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Issue(s): Policy
Witness: Warner L. Baxter
Sponsoring Party: Union Electric Company
Type of Exhibit: Surrebuttal Testimony
Case No.: ER-2012-0166
Date Testimony Prepared: September 7, 2012

MISSOURI PUBLIC SERVICE COMMISSION

Case No. ER-2012-0166

SURREBUTTAL TESTIMONY

OF

WARNER L. BAXTER

ON

BEHALF OF

UNION ELECTRIC COMPANY
d/b/a Ameren Missouri

St. Louis, Missouri
September, 2012

SURREBUTTAL TESTIMONY

OF

WARNER L. BAXTER

CASE NO. ER-2012-0166

Q. Please state your name and business address.

A. My name is Warner L. Baxter. My business address is One Ameren Plaza, 1901 Chouteau Avenue, St. Louis, Missouri 63103.

Q. Are you the same Warner L. Baxter who filed direct testimony in this case?

A. Yes, I am.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to respond to Missouri Public Service Commission Staff ("Staff") witness John Cassidy's contention that the Company has not experienced and does not experience a permanent loss of the depreciation and return associated with assets placed in-service between rate cases. Related to that point is my rebuttal of Mr. Cassidy's suggestion that because certain "variables" (costs and revenues) go up and down between rate cases, he suggests that tbe regulatory framework in Missouri is balanced and that a mechanism such as Plant-in-Service Accounting is unnecessary.

Q. Has the Company experienced permanent losses associated with assets placed in service between rate cases?

A. Absolutely. As I have previously indicated and show further below, the Company has systematically been denied a reasonable opportunity to earn a fair (and its allowed) return on equity. If the Company cannot earn a fair return on equity, then by definition it is not recovering the operating expenses, depreciation, taxes, and cost of capital that it incurs in operating its business. After years of working on this problem, I can tell you that one of the principal drivers of this shortfall are the significant investments in infrastructure that we make year after year after year and that serve customers, but which, between their in-service dates and the re-setting of rates, are not reflected in our rate base for ratemaking purposes. As a result, the depreciation expense and cost of capital related to these assets that are incurred between cases are permanently lost to the Company under the current regulatory framework. The more we invest in our system, the greater this permanent loss is. In other words, the current regulatory framework creates a powerful financial disincentive for the Company to make proactive, incremental investments in its system, even when those investments would benefit customers by making the system more reliable and meet their ever-increasing expectations.

Q. But what about Mr. Cassidy's contention that some variables go up while some go down, and that overall, the regulatory framework in Missouri is balanced and provides utilities with a reasonable opportunity to earn a fair return?

A. While it is true that some variables (costs and revenues) go up and down between rate cases, it is also true that for several years costs and investment needs are rising and continue to meaningfully outpace increases in revenues from weather normalized customer growth. As a result, the regulatory framework in Missouri is not balanced and does not provide our Company with a reasonable opportunity to earn a fair return on our investments. It simply has not kept pace with the changing market conditions over the last several years.

Q. What is the basis for your views?

A. Despite the fact that we have received four rate increases since 2007, and have significantly reduced our expenditures since the economic crisis in 2008, about which I have previously testified, we have consistently been unable to earn a fair return on our investment. That remains true today, as indicated by Schedule WLB-ES1 attached to my testimony, which is an update to a chart prepared in my direct testimony. [1]

Q. What does Schedule WLB-ES1 show?

A. It shows that on a weather-normalized basis, which is how rates are set, that despite four rate increases starting in 2007 we have never earned our allowed return, which leads me to conclude that the regulatory framework in Missouri is not providing our Company with a reasonable opportunity to earn a fair return on our investment.

Q. I understand that the rate-setting proeess assumes normal weather, which is one of those variables that can go up and down, but hasn't the unusually warm weather in recent years solved this problem for you?

A. No it has not. As Schedule WLB-ES2 shows, even if you do not adjust our return for the impact of weather, we have only earned our allowed return nine times since June 2007, or only about 15% of the time. Weather has not solved the problem, nor should it be expected to solve the problem. Indeed, it is completely inappropriate to expect a utility's earnings to be "saved" by abnormal weather. Rates must be set to allow a utility to recover

[1] Schedule WLB-ES1 (and Schedule WLB-ES2) update the charts presented in my direct testimony by adding data for additional months through July, 2012. They also reflect corrections to the data utilized in my direct testimony charts because of two errors in the original data. Those errors related to errors in the weather normalized loads used in the charts for a few of the months shown, and an error related to including income tax benefits resulting from the Taum Sauk rate base disallowance ordered by the Commission which were too high. The errors do not materially change the chronic under-earnings shown in the original charts; in fact the original charts overstated the Company's returns for the affected periods.

its costs and have the opportunity to earn a fair return under normal weather conditions. Our Plant-in-Service Accounting proposal is one way to help mitigate this ongoing problem, no matter what the weather.

Q. Isn't it true that there have been some unusual items affecting your Company's earnings in 2011 aud 2012 and that if you remove the impact of those unusual items from your earned return it could change your conclusion?

A. No, it would not change my conclusion at all. It is true that there have been some unusual items which have impacted our earnings in 2011 and 2012. Those items are the disallowance under the Fuel Adjustment Clause ("FAC") ordered by the Missouri Public Service Commission ("Commission") in April 2011, the disallowance associated with Taum Sauk ordered by the Commission in July 2011, and the refund of purchased power costs from Entergy due to an order from the Federal Energy Regulatory Commission in May 2012. But even when you factor these unusual items out, we still have never earned our allowed return on either a weather-normalized basis (see Schedule WLB-ES3), or on a non-weather-normalized basis (see Schedule WLB-S4) in either 2011 or through July 2012. This is despite the fact that we had an electric rate increase during that time, continued to meaningfully reduce our expenditures and experienced some of the warmest weather in Missouri's history.

Q. Are you saying that if cost and revenue variables went "up and down" all of these charts would look different?

A. Yes, and the evidence that this is so is clear. The regulatory framework in Missouri is not providing our Company with a reasonable opportunity to earn a fair return on our investment. If these charts showed earned returns that were above the allowed return, then below it, then above it, then below it, on a relatively consistent basis, then Mr. Cassidy's theory about how the variables change in both directions under the Missouri regulatory framework might hold water. But what we see here is a pattern where we consistently do not recover our costs and earn a fair return on our investment. This demonstrates that the regulatory framework has become asymmetrical, and that there is a much greater chance that we will not recover our costs and earn a fair return. So while it is true that a "utility's revenues, expenses and investments are constantly changing," as Mr. Cassidy testifies, it is not true that taken together, the impact of those changes is such that we have an equal chance to cover our costs and earn a fair return or even any reasonable chance to do so.

Q. Do you have auy other comments about the systemic inability to earn your authorized return and its relationship to Mr. Cassidy's claims?

A. Yes, I do. As both Mr. Reed and I have stated in our earlier testimony, the current regulatory framework employed in Missouri is simply inadequate to address the fundamental changes that have occurred in the utility industry over the last several years. While this framework may have been adequate in the distant past to cover rising costs and the energy infrastructure investments we were making to serve an expanding service territory with growing energy demands and steady, if not robust customer growth, the fact of the matter is that we currently face a meaningfully different paradigm. Today, we still face the impact of steady (albeit lower) inflation on many of our costs, including labor, medical costs and materials. And we also face ever-increasing investment needs, but they are not to serve an expanding service territory or robust load growth. Over the last several years, customer load growth has been rather flat, and the economy continues to be challenging. Instead, our greater investment needs are being driven by greater regulatory mandates and the need to replace our aging infrastructure – that same infrastructure that was built decades ago to meet the demands of our then-growing service territory. Therefore, we are not receiving the incremental revenues and cash due to load growth that we may have seen several years ago to offset these additional costs. As a result, the current regulatory framework results in excessive regulatory lag that is not in the best interest of customers or the state of Missouri.

Over the years, regulators across the country, including this Commission, have recognized some of these changing circumstances and challenges and have put in place several constructive regulatory mechanisms to help address this issue. In Missouri, those mechanisms include the FAC, cost tracking mechanisms for pension and OPEBs and vegetation management and infrastructure inspections, as well as "construction accounting" for the scrubber project at our Sioux Energy Center. I commend the Commission for taking these constructive steps and it is imperative that these same mechanisms remain in place as they have in the past.

The Commission continues to acknowledge that today's economic environment has changed and requires what I would view as "thinking outside the box" to meet our customers' and state's energy needs in an effective manner. Those "out of the box" ideas include the Commission's current consideration of a low-income rate class, as well as the Commission's desire to consider forms of rate stabilization plans. As our comments in the low-income rate docket indicate (and as testimony we would have filed regarding rate stabilization would have indicated), we are supportive of continuing to examine ways to enhance the overall regulatory framework in Missouri to serve our customers and the state's current and long-term interests better. Indeed, that is what our Plant-in-Service Accounting proposal is. It is an "out of the box" proposal which does not affect rates in this case at all.

However, it will help address the excessive regulatory lag we face in Missouri and help provide us with a reasonable opportunity to earn a fair return. It is a proposal that is not only within the Commission's jurisdiction to approve, but is consistent with a practice it has already deployed in the past (i.e. construction accounting). Importantly, it will help remove the disincentive for our Company to proactively invest in our system to meet our customers' number one priority – reliability. And these investments will also do two more things – they will sustain and create jobs. Other states already have in place mechanisms that better support proactive investment in infrastructure. Standing still means we are falling behind. That is not in the best interest of our customers and the state of Missouri as we prepare to meet our state's energy needs in the future. I strongly encourage the Commission to adopt our Plant-in-Service Accounting proposal.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a Ameren Missouri's Tariffs to Increase Its Revenues for Electric Service.	)))	Case No. ER-2012-0166

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 Ameren Missouri as President and Chief Executive Officer.

2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony on behalf of Ameren Missouri consisting of 7 pages, and Schedules WLB-ES1 thru WLB-ES4, 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
Warner L. Baxter

Subscribed and sworn to before me this 7th day of September, 2012.

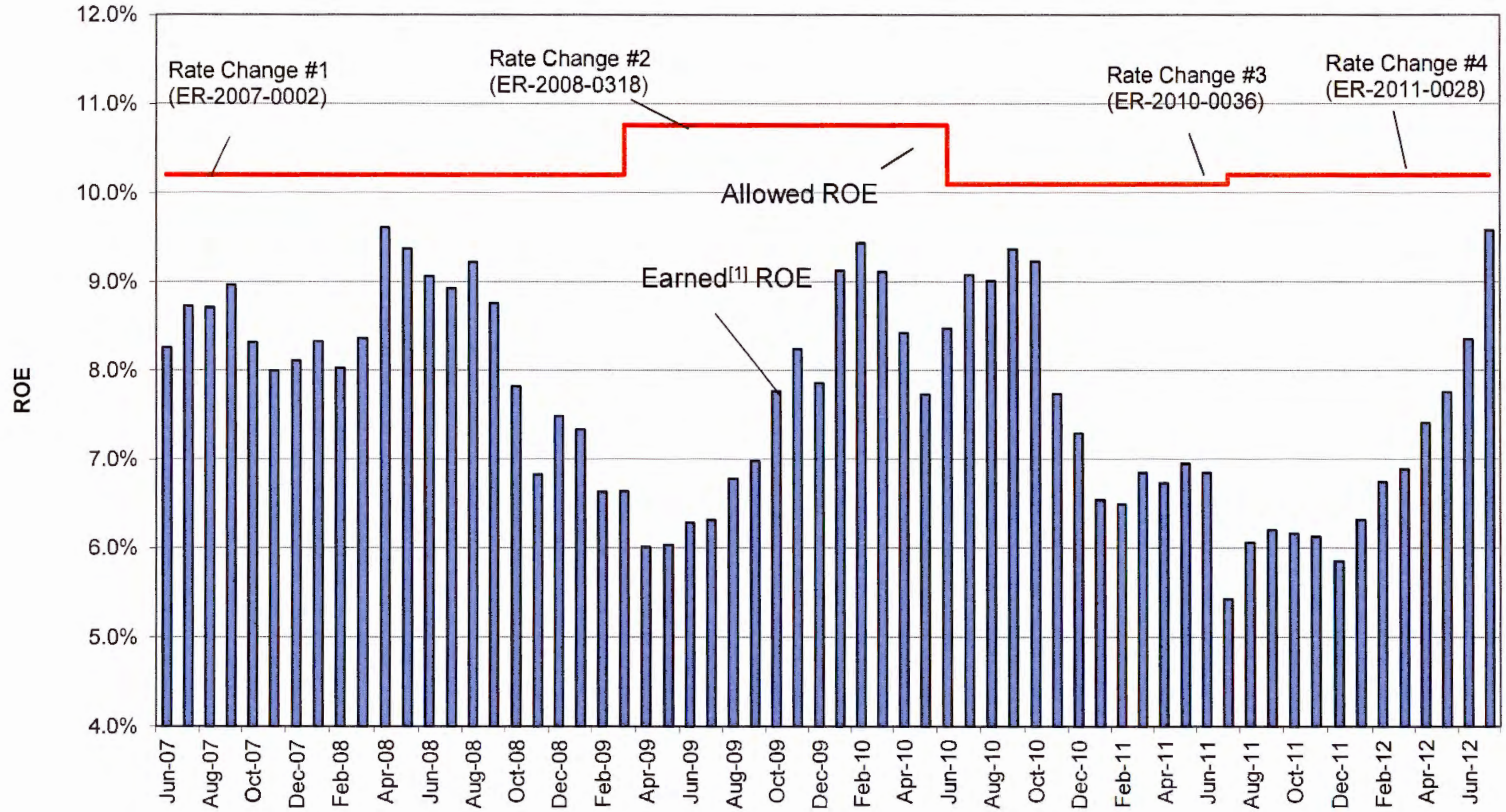
Julie Donohue
Notary Public

My commission expires:

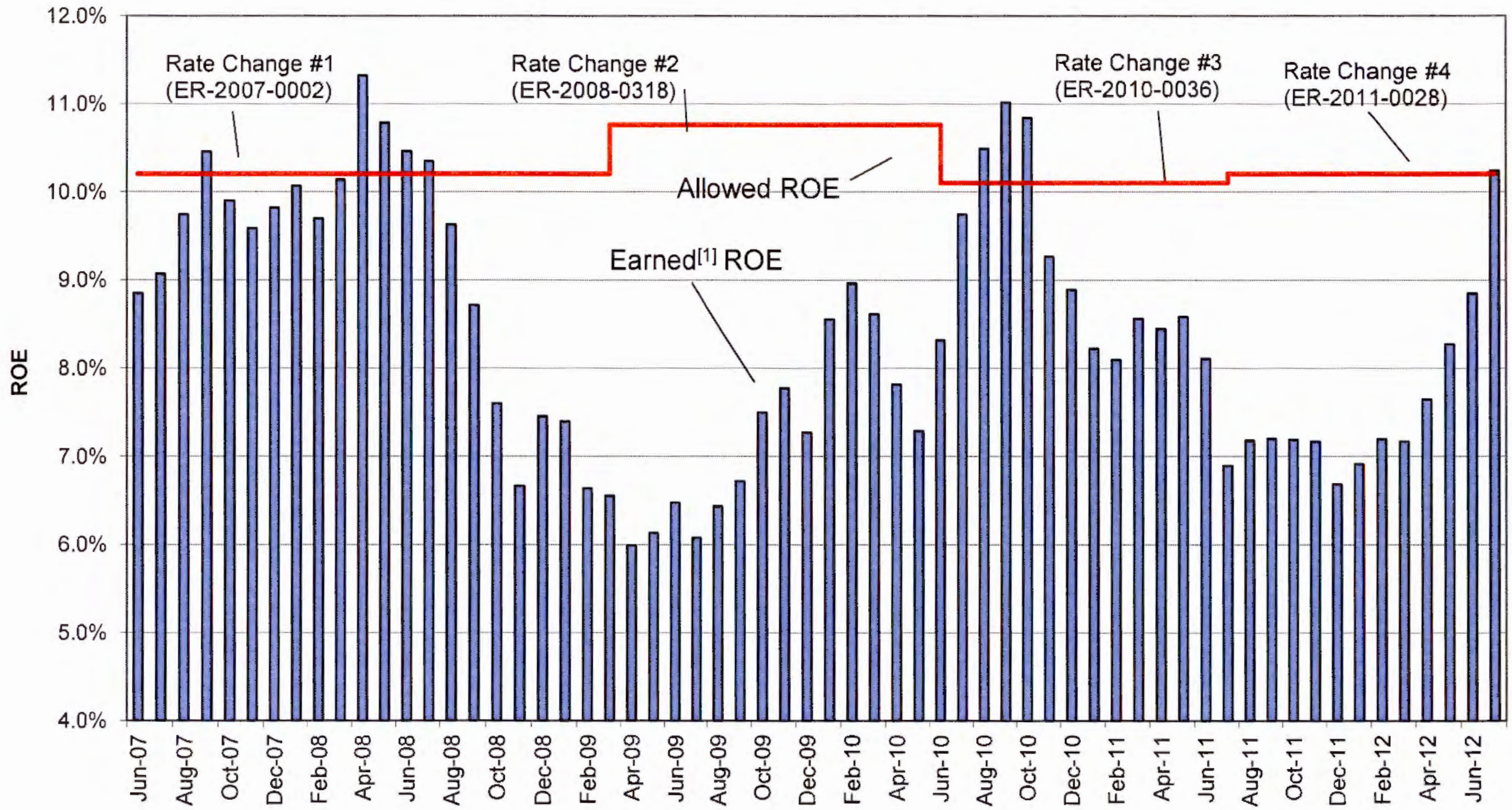
Julie Donohue - Notary Public
Notary Seal, State of
Missouri - St. Louis City
Commission #09753418
My Commission Expires 2/17/2013

Comparison of Ameren Missouri Earned ROEs and Allowed ROEs

Reflects Four Rate Changes - *Weather-Normalized*



Comparison of Ameren Missouri Earned ROEs and Allowed ROEs
Reflects Four Rate Changes - Not Weather-Normalized

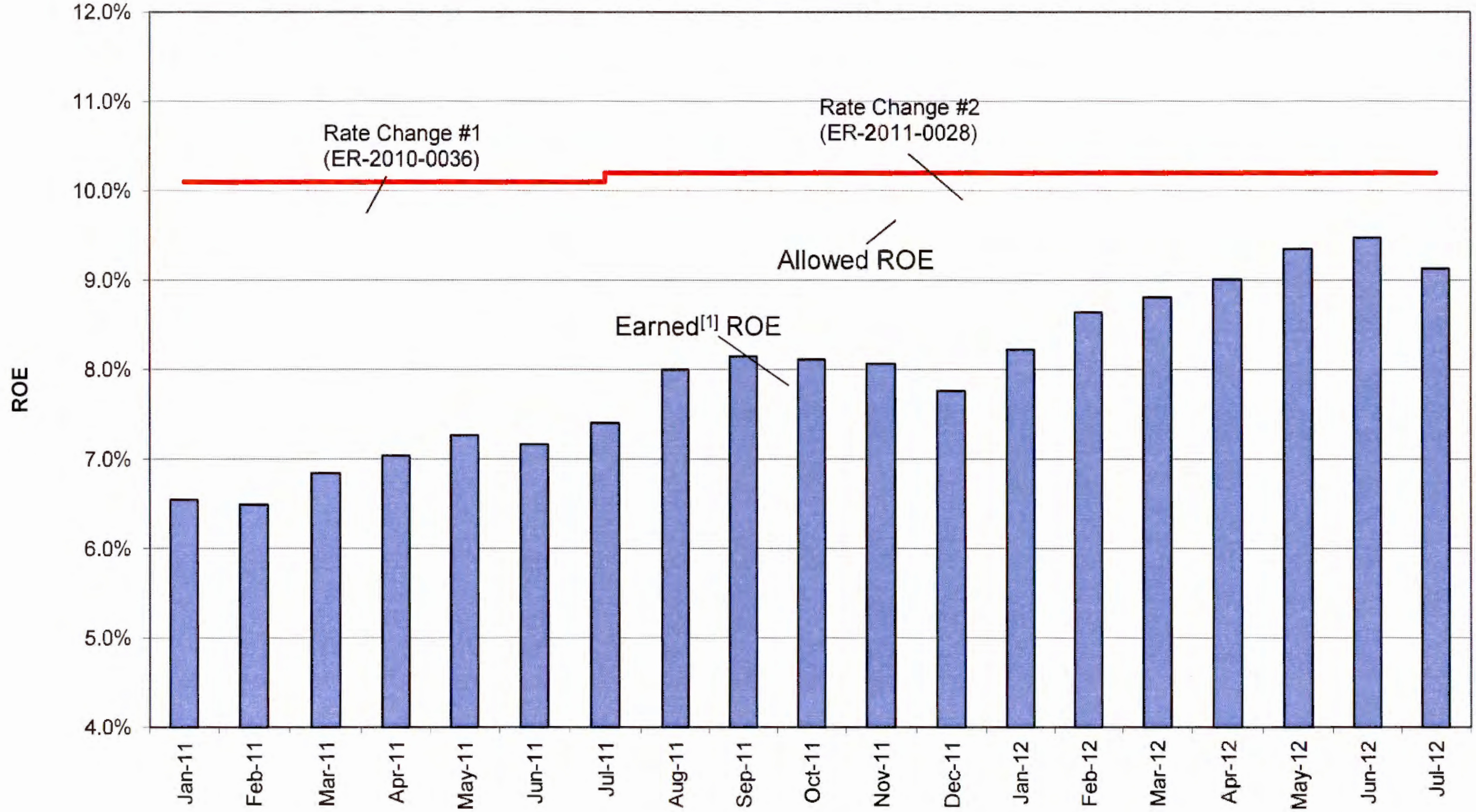


Schedule WLB-ES2

Comparison of Ameren Missouri Earned ROEs and Allowed ROEs

Reflects Two Rate Changes - *Weather-Normalized*

Accounts for Unusual Items 2011- 2012



Schedule WLB-ES3

Comparison of Ameren Missouri Earned ROEs and Allowed ROEs

Reflects Two Rate Changes - Not *Weather-Normalized*

Accounts for Unusual Items 2011 - 2012