Company witness Lyons' explanation as to why the Commission should be wary of Staff's departure from GAAP?

A. No. Company witness Lyons states in his rebuttal testimony on page 13, lines 23-25, "Whatever principles the Staff is following, if they may be called principles, it is clear that they are not any generally accepted or universally recognized method of accounting." Mr. Lyons continues on page 14, lines 12-13 with the following, "In short, the Staff's departure from GAAP, the generally accepted accounting standard, is arbitrary and without foundation." Yet as was explained in the previous question and answer, the Staff bases its recommendation to use the cash basis of accounting on sound ratemaking theory. The Staff's position is not acceptable to the Company, but it is consistent with GAAP, especially the portion of GAAP directly related to this proceeding. Staff witness Mark L. Oligschlaeger addresses FAS 71 and the relationship of GAAP with regard to ratemaking practices in greater detail in his surrebuttal testimony.

The Staff's adjustments are based on traditional sound regulatory practices such as the use of the known and measurable standard. Costs should only be considered for regulatory purposes if the event giving rise to the cost is highly probable to occur and the impact on ongoing cost of service can be measured with a high degree of accuracy.

Q. Has the Commission commented on the relationship of GAAP to ratemaking and relying on sound regulatory practices for purposes of determining rates in a regulated environment?

A. Yes. In Case No. TR-93-181 et al., involving United Telephone Company (UTM), the Commission dealt with a post-retirement employee benefits (OPEBs) issue. The Commission sided with the Staff's approach of using a cash basis rate treatment for these costs, as opposed to the Company's proposed accrual method of accounting for OPEBs using FAS 106, "Employers' Accounting for Postretirements Benefits Other Than Pensions." The following was taken from the Commission's Report And Order from that case:

> The Public Service Commission has been charged with the responsibility of regulating the various investor-owned utilities to achieve fairness and balance between the interests of the ratepayers and shareholders and to insure that safe, economical and efficient utility service is provided to the public. Inherent in that responsibility is the obligation to set rates at levels that reflect the cost of service and duly compensate the shareholders for their investment, but protect the ratepayer from abuses of the natural monopoly. The Commission believes that allowing the FAS Board to dictate such a profound effect in rates, and in the balance maintained by the Commission between the ratepayer and the utility through the ratemaking process, without the benefit of the due process normally accorded both the company and the ratepayer in Missouri would usurp the powers and duties of the Commission and violate the clear mandate of the people of the state in giving this Commission its responsibility. The FAS Board is neither elected by nor representative of any constituency. It is the opinion of this Commission that, to allow such a body to simply dictate a rate outcome so far-reaching and expensive to the citizens of Missouri, could well be characterized as an abrogation by the Commission of the public trust placed in it. This is wholly unacceptable to this Commission.

Q. Are the levels of expense included by the Staff for legal and environmental expenses under the cash basis approach appropriate for regulatory purposes?

A. Yes. The Staff has been conservative in its use of the cash basis accounting approach. For legal expenses, the Staff exhibited this conservatism by including one of the highest annual levels of actual legal expense that the Company has incurred during the last five years. Please refer to Schedule 1 attached to this surrebuttal testimony which shows a comparison of the Staff and Company legal expense position at issue as well as a comparison to a three year and a five year average. Similarly, the Staff has been conservative in its cash basis treatment for environmental expense by including one of the highest annual levels of actual environmental expense that the Company has incurred during the last ten years. Also, the Staff has included an annual level of environmental expense that represents 88% of what the Company has actually spent in total on environmental expense during the past ten years. Please refer to Schedule 2 attached to this surrebuttal testimony which shows a comparison of the Staff and Company environmental expense position at issue as well as a comparison to a three year average, a five year average and total actual environmental expense during the past ten years. Furthermore, the Company does not dispute the amount of Staff's cash basis levels or that these amounts represent ongoing levels of expense anywhere in their rebuttal testimony.

Q. In general, what problems exist with Company witness Lyons' accrual method of accounting for purposes of determining rates?

A. Accrual basis accounting inherently uses an estimate of future costs that have not yet occurred and are not a factor in the actual operations that existed during the test period being examined, making it a "hypothetical" method or approach. Company witness Lyons admits to the shortcomings of his approach on page 19, lines 8-10 "… the accrual basis of accounting requires some attempt at a forward looking estimation of anticipated cash flows associated with known liabilities (i.e. incurred costs)." This is an inherent flaw in using the accrual method to account for legal and environmental expenses in a regulatory environment. Rates should be based on actual known and measurable costs, which the cash basis of accounting provides. Rates should not be based on Company's attempts to estimate what costs will be at some undetermined time in the future as the Company's hypothetical method provides. Furthermore, if granted the regulatory approval to include hypothetical levels of legal and environmental expense in the cost of service calculation, the Company would be granted a "blank check." This blank check would give the Company the incentive to "fill in the blank" with an overestimate for future anticipated liabilities such as legal and environmental expense and immediately correct the test year levels after the period occurs or rates are set. The Staff believes ratepayers must be protected from the Company's proposed blank check hypothetical approach, which would force them to pay for potentially inflated predictions of future expenses, which may or may not ever materialize at some undetermined time in the future.

Q. Has the Commission ruled against the inclusion in rates of estimated future expenses in other rate proceedings?

A. Yes. In Case No. ER-2001-299, involving The Empire District Electric Company (Empire), a case in which Company witness Lyons submitted testimony, the Commission found that depreciation rates should not include estimated future costs and that the appropriate time to consider such cost is when they are known and measurable. The depreciation issue in the Empire case exactly mirrors the Staff's cash basis versus the Company's hypothetical method at issue in this current case involving AmerenUE. In the Empire Case, Empire predicted certain future events (the timing and amount of major maintenance projects and the amount of net salvage to be incurred related to current plant in service) in determining depreciation expense. In contrast, the Staff relied on data from past and current events to determine depreciation expense, which did not require the estimation of costs that may be incurred at an unknown date in the future. This is precisely the problem at hand in the current case. Company witness Lyons proposes to use a hypothetical method of accounting for ratemaking purposes, for both legal and environmental expense, which relies on estimates of future expenses, to be paid out at a date which is undetermined and unknown. Furthermore, the Company's estimated future levels of hypothetical legal and environmental expense may or may not ever materialize. The Staff proposes the cash basis method, for both legal and environmental expense, which relies on actual, known and measurable data that has already occurred to determine ongoing levels of expense for these categories. The Commission took a dim view of using estimated future costs to set rates in the Empire case, as can be seen from the following excerpt taken from its Report And Order in Case No. ER-2001-299:

> Because Empire's approach requires that both the date each future major maintenance cost will be incurred and the magnitude of those costs be projected, the Commission finds it to be too speculative. The Commission finds that depreciation rates should not include these estimated future costs and that the appropriate time to consider such costs is when they are known.
>
> The Staff and Empire also disagree on whether depreciation rates should include net salvage. Inclusion of net salvage value creates the need to project the date that plant will be removed, the cost of removal at the time it is removed and the gross salvage value, for plant that may never be removed or at least not be removed for some considerable time after it is retired… This uncertainty provides sufficient grounds to reject Empire's determination of net salvage cost. The Staff's approach of treating net salvage cost as an expense based on Empire's recent historical data reduces this uncertainty… The Commission finds that net salvage cost considered in setting rates should be based on historical net salvage cost that Empire has actually incurred in the recent past and that it should be treated as an expense.

The Staff's cash basis approach for legal and environmental expense is entirely consistent with the Commission's ruling on depreciation expense and net salvage cost in Case No. ER-2001-299, involving Empire. However, the Company's proposed hypothetical approach for legal and environmental expense contradicts the Commission's Empire Order in this current situation involving very similar circumstances, because it seeks to estimate unknown costs, which might occur at some unspecified dates in the future. Finally, not only is Mr. Lyons' hypothetical approach attempting to include costs that are unknown in amount and date of occurrence, his approach runs the risk of including expenses in the ongoing cost of service that may never materialize.

Q. In what other cases has the Commission ruled against the inclusion in rates of estimated future costs?

A. In Case No. GR-96-285, involving Missouri Gas Energy (MGE), the Commission ruled in favor of the Staff's use of cash basis ratemaking for injuries and damages expense. In that case, the issue revolved around determining injuries and damages expense for the purpose of establishing MGE's rates. MGE proposed to include in its test year all paid losses as well as amounts that MGE accrued to pay losses which have occurred, but for which payment was yet to be made. Again, the Commission ruled against an accrual approach in favor of using actual historical costs, as the following excerpt from that Order demonstrates:

> MGE's approach to this issue is not tenable because it would include paid losses, as well as incurred but not paid losses…The Commission finds that the approach utilized by the Staff is the most reasonable one presented because it relies on the actual historical experience of MGE while operating in the State of Missouri.

In Case No. ER-93-41, involving St. Joseph Light & Power Company (SJLPC), the Commission ruled in favor of the Staff's cash basis accounting method for OPEBs. In that case, the Commission ruled as follows:

> The Commission finds that the cash basis accounting method is the appropriate method to determine OPEB expense for ratemaking purposes. In addition, the Commission will authorize SJLPC to continue to use the pay-as-you-go method for calculating the amounts charged to post-retirement benefits expenses other than pensions on its financial statements, based on actual payments to retirees. The difference between the expense amount calculated under FAS 106 and the pay-as-you-go amount shall be booked to the Uniform System of Accounts No. 186, Miscellaneous Deferred Debt, as a regulatory asset.

In Case No. TR-93-181 et. al., involving United Telephone Company (UTM), the Commission dealt with another OPEBs issue that involved cash basis accounting as opposed to the accrual method of accounting using FAS 106 in accordance with GAAP. The following are excerpts taken from the Commission Report and Order from that case:

> It is UTM's position, as supported by intervenors SWBT and GTE, that all FASB pronouncements are considered part of the generally accepted accounting principles (GAAP) currently in use by both the regulated utilities and the Commission. UTM is of the opinion that the Commission is obliged to accept FAS 106 as part and parcel of the GAAP standards…
>
> UTM maintains that the use of GAAP standards are required by the Securities and Exchange Commission in conjunction with the external auditing of investor-owned companies…
>
> In addition, UTM argues that accrual accounting for OPEBs properly matches the cost of providing service with the revenues received for that service. This is commonly referred to when discussing the OPEB issues as "intergenerational equity." UTM feels this will match the "cost causer with the cost payer." In addition, as the result of the rising cost of medical care, UTM maintains that the accrual method will avoid extraordinary cost to ratepayers at some time in the future, when those costs are actually incurred. Finally, UTM states that, to avoid inaccurate estimates as the result of the inherent uncertainty regarding actuarial assessments, the accrual amount for OPEBs will be adjusted annually.
>
> The Staff and OPC are opposed to any form of accrual accounting for OPEBs. The Staff takes the position that the Commission should maintain pay-as-you-go accounting for the expense level of non-pension benefits including in the revenue requirement determination…
>
> The Staff disagrees with UTM in its contention that the accrued amount under FAS 106 is known and measurable. The Staff points out that the ability to make an actuarial calculation for OPEBs does not make them known and measurable for ratemaking purposes…The Staff states that the actuarial calculations themselves may be correctly done, but the costs and expenses are incapable of being measured. Assumptions must be made to make these actuarial calculations.
>
> After an in-depth review of the issues and testimony surrounding the proposed adoption of FAS 106, the Commission reaffirms its current

> position. For ratemaking purposes, the pay-as-you-go method will continue to be used for OPEBs. ...

In summary, the Staff's cash basis approach for both legal and environmental expense follows previous Commission precedent in similar situations in cases involving Empire, MGE, SJLPC and UTM. In all of these cases, the Commission ruled against including in rates hypothetical estimates of future costs because they were not known and measurable and because of the uncertainty of whether the costs will ever really be incurred. In all of these cases, the Commission found that traditional regulatory practices involving the known and measurable standard, and the use of actual historical expenses levels that the cash basis method provides, was superior to reliance on GAAP for purposes of determining rates.

Q. Does Mr. Lyons' rebuttal testimony contradict the Commission's view of using uncertain future cost estimates to establish ongoing rates?

A. Yes. In several places in his testimony this contradiction can be found as the following examples demonstrate:

> Staff's recommendation of the cash basis… recommends setting rates on a purely backwards looking, inductive basis, rather than a forward-looking basis. ... Lyons page 18 lines 14, 16-17.

> A utility such as AmerenUE frequently incurs costs, the cash impacts of which will not be borne by the Company for some years to come. For instance, environmental and legal liabilities may not be satisfied for up to and over five years. Lyons page 18, lines 18-20.

> More importantly, as I will explain in more detail below in rebutting specific adjustments, the accrual basis of accounting requires some attempt at a forward looking estimation of anticipated cash flows associated with known liabilities (i.e. incurred costs). For instance, the Company's accrual for injuries and damages is based on estimates of legal liability made by those intimately familiar with the likely exposure in any given case. Lyons page 19, lines 7-12.

> Accrual accounting, on the other hand, …attempt[s] to estimate probable cash flows to be paid in a future period. Lyons page 21, lines 16-17.

Q. Does Company witness Lyons acknowledge that the Staff's cash basis method of accounting for legal and environmental expense is based on actual, known and measurable costs?

A. Yes. Company witness Lyons states on page 21, lines 2-5 the following:

> While the Staff's adjustment is indeed based on actual known and measurable cash flows – associated with costs long since incurred in the provision of electric service – Staff makes no attempt to relate those cash flows to the costs of any future period.

Q. What is the Staff's response to Company witness Lyon's assertion that the Staff's cash basis approach "makes no attempt to relate those cash flows to the costs of any future period?"

A. The Staff disagrees with Company witness Lyons that the cash basis approach of using actual known and measurable expenses to determine rates will not necessarily relate to what will take place in the future. These costs are the best indication of future ongoing cost based upon the data available. Mr. Lyons has provided no information to indicate that historical levels will not continue into the future. The Staff's cash basis approach provides a method of determining rates based on known and measurable costs, which is consistent with previous Commission orders in similar circumstances, as opposed to the Company's method of using hypothetical estimates.

Q. Does AmerenUE consistently apply its use of accrual accounting to all of its areas of expense?

A. No. When asked if AmerenUE accrues for costs associated with the Callaway refueling, an event that happens every eighteen months, the Company indicated that no accruals are performed. The following is Company's response to Staff's inquiry contained in Staff Data Request No. 182:

> Based upon my research, a decision was made by Senior Management to book Callaway refueling costs as they actually were incurred. AmerenUE has not accrued for future period expenditures, if the service or material has not been received/performed in the current period.

This example illustrates the inconsistency with which the Company applies accrual accounting. AmerenUE is unwilling to accrue for expenditures associated with the Callaway refueling that it knows will be incurred within eighteen months, but it is willing to accrue for both environmental and legal expenses which take several years until services are received (see Lyons page 18, lines 18-20), if they are ever received. Please refer to the Company's response to Staff Data Request No. 182, which is attached as Schedule 3, to this surrebuttal testimony.

Q. During the next two years, what is the level of electric related environmental liability expense exposure that the Company possibly may incur related to environmental cleanup?

A. In the response to Staff Data Request No. 37 in Case No. EC-2002-1, the Company indicated that the most it would spend on cleanups at Sauget areas 1 and 2 would be between ** P ** over the next two years.

Q. When did the contamination of the Sauget areas 1 and 2 occur?

A. The Company has indicated to the Staff that Sauget area 1 was originally contaminated during the 1920's while Sauget area 2 was contaminated during the 1960's and 1970's. AmerenUE only became aware that the United States Environmental Protection Agency (EPA) and the United States Department of Justice (DOJ) had named them as a potentially responsible party to the environmental cleanup during the year 2000.

Q. Mr. Lyons states on page 21, lines 16-18 that "Accrual accounting…attempt[s] to estimate probable cash flows to be paid in a future period, and to recognize those costs when they are incurred in the provision of electric service." Does Mr. Lyons hypothetical method truly "recognize costs when they are incurred in the provision of electric service?"

A. No. The Staff contends that Mr. Lyons' proposed hypothetical method does not truly recognize costs when they are incurred. Mr. Lyons' hypothetical method of accounting for environmental expenses only attempts to match costs with ratepayers who were customers at the time the Company became aware of its potential responsibility as a party to an environmental contamination, which actually occurred decades ago. To achieve intergenerational equity, this matching would require holding ratepayers who were customers at the time the actual contamination took place as being responsible for the environmental cleanup, since they were the actual customers of the Company when the events triggering this environmental cleanup expense occurred. Mr. Lyons fails to recognize that his method still does not truly address the intergenerational equity problem. The ratepayers he is asking to pay for the liability are those who happened to exist when another event occurred, namely, the Company gaining knowledge of their being a potentially responsible party to the liability of cleanup. These ratepayers are not the same ratepayers who were customers when the contamination occurred decades ago. Mr. Lyons' method is also not fair or consistent with an intergenerational equity viewpoint like the Staff's that requires ratepayers who are customers at the time the environmental costs are actually known and measurable, to bear these costs. This is true because the costs proposed for inclusion by Mr. Lyons are so speculative that they may never occur.

Q. How does the Staff respond to Company witness Lyons' point that because of the length of time associated with environmental remediation projects, postponement of recovery in rates until environmental liabilities are actually paid (i.e. a cash basis is used), requires ratepayers who did not benefit from the Company's actions to pay for those actions?

A. The Company does not truly match environmental expenses to the ratepayers who were customers at the time when the environmental contamination took place. Customers rarely achieve true intergenerational equity. Intergenerational equity requires a highly speculative estimate to quantify a future expenditure. There is a high probability the estimate will require adjustment in the future. Therefore the customers that pay the future costs will not be the same customers that will receive the benefit of the modification. Sometimes these corrections are made outside of rate cases, thereby creating a situation where customers never receive the benefit. Regulatory approval of the Company's hypothetical approach would give the Company a blank check to fill in at its convenience. The Company would always have the opportunity to overstate rates in any future case based on its own estimates of future costs. This provides an ongoing incentive to overaccrue expenses. Under such a scenario, the Staff would be placed in a position of trying to determine if the Company's prediction of future costs is accurate. However, such future costs are not known and measurable. This would lead to overcharging customers today and on an ongoing basis for a prediction regarding an unknown cost that may occur, if ever, at some future unspecified date. For these reasons, the Company's hypothetical approach should not be permitted in a ratemaking environment.

Q. Please respond to Company witness Lyons' assertion that "the cash basis is readily subject to self-interested manipulation."

A. The Staff finds Company witness Lyons' thought process as expressed in his rebuttal testimony on page 20, lines 1 through 10 disturbing. Here, Mr. Lyons states the following:

> …the cash basis is readily subject to self-interested manipulation. Were the Commission to adopt it, nothing would prevent a utility from cooking its books as surely as the sun rises and sets. Staff, proposes, for instance that the cash basis is appropriate for injuries and damages. Were that to be the rate making treatment, nothing would prevent a company from settling a large number of cases in a given year – and promptly filing a rate case based on that test year. A company could similarly monkey with its books through creating pre-payments – having vendors bill in advance for services yet to be rendered; or it could manipulate its environmental expenses in a manner similar to injuries and damages. The simple fact is that unlike USOA-mandated accrual basis, the cash basis is rife with opportunity for manipulation.

The controllers of utilities under the jurisdiction of the Commission should never entertain thoughts of manipulating their books. The energy and accounting industries are currently paying for a significant loss of public trust because of these types of actions. The Staff believes Mr. Lyons' accruals are more readily subject to self-interested manipulation. If the Company decided to settle a large number of injuries and damages cases, under a cash basis approach the Staff would audit the underlying reasons and prudence supporting these actions. If the Company decided to buy a 100 year supply of office supplies and tried to include it as an ongoing expense, the Staff would not include such a level as a reasonable, ongoing, prudently incurred level of expense. The Company would then be exposed to the possibility of not receiving enough revenues to cover its expenditures. The Company could not game the system, as easily as Mr. Lyons suggests, because by using the cash approach the Staff would always have the data supporting these actual known and measurable costs to examine and could review under what circumstances they were incurred. Therefore, in Mr. Lyons hypothetical example, he suggests inclusion in the cost of service amounts of actual costs that would be unreasonable and not reflective of ongoing levels, as well as being imprudently incurred. Similarly, using Mr. Lyons' example, if the Company were to create pre-payments with vendors to bill in advance for services, this would involve collusion with a party outside of the Company, which would increase the chances of being discovered. Highly irregular activities of this nature could be discovered as a result of the document trail that would be available for examination. In addition, because expenses have been incurred, there are invoices to examine and actual costs to audit and question.

Quite to the contrary, the Staff contends that it is the Company's hypothetical method that is readily subject to self-interested manipulation on Company's part. This is because under the Company's hypothetical method there would be no invoices to examine. There would be no actual known and measurable cost trail to examine, only the Company's prediction as to what the costs may be at some undetermined date in the future. If the Commission upheld the Company's hypothetical method for ratemaking purposes, the Company would only need to collude with itself to always overestimate future levels of expense, thereby forcing its ratepayers to pay for expenses that may never materialize. The Company's ratepayers must be afforded protection from the opportunity for ratemaking abuse that this blank check approach for legal and environmental expenses would provide to the Company within a regulatory context.

Environmental

Q. Is AmerenUE's environmental accrual and corresponding reserve balance determination based solely on the liability it expects to incur related to the electric operations?

A. No. A major component of the Company's determination of its environmental accrual is based on estimates of liabilities that relate to Manufactured Gas Plant (MGP) cleanups that the Company is involved with. In the late 1800s and early 1900s, MGPs existed to manufacture gas from coal to heat homes and businesses. This process was discontinued when it became possible to transport natural gas from gas wells through long distance pipelines. As a result, MGP sites were abandoned since they were no longer economically feasible. The EPA is currently in the process of identifying and evaluating these sites because of the potential contamination from coal tar and other residual chemicals left in the soil when the MGP sites were abandoned. The Staff contends that the Company's accrual for its electric operations is improperly inflated because it includes estimates of the MGP liabilities, which should be accounted for separately as part of the Company's gas operations. Currently, the Company determines their environmental accrual based on their liability exposure for gas and electric as well as nonjurisdictional Illinois operations. Then the Company allocates roughly 3-4% of this amount to gas operations and approximately another 8% to Illinois operations. The following chart shows the minimum and maximum estimated liabilities related to MGP cleanup which has impacted its accrual decision, but which is in no way related to the Company's electric operations:

**		**HC**		
	HC			
	HC	_	_	
	HC	_	_	
	HC	_	_	
	HC	_	_	
		_	_	
	HC	_	_	
	HC	_	_	
	HC			**

Considering the fact that the Company estimates that the most it expects to expend during the next two years is ** P ** for electric related cleanup at Sauget, the Staff believes that it is the MGP cleanup that is driving the Company's determination of its environmental accruals. In addition, the Alton MGP cleanup is related to the Company's Illinois operations. Therefore, the Company's accrual is heavily biased with MGP expense that has no relationship to the Company's electric operations. Also, to reiterate the discussion in my direct testimony on page 17, lines 3 –5, "Even after making this (environmental) adjustment (S-17.3), the Company will still have an over-accrued environmental reserve balance in excess of ** P ** to serve as a cushion against any large future environmental expenses." In addition, the Staff is proposing to include in rates on an annual ongoing basis, ** P ** of additional environmental expense, which represents one the highest twelve month levels of environmental expense the Company has incurred during the past ten years. The Company would need to spend ** P ** before it would even need the level of expense the Staff is allowing in this case on an annual ongoing basis.

Q. What amount of funds has the Company already received in credits as part of the EARP for environmental expenses?

A. During the first three years of the first EARP, the Company accrued and was allowed to recover ** P **. This represents an amount that is even larger than the Company's anticipated maximum exposure of ** P ** related to cleanups at Sauget Areas 1 and 2 over the next two years.

Legal

Q. Has the Staff been able to adequately examine the support for the Company's test year legal expenses?

A. No. The Staff requested supporting documentation for test year legal expenses that pertained to matters concerning Case No. EC-2002-1 (and the related earnings investigation) in Data Request No. 92. A representative portion of the Company's response to this data request is attached as Schedule 4 to this surrebuttal testimony. The Company has indicated that it has redacted information that is protected by the attorney-client privilege. As can be seen by viewing the attached response, the Company has redacted pertinent information, preventing the Staff from making an accurate assessment of the Company's actual test year legal expense respecting AmerenUE. For example, the Staff is being asked to assume that the activity that is redacted relates to AmerenUE and the Staff's earnings investigation/complaint case rather than other legal activity respecting Ameren. This response does not justify inclusion of the level of legal expenses included in the test year.

The Staff contends that if this were a rate case instead of a complaint case, the Staff would propose to disallow the Company's outside legal expense until such time that the Company provided adequate justification and support to the Staff. Given that this case is a complaint case, and staying consistent with its conservative treatment of the Company's expenses in this case, the Staff has given the Company actual paid outside legal expenses in its cost of service calculation, with exception of approximately **P   ** of nonrecurring legal work performed in relation to the third sharing period of the second EARP. Certainly, the Company's lack of support for legal costs associated with this complaint case is justification for not allowing any additional legal fees in rate case expense as part of the ongoing cost of service. For a further discussion regarding the area of rate case expense, please refer to the direct and surrebuttal testimonies of Staff witness Leasha S. Teel.

Q. Is any other Staff witness addressing cash versus accrual issues?

A. Yes. Staff Accounting witness Mark Oligschlaeger is also addressing these issues in his surrebuttal testimony.

MIDWEST ISO

Q. What is the Company's position on how the Midwest ISO exit fee should be treated?

A. In his rebuttal testimony, Company witness Baxter, proposes to include a four-year amortization of the $12.5 million exit fee. However, if the Staff does not agree to include a four-year amortization of the exit fees in its cost of service calculation, Mr. Baxter argues that the Staff should include approximately $6 million of estimated future Midwest ISO administrative expense. This estimated level of Midwest ISO expense is described in Company witness Whiteley's rebuttal testimony on page 16, lines 3-15.

Q. Subsequent to the Staff's direct testimony filing, has AmerenUE reached a decision on whether it will rejoin the Midwest ISO?

A. Yes. AmerenUE has announced that it will rejoin the Midwest ISO and will begin operations under the Midwest ISO no later than four months after receipt of the last regulatory approval. Within 60 days of receipt of FERC approval, AmerenUE will receive a full refund of the $12,502,000 exit fee payment, with interest. Attached as Schedule 5 to this direct testimony is an Ameren Service Company Compliance filing before the FERC and an executed agreement between AmerenUE and the Midwest ISO which explains Ameren's intent to rejoin the Midwest ISO and also the settlement terms for refunding AmerenUE's exit fee with interest.

Q. Does the Staff propose to disallow the Midwest ISO exit fee "based on the speculation that it will be refunded at some point in the future" as was portrayed in the rebuttal testimony of Company witness Warner L. Baxter on line 18, page 54 and supported by Company witness Whiteley on page 15, lines 12-20?

A. No. The basis for the Staff's disallowance of the Midwest ISO exit fee is that it is a one time, non-recurring event as the Staff has previously stated in its direct testimony. However, it is an important point to realize that the Company will receive a full refund for the exit fee expense with interest, because it further compounds the problem associated with Company's proposal to allow the Company to recover this Midwest ISO exit expense through the use of a four year amortization. If given a four year amortization of Midwest ISO expense, the Company would be allowed to recover from ratepayers an item that is not only one time and non-recurring, but will also be recovered from the Midwest ISO. To allow this item in rates would constitute double-recovery on the Company's part.

Q. Should the Company be allowed to include the $6 million of estimated Midwest ISO administrative expenses, as described in Company witness Whiteley's rebuttal testimony, if a four year amortization is not allowed?

A. No. These costs represent an estimated amount of future expense that will begin to be incurred in their entirety, well beyond the Staff's test year and update period as has been ordered by the Commission in this case. As such, they should not be considered as part of this case. Also, further examination of Mr. Whiteley's forward looking calculations shows a failure to recognize any offsetting cost savings as part of AmerenUE's decision to rejoin the Midwest ISO. Such cost savings include the following items:

- Payments made by AmerenUE to Mid America Interconnected Network (MAIN) for various services during the test year will be eliminated in the future.
- AmerenUE may eliminate employees because they will no longer have to handle transmission services that will now be handled by the Midwest ISO.
- Recognition of future transmission revenues.

In Staff Data Request No. 210 which is unanswered to date, the Staff has asked the Company to identify all cost savings that will result from its decision to rejoin the Midwest ISO. This data request also asks AmerenUE to identify all costs that are already included in the test year for administrative expenses that AmerenUE paid the Midwest ISO and the Alliance Regional Transmission Organization. These costs were also not considered as part of Mr. Whiteley's calculations.

<u>FUEL COSTS FOR COAL INVENTORY</u>

Q. Why does the Company disagree with using the cost of coal burned as annualized by the Staff to develop the coal inventory adjustment?

A. Company witness Gary S. Weiss states on page 3 of his rebuttal testimony that the Staff's annualized cost of the coal burned has three main problems. First, the cost used includes coal cost and cost of all other fuels burned. Second, this fuel cost is based on the Staff's AmerenUE stand alone production cost model and does not reflect the total cost based on the Joint Dispatch Agreement (JDA). Third, this fuel cost is based only on native load and not the total generation load.

Q. How does the Staff respond to the Company's three concerns with the fuel prices used to develop the coal inventory?

A. Regarding the first concern, the Staff's coal inventory levels in its direct filed case did include coal cost as well as minor amounts of gas and oil fuel costs. Upon learning of this, the Staff revised its calculation of the coal burned to eliminate the costs of all other fuels burned. These revised coal costs as reflected in the Staff's most recent production cost model, which is discussed in the surrebuttal testimony of Staff witness Leon C. Bender, were provided to Staff witness Paul R. Harrison to incorporate into his coal inventories calculation. Please refer to the surrebuttal testimony of Mr. Harrison for a complete discussion of the Staff's updated adjustment to coal inventory.

The Company's other two arguments that the Staff failed to reflect total fuel costs based on the JDA and that it is based only on native load are not valid arguments. By making these two arguments AmerenUE is seeking to include in the cost of service calculation a level of coal costs that represents a level of coal inventory to serve the JDA load rather than Missouri customer load. Coal inventory costs associated with serving the energy transfers from AmerenUE to Ameren Energy Generating Company (AEG)/Ameren Energy Marketing (AEM) are not included in the margin above incremental fuel cost as described in the direct testimony of Staff witness Michael S. Proctor. In other words, AmerenUE does not receive any compensation from AEG/AEM for coal inventory costs associated with energy transfers from AmerenUE to AEG/AEM. For a discussion of the margin related to energy transfers from AmerenUE to AEG/AEM, refer to Dr. Proctor's direct testimony page 7, lines 4-14. In addition the surrebuttal testimony of Staff witness Robert E. Schallenberg discusses the impact of recognizing the costs associated with coal inventory.

INCREMENTAL OVERTIME – CALLAWAY REFUELING

Q. What is the Company's witness Gary S. Weiss' position on overtime costs related to Callaway refueling?

A. Company witness Weiss believes that the overtime expense that was associated with the Spring 2001 refueling is the most representative ongoing level of overtime expense. This belief is also stated on page 20 of the rebuttal testimony of Company witness Gary L. Randolph.

Q. What explanation has the Company provided as to why the level of overtime expense associated with the Spring 2001 refueling has exceeded each of the five previous refuelings?

A. The Staff asked the Company this very question in Data Request No. 207. In response to this question, the Company referred the Staff to its response to Staff Data Request No. 138 where the Staff asked the Company to explain why the maintenance project expense during the spring 2001 refueling exceeded each of the previous five refuelings. In response to that question, the Company stated the following:

> ** P
> P
> P
> P
> P
>
> P **

Apparently, the Company is stating that there is a correlation between the level of overtime expense associated with Callaway refueling and the maintenance activities that it performs. The Staff has attached Data Request No. 207 as Schedule 6 and Data Request No. 138 as Schedule 7 to this surrebuttal testimony.

Q. Does a strong correlation between overtime expense and maintenance activities exist with regard to the Callaway refueling project for Spring 2001?

A. No. The Staff has prepared the following chart summarizing maintenance projects expense and incremental overtime wages for the past six refuelings and showed the percentage of incremental overtime to maintenance project expense.

** **P**

P

P

P

P

P

P

P **

This chart shows that the Company is proposing to include a level of overtime expense that represents the highest ratio of overtime to maintenance expense that the Company has experienced during its last six refuelings over a period covering nine years. Therefore, the Company's attempt to correlate test year incremental overtime expense with test year maintenance projects is flawed. This chart also shows that the duration of days associated with the test year refueling is much longer than usual.

Q. How did the Staff adjust the incremental overtime incurred during the test year?

A. The Staff used an adjusted average of the incremental overtime incurred during the most recent three Callaway refuelings.

Q. How does the Staff’s adjusted average of incremental overtime wages associated with the three most recent Callaway refuelings compare with the test year level of maintenance project expense?

A. The Staff’s three refueling average compared to test year maintenance project expense is shown by the following calculation:

** P
P
P ________

P

P
P ________

P
**

This calculation shows that the Staff’s use of a three refueling average produces a ratio of overtime to maintenance projects that is more consistent with the ratios that have occurred during the past five refuelings, as shown above in this surrebuttal testimony.

Q. Did the Staff factor up the overtime expense associated with the Callaway refueling for wage rate increases?

A. Yes. The Staff included in its cost of service calculation a three refueling average of overtime wages, factored up for all wage rate increases that have occurred during those three refuelings in order to price past overtime expense consistently with current overtime expense. The following chart shows adjusted overtime wages to reflect the effect of all wage rate increases that have occurred during the past three refueling as well as a three refueling average of these amounts:

** **P**
P
P

P

P

P **

To complete its annualization, the Staff took two-thirds of ** P ** to calculate its annualized level of ** P ** for incremental overtime. The Staff and the Company also included two-thirds of the ** P ** for maintenance projects. Since the Company refuels the Callaway nuclear plant on an eighteen month cycle, the Staff included two-thirds to properly normalize refueling cost over the eighteen month Callaway refueling cycle to reflect an amount incurred during a twelve month period.

Q. What level of maintenance project expense associated with Callaway refueling is the Company budgeting for future Callaway refuelings?

A. The Company's response to Staff Data Request No. 138, attached as Schedule 7-8 to this surrebuttal testimony, shows that the Company has budgeted ** P ** for Refueling 12 (scheduled to occur in Fall 2002) and ** P ** for Refueling 13 (scheduled to occur in Spring 2004). This is less than the ** P ** amount which occurred during the test year associated with Refueling 11 (Spring 2001), to which the Company's level of incremental overtime is directly tied. Using the Company's argument that there is a correlation between the level of incremental overtime expense associated with Callaway refueling and the maintenance activities that it performs, these budgeted amounts indicate that incremental overtime should actually decline in relation to the Company's next two refuelings.

Q. Please summarize why the Staff believes that the Company's position is inappropriate for determining ongoing levels of Callaway refueling incremental overtime expense.

A. The cost of incremental overtime experienced for the latest refueling that occurred during the Staff's test year is higher than any level AmerenUE has incurred during the previous five refuelings. Furthermore, when the Company tries to correlate incremental overtime with maintenance projects, the Staff's calculations (shown above in this surrebuttal testimony) demonstrate that the relationship during the test year was not consistent with the relationship that occurred during the previous five refuelings. However, the relationship between the Staff's three refueling average more closely reflects the relationship that existed during the previous five refuelings. The Staff contends that its use of a three refueling average of incremental overtime best reflects the normalized incremental overtime for refueling Callaway because of this stronger relationship. Also, the Staff's adjustment is conservative because the three refuelings average includes in the cost of service calculation a level of incremental overtime expense that is higher than any of the past five Callaway refuelings. Lastly, the Company budgets a level of maintenance projects expense that is lower than the test year actual level. Since the Company correlates incremental overtime expense with maintenance projects expense, this would indicate that future incremental overtime expense should decline.

PAYROLL

Q. Other than the Callaway incremental overtime are there any other areas in payroll that the Company and the Staff are in disagreement over?

A. No. I have been informed through discussions with Company witness Gary S. Weiss that the Company will make an adjustment to production payroll to eliminate three months of the annualization of payroll that are included in the Company's production expenses through September 30, 2001. Mr. Weiss also indicated that he would reduce payroll by $80,000 to correct an error in the Company's calculation of incremental overtime. To the extent the Company does not make these adjustments, the Staff reserves the right to file supplemental surrebuttal testimony regarding these areas.

OTHER CORRECTIONS AND CHANGES TO STAFF'S CASE

Q. What change are you sponsoring to the Staff's case?

A. Staff witness Leon Bender performed a revised calculation of annualized fuel and purchased power expense, using his production cost model. This change has been reflected through Adjustment S-7.1. The reasons for making this change are explained in detail in Mr. Bender's surrebuttal testimony and summarized in Schedule 1, which is also attached to his surrebuttal testimony.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.