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Issue(s): Policy
Witness: Warner L. Baxter
Sponsoring Party: Union Electric Company
Type of Exhibit: Rebuttal Testimony
Case No.: ER-2010-0036
Date Testimony Prepared: February 11, 2010

MISSOURI PUBLIC SERVICE COMMISSION

Case No. ER-2010-0036

REBUTTAL TESTIMONY

OF

WARNER L. BAXTER

ON

BEHALF OF

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

**St. Louis, Missouri
February, 2010**

UE Exhibit No. 101
Date 3-15-10 Reporter FF
File No. ER-2010-0036

1 **REBUTTAL TESTIMONY**

2 **OF**

3 **WARNER L. BAXTER**

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

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

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

8 **Q. Are you the same Warner L. Baxter who filed direct testimony on July 24,**
9 **2009, and who also filed direct, rebuttal, and surrebuttal testimony on interim rates in this**
10 **case?**

11 A. Yes, I am.

12 **Q. What is the purpose of your rebuttal testimony?**

13 A. The purpose of my rebuttal testimony is to summarize the Company's response to
14 some of the positions taken on various issues in this case, as reflected in the Staff's Cost of
15 Service Report (Staff's Report) and in the direct testimony of certain other parties. I will also
16 address the concerns expressed by our customers regarding the impact on them of the rate
17 increase we are seeking in this case, and will outline the specific steps we have taken, and are
18 continuing to take, to control our costs while also continuing to deliver the reliable service our
19 customers expect from us. In addition, I will suggest a rate design mechanism the Commission
20 could adopt to help mitigate the impact of our rate increase on our residential customers,
21 including low income customers. Finally, I will provide a list of the Company's rebuttal
22 witnesses and the principal issues being addressed by each of them.

1 **Q. Please summarize the key points of your rebuttal testimony.**

2 **A.**

- 3 • Certain positions advocated by parties in this case are significantly outside
4 the mainstream (including recommendations associated with return on
5 equity and depreciation) and/or use aggressive cost normalization methods
6 that effectively disallow significant costs we have incurred relating to the
7 maintenance and improvement of our energy infrastructure.
- 8
- 9 • With regard to return on equity (ROE), the Company has reduced its
10 original request of 11.5% to 10.8% based on updated data related to its
11 cost of capital. Our revised recommendation is now in line with the
12 national average of 10.6% for integrated electric utilities, as well as our
13 current allowed ROE of 10.76%. All other parties' ROE
14 recommendations in this case are far below the mainstream. Approval of
15 a reasonable ROE, in line with that approved by the Commission only one
16 year ago, is critical to maintaining AmerenUE's financial stability,
17 allowing the Company to compete for capital with other utilities on
18 reasonable terms and enabling it to continue to make the kind of energy
19 infrastructure investments that it needs to make in order to deliver the
20 level of service and reliability our customers expect.
- 21
- 22 • Certain parties' recommendations concerning the Company's depreciation
23 rates are also significantly outside of the mainstream. The Commission
24 should adopt the standard life span approach to depreciating our coal-fired
25 generating plants. The life span approach is recommended for use in
26 depreciating power plants by authoritative depreciation texts, it is widely
27 used for that purpose in nearly all jurisdictions, and is supported in this
28 case by sound, reasoned estimates of the retirement dates of the
29 Company's coal-fired plants. Moreover, the Commission should reject the
30 many other punitive depreciation expense reductions proposed by the
31 Missouri Industrial Energy Consumers (MIEC), which, if adopted, would
32 result in depreciation rates at AmerenUE that would barely exceed the 2nd
33 percentile compared to the Company's peers. Depreciation rates at that
34 level will fail to provide a return of the capital invested in the Company's
35 system over the life of the utility plant that serves customers, and will
36 provide inadequate cash flows to support the high level of investment the
37 Company needs to continue to make in its energy infrastructure.
- 38
- 39 • Both the Staff and MIEC have employed aggressive cost normalization
40 methods for power plant expenses. It is critical that the Staff's and the
41 MIEC's proposed reduction in test year coal-fired power plant
42 maintenance expenses be rejected because, if adopted, this reduction
43 would severely undermine the Company's ability to perform important
44 planned maintenance outage work at these power plants. That maintenance

1 is necessary to continue the high level of equivalent availability we have
2 been able to achieve at these plants which, in turn, lowers net fuel costs for
3 our customers. Consequently, the test year level of coal-fired power plant
4 maintenance should be included in rates, because it is reflective of the
5 ongoing level of maintenance expenses that the Company expects to incur
6 during the time rates to be set in this case will be in effect.
7

- 8 • Should the Commission adopt the "out of the mainstream" positions,
9 and/or the aggressive cost normalization proposals advocated by these
10 parties, there would be meaningful negative implications. In particular,
11 the excessive regulatory lag which I described in my previous testimonies
12 would only be aggravated further. Consequently, the related negative
13 policy implications of excessive regulatory lag would clearly become
14 worse. The rates that the Commission would establish would not provide
15 us with a reasonable opportunity to recover our prudently incurred costs of
16 providing service, as well as a reasonable opportunity for our shareholders
17 to earn a fair return on their investment. In addition, our already existing
18 negative free cash flows would materially increase. Consequently, our
19 credit quality, financing costs, and ability to access the capital markets at
20 reasonable rates would be negatively impacted. Finally, not only would
21 adoption of these positions create a strong disincentive for us to pursue
22 any new investments to meet customer expectations or strongly support
23 state and federal policies and initiatives, we would be left with no
24 reasonable choice but to meaningfully reduce our level of investment in
25 our energy infrastructure and in our operations, consistent with the cash
26 flows we derive from this rate case. This reduced investment would
27 weaken the reliability of our distribution system and power plants, result
28 in job losses, further weaken the economy of our communities and the
29 state, and ultimately harm our customers.
30

- 31 • The Company has listened attentively to the comments and concerns of
32 our customers, expressed in connection with the local public hearings and
33 otherwise. We believe our customers want us to continue our efforts to
34 deliver high quality and reliable service at a reasonable cost. As a result,
35 we have taken many proactive steps to reduce our costs, including
36 reducing certain planned 2009 costs by in excess of \$100 million, taking
37 steps to implement approximately \$1 billion in reductions of certain costs
38 originally included in the five-year plan we developed early in 2009,
39 implementing voluntary and involuntary employee reductions, and
40 freezing management salaries.
41

- 42 • We recognize that there is never a good time to ask for a rate increase, and
43 we heard our customers who appeared at the public hearings express the
44 hardships that our proposed rate increase would cause them. In light of
45 these testimonies, we recommend that the Commission consider adopting
46 a rate design that would help mitigate the impact of any increase that is

1 ultimately approved in this case on Missouri families (including our low
2 income customers). As a consequence, the Commission should consider
3 shifting 1% of the total costs that would otherwise be borne by the
4 residential class to the Large Primary Service and Large Transmission
5 Service classes, which currently pay much lower rates than the Residential
6 class.
7

8 **I. Response to Positions of Certain Other Parties**

9 **Q. Your July 24, 2009 direct testimony discussed, among other things, the**
10 **considerable infrastructure investments being made by the Company to continue to**
11 **maintain and improve reliability, the challenges the Company faces in this time where the**
12 **Company's capital expenditure needs are high, and the challenges posed by regulatory lag**
13 **and its related policy implications. Do the positions reflected in the Staff's Report and**
14 **other direct testimony filed in this case adequately address the Company's investment**
15 **needs and those challenges?**

16 **A. No, they do not. Certain positions advocated by parties in this case are**
17 **significantly outside the mainstream (including recommendations associated with return on**
18 **equity and depreciation) and/or use aggressive cost normalization methods that effectively**
19 **disallow significant costs we have incurred relating to the maintenance and improvement of our**
20 **energy infrastructure. Should the Commission adopt these out of the mainstream positions, or**
21 **the aggressive cost normalization proposals advocated by the parties, there would be meaningful**
22 **negative implications. In particular, the excessive regulatory lag which I described in my**
23 **previous testimonies would only be aggravated further. Consequently, the related negative**
24 **policy implications that I also described would clearly become worse. The rates that the**
25 **Commission would establish would not provide us with a reasonable opportunity to recover our**
26 **prudently incurred costs of providing service, as well as a reasonable opportunity for our**
27 **shareholders to earn a fair return on their investment. In addition, our already existing negative**

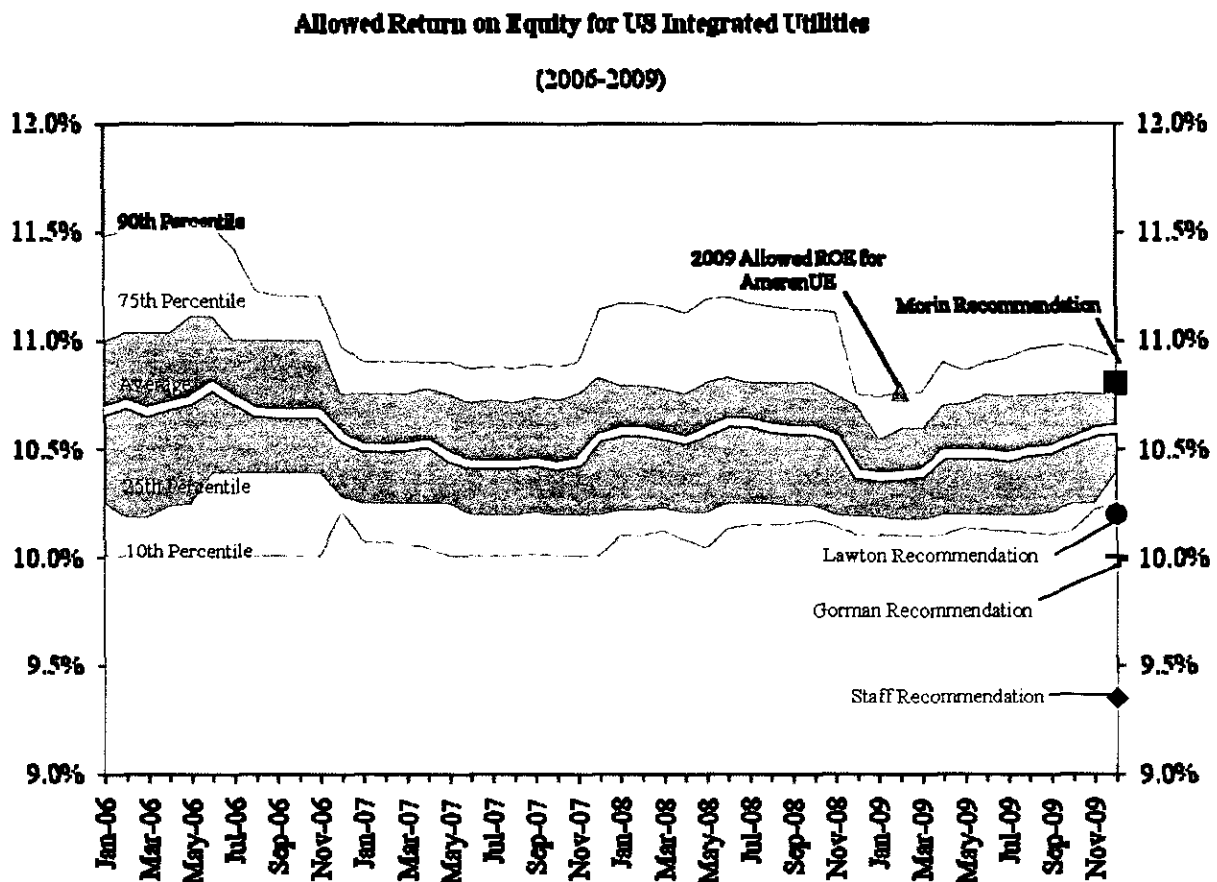
1 free cash flow levels would materially increase. Consequently, our credit quality, financing
2 costs, and ability to access the capital markets on reasonable terms would be negatively
3 impacted. Finally, not only would adoption of these positions create a strong disincentive for us
4 to pursue any new investment to meet customer expectations or strongly support state and federal
5 policies and initiatives, we would be left with no reasonable choice but to meaningfully reduce
6 our level of investment in our energy infrastructure and in our operations, consistent with the
7 cash flows we derived from this rate case. This reduced investment would weaken the reliability
8 of our distribution system and power plants, result in job losses, further weaken the economy of
9 our communities and the state, and ultimately, harm our customers. Simply put, the aggressive
10 ratemaking policies advocated by certain of the parties are not consistent with sound energy
11 policy. Adoption of these positions by the Commission would have meaningful, negative long-
12 term implications for our customers, our communities and our state.

13 **Q. Earlier, you stated that one of the out of the mainstream recommendations**
14 **advocated by the parties related to return on equity. Please elaborate.**

15 **A.** Similar to its recommendation in the Company's last rate case, the Commission's
16 Staff is proposing an allowed ROE ranging from approximately 90 to 160 basis points below the
17 average allowed ROE (10.6%) for integrated electric utilities like AmerenUE over the past year.
18 The Staff's recommendation is substantially below the ROEs authorized by this Commission for
19 other electric utilities in recent cases, and ranges from 106 to 176 basis points below the
20 Company's currently authorized ROE, approved just 12 months ago (10.76%). To put this in
21 perspective, the midpoint of the Staff's range (just 9.35%) would put AmerenUE literally off-
22 the-chart for allowed ROEs for integrated electric utilities.

While not as unreasonable and punitive as the Staff's ROE recommendation, both the recommendations of MIEC (10%) and the Office of the Public Counsel (OPC) (10.2%) are also substantially below the average allowed ROEs in the past two years and if adopted would put AmerenUE's allowed ROE below the 10th percentile for allowed ROEs for similarly situated integrated electric utilities.

The out-of-the-mainstream positions of the other parties are made clear by a chart from Dr. Morin's rebuttal testimony, which I have reproduced below:



Sources and Notes:

Analysis of data compiled by Regulatory Research Associates.

[1]: Allowed ROE calculated as 12-month rolling average of commission-approved returns.

[2]: Averages and percentiles exclude decisions that apply only to electric distribution companies or individual generating plants.

1 In summary, these low ROEs, which would substantially reduce the Company's current
2 ROE, would undermine AmerenUE's financial stability, materially reduce its ability to compete
3 for capital on reasonable terms with other utilities, and compromise its ability to continue the
4 kind of reliability-related investments it has made and needs to continue to make to meet
5 customer expectations. Further, it would signal to investors that the regulatory environment in
6 Missouri is inconsistent in its application, not supportive of providing investors with a reasonable
7 opportunity to earn a fair return on their investment, and that it fails to support the significant
8 investment needs of its utilities, including AmerenUE.

9 **Q. Are you a rate of return expert?**

10 **A.** No I am not, but I am ultimately responsible for making the decisions the
11 Company must make with regard to when, how, and how much to invest in its energy
12 infrastructure. I know how such low ROEs would impact those decisions. Moreover, my views
13 on the impact of these low ROE recommendations are supported by the Company's ROE expert,
14 Dr. Roger Morin, and an equity investment expert who is filing rebuttal testimony on behalf of
15 the Company, Ms. Julie Cannell. So while it is true that rate of return experts, including Dr.
16 Morin, rely on complicated analyses to "calculate" a recommended ROE (such as the discounted
17 cash flow (Dcf), the Risk Premium, and the CAPM analyses), and while it is true that the results
18 these experts reach can vary considerably, it is also true that that the final ROE adopted by the
19 Commission must be in the mainstream of ROEs approved for similar utilities in Missouri and
20 other states in order to put the Company in a position to access the capital it needs at a
21 reasonable cost, and to continue to invest in its system as it needs to do and as customers expect
22 it to do.

1 **Q. Why is adoption of a reasonable ROE for AmerenUE that is in the**
2 **mainstream important?**

3 A. AmerenUE must compete for capital with other utilities. If its authorized ROE is
4 materially below the ROEs awarded to other similar utilities, it will be at a disadvantage in
5 obtaining the capital it needs (at reasonable terms) to maintain and improve its infrastructure.
6 This is a particularly important consideration in the current environment where AmerenUE needs
7 to continually access the capital markets to finance its operations (due to its significant negative
8 free cash flows) in order to continue to invest significantly in its system to meet the expectations
9 of its customers as well as meet state and federal requirements. If the Company is to be able to
10 access the capital it needs at a reasonable cost, it must be provided fair regulatory treatment,
11 similar to that provided to other utilities. The sub-10% return being proposed by Staff and the
12 near 10% returns on equity being proposed by others do not meet this standard.

13 **Q. Earlier, you also stated that certain parties' positions on depreciation were**
14 **outside of the mainstream. Can you elaborate on that as well?**

15 A. As discussed in detail in the direct and rebuttal testimonies of AmerenUE
16 witnesses John Wiedmayer, proper depreciation accounting practices strongly support use of the
17 life span approach in setting depreciation rates for electric production plants, including the
18 Company's coal-fired units. Failure to use the life span approach, which as Mr. Wiedmayer
19 discusses is used almost universally outside Missouri, results in unreasonably low depreciation
20 rates. Indeed, the Staff's composite depreciation rate for all of AmerenUE's plant-in-service
21 would rank just above the 20th percentile as compared to peer utilities, and MIEC's proposed
22 rates would barely exceed the 2nd percentile. At a time when the Company needs more, not less
23 cash to continue to invest in its system, setting unreasonably low depreciation rates is poor

1 policy, will meaningfully increase our negative free cash flows, and in the long run is harmful to
2 customers.

3 **Q. Aside from the ROE and depreciation issues, are there other noteworthy**
4 **positions sponsored by some of the other parties that would systematically disallow**
5 **prudently incurred costs through aggressive cost normalization methods, undermine**
6 **AmerenUE's financial stability, compromise its ability to make needed investments in**
7 **infrastructure, and ultimately harm consumers?**

8 **A.** Yes, there is one in particular. Both the Staff and MIEC are proposing
9 disallowances of coal-fired power plant maintenance costs that will severely undermine the
10 Company's ability to continue to operate those plants at the very high level of reliability and
11 availability that the Company and our customers have enjoyed for the past several years. As
12 addressed in detail in the rebuttal testimony of AmerenUE witness Mark Birk, the Company is as
13 of the writing of this testimony in the middle of a planned outage at one of its coal-fired power
14 plants, has already completed another outage this year, and will be conducting additional planned
15 outages later in 2010. As Mr. Birk also explains, this outage work means that the level of coal-
16 fired power plant maintenance in 2010 will be almost identical to the test year level included in
17 the Company's revenue requirement. Moreover, as also explained by Mr. Birk, the Company is
18 now at the point in its planned outage cycles that it must continue to perform a higher level of
19 planned outages over the next few years than it performed over the past two or three years (the
20 periods relied on by the Staff and MIEC) in order to maintain the reliability and high equivalent
21 availability that benefits the Company and customers. Indeed, if the Company can maintain that
22 high equivalent availability, it will have lower net fuel costs (due to greater plant efficiency and
23 higher off-system sales revenues), which will directly benefit customers through the Company's

1 fuel adjustment clause. Unfortunately, both the Staff and MIEC are proposing to “normalize”
2 coal-fired power plant maintenance expense down to a level that simply will not support the
3 maintenance that needs to occur in order to maintain those plants at the high level of equivalent
4 availability we enjoy today. Adoption of those adjustments would force the Company to cut its
5 planned maintenance, which would almost certainly be detrimental to our customers.

6 **II. Impact of the Rate Increases – Steps Taken by the Company**

7 **Q. In your direct testimony you acknowledged that any rate increase, including**
8 **this one, would create financial hardship for some of your customers. You also addressed**
9 **in general terms certain proactive steps the Company was taking to reduce its costs. Can**
10 **you please elaborate on those issues now in light of the developments that have occurred in**
11 **the more than six months that have passed since this case was filed?**

12 **A. Yes. Before getting into specifics, I want the Commission to know that we take**
13 **very seriously our obligation to listen to the concerns our customers express at local public**
14 **hearings and at meetings that occur prior to each local public hearing. That is one of the reasons**
15 **either I or one of my officers at UE attended every single one of these meetings and the 17 local**
16 **public hearings that were held by the Commission. If a service or billing concern of any kind**
17 **was brought to our attention during this process, we are following up with that customer to**
18 **promptly address those concerns. AmerenUE witness Dave Wakeman addresses this follow-up**
19 **in his rebuttal testimony. I have also been encouraged by some positive comments by our**
20 **customers at these hearings, in particular in areas relating to the reliability improvements the**
21 **significant investments in our energy infrastructure are now producing, and in regard to our**
22 **storm recovery efforts, which reflect the investments and improvements we have made in that**
23 **area as well.**

1 **Q. What are your main observations relating to the comments at these meetings**
2 **and the testimony at these local public hearings?**

3 A. As I acknowledged in my direct testimony, the comments and local public hearing
4 testimony confirm that a rate increase will create hardship for some, and they confirm that a rate
5 increase will of course require everyone to pay more for their electric service than they would
6 like. Large numbers of people turned out for the pre-hearing meetings and the local public
7 hearings themselves, which I believe were driven, in part, by the mailers and robo-calls from the
8 "Fair Electricity Rate Action Fund" (FERAF). Nonetheless, these hearings gave us a great
9 opportunity to speak to our customers directly, answer their questions, and listen and respond to
10 their concerns.

11 It is noteworthy that we heard few, if any, comments from our customers that suggest that
12 our customers do not want us to continue to invest in the reliability of our power plants and
13 energy delivery systems, in our storm response efforts, and in customer service in general. And
14 while there of course were some concerns expressed about service, it was notable that there were
15 a relatively low number of service-related concerns expressed at the pre-hearing meetings and
16 during the hearings themselves relative to the number of people who participated in the meetings
17 and who testified. Having said that, we recognize that there is never a good time for a rate
18 increase and it is particularly difficult during these challenging economic times. We take this
19 matter very seriously and that is why we have taken several proactive steps to meaningfully
20 reduce our costs, implement energy efficiency programs and provide several customer energy
21 assistance programs to help our customers with their current and future energy costs.

22 **Q. Can you describe some of the proactive steps the Company has taken to**
23 **reduce its costs?**

1 A. Certainly. In 2009, we reduced certain costs in excess of \$100 million from our
2 original 2009 plan. In addition, later in 2009, we implemented voluntary and involuntary
3 separation programs, and made the decision to freeze all management salaries in 2010.
4 Moreover, we are taking steps to implement approximately \$1 billion in reductions of certain
5 costs originally included in the five-year plan we developed in early 2009.

6 **Q. Is there anything the Commission could do to address the concerns expressed**
7 **by residential customers at the local public hearings who are having difficulty paying their**
8 **electric bills?**

9 A. The Company is concerned about its most vulnerable residential customers, and
10 has sponsored numerous programs, including the Clean Slate program, low income
11 weatherization, the Dollar More program, and energy efficiency programs designed to help low
12 income customers. However, one way the Commission could provide additional help to
13 Missouri families (including our low income customers) would be to allocate one percent of the
14 costs that would otherwise be allocated to the residential class to the Large Primary Service and
15 Large Transmission Service classes, classes of customers whose rates are currently lower than
16 the Residential class. AmerenUE witness Wilbon Cooper explains how this would work in his
17 rebuttal testimony. This reallocation would provide some small measure of relief to residential
18 customers, without significantly impacting the other affected classes of customers. In
19 accordance with the Commission's February 10, 2010 *Order Directing the Parties to Address the*
20 *Concerns Raised by AmerenUE's Low-Income Residential Customers*, the Company will provide
21 additional information to the Commission regarding this important issue when it files direct
22 testimony related to this issue on February 19, 2010.

1 **Q. Please summarize the witnesses filing rebuttal testimony for the Company**
2 **and the issues they are addressing.**

3 **A. In addition to me, the following witnesses are filing rebuttal testimony on behalf**
4 **of the Company:**

<u>Witness</u>	<u>Principal Issues Addressed</u>
6 Dr. Roger Morin	Cost of Equity
7 Julie M. Cannell	Equity Investor Perspectives and Return Requirements
8 Mark C. Birk	Coal Plant Maintenance and ECRM
9 John F. Wiedmayer	Depreciation
10 Dave Wakeman	Reliability and Infrastructure Costs
11 Krista Bauer	Incentive and Executive Compensation
12 Wilbon L. Cooper	Rate Design/LTS Class (Noranda) Rate Design
13 Gary S. Weiss	Miscellaneous Revenue Requirement Issues
14 Stephen M. Kidwell	Energy Efficiency/Rate Case Expense
15 Matt Michels	Energy Efficiency Modeling
16 Randall Irwin	Nuclear Fuel Costs/Callaway Outages
17 Timothy Finnell	Production Cost Modeling
18 Michael O'Bryan	Equity Infusion/Flotation Costs
19 Richard Mark	Advertising Costs
20 William Warwick	Class Cost of Service Study
21 Bill Barbieri	Pure Power
22 Michael Adams	Cash Working Capital

23
24 **Q. Does this conclude your rebuttal testimony?**

25 **A. Yes, it does.**

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

In the Matter of Union Electric Company d/b/a) Case No. ER-2010-0036
AmerenUE's Tariffs to Increase its Annual) Tracking No. YE-2010-0054
Revenues for Electric Service.) Tracking No. YE-2010-0055

AFFIDAVIT OF WARNER L. BAXTER

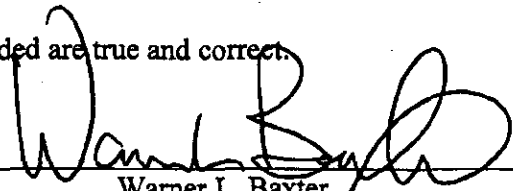
STATE OF MISSOURI)
) ss
CITY OF ST. LOUIS)

Warner L. Baxter, being first duly sworn on his oath, states:

1. My name is Warner L. Baxter. I work in the City of St. Louis, Missouri, and I am employed by Union Electric Company d/b/a AmerenUE as President and Chief Executive Officer.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony behalf of AmerenUE consisting of 13 pages and Schedules ~~WLB-ER-XXX~~ through ~~WLB-ER-XXX~~ all of which have been prepared in written form for introduction into evidence in the above-referenced docket.

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



Warner L. Baxter

Subscribed and sworn to before me this 10 day of February, 2010.



Notary Public

My commission expires:

