

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

Central Illinois Light Company	)	
d/b/a AmerenCILCO	)	
	)	
	)	
Central Illinois Light Company	)	
d/b/a AmerenCIPS	)	Docket Nos. 07-0585, 07-0586, 07-0587
	)	07-0588, 07-0589, 07-0590 (cons.)
	)	
Illinois Power Company	)	
d/b/a AmerenIP	)	
	)	
Proposed general increase in rates for	)	
delivery service	)	

**DIRECT TESTIMONY OF  
RICHARD A. BAUDINO  
ON BEHALF OF THE COMMERCIAL GROUP**

**J. KENNEDY AND ASSOCIATES, INC.**

**March 14, 2008**

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

2 A. My name is Richard A. Baudino. My business address is J. Kennedy and Associates, Inc.  
3 ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia  
4 30075.

5 **Q. What is your occupation and by whom are you employed?**

6 A. I am a consultant to Kennedy and Associates.

7 **Q. Please describe your education and professional experience.**

8 A. I received my Master of Arts degree with a major in Economics and a minor in Statistics  
9 from New Mexico State University in 1982. I also received my Bachelor of Arts Degree  
10 with majors in Economics and English from New Mexico State in 1979.

11 I began my professional career with the New Mexico Public Service Commission Staff in  
12 October 1982 and was employed there as a Utility Economist. During my employment  
13 with the Staff, my responsibilities included the analysis of a broad range of issues in the  
14 ratemaking field. Areas in which I testified included cost of service, rate of return, rate  
15 design, revenue requirements, analysis of sale/leasebacks of generating plants, utility  
16 finance issues, and generating plant phase-ins.

17 In October 1989, I joined the utility consulting firm of Kennedy and Associates as a  
18 Senior Consultant where my duties and responsibilities covered substantially the same  
19 areas as those during my tenure with the New Mexico Public Service Commission Staff.  
20 I became Manager in July 1992 and was named Director of Consulting in January 1995.  
21 Currently, I am a consultant with Kennedy and Associates.

22 CG Exhibit 1.1 summarizes my expert testimony experience.

23 **Q. On whose behalf are you testifying?**

24 A. I am testifying on behalf of the Commercial Group, which is an ad hoc association of  
25 retail companies that own and operate retail stores within Ameren's service territory.  
26 These companies include Best Buy Co., Inc., J.C. Penney Corporation, Inc., Macy's, Inc.,  
27 and Wal-Mart Stores, Inc.

28 **Q. Please describe the impact the Commercial Group has on the State of Illinois.**

29 A. These commercial customers of Ameren have a significant positive economic impact on  
30 the State of Illinois. The hundreds of retail and distribution centers operated in Illinois by  
31 members of the Commercial Group support tens of thousands of Illinois employees. In  
32 addition, the group supports thousands of other Illinois businesses as well by purchasing  
33 tens of billions of dollars each year of services and supplies from Illinois businesses. Of  
34 course, rising energy costs are a significant cost component for the operations of the  
35 Commercial Group.

36 **Q. What is the general electric load profile of the Commercial Group?**

37 A. Most of the electric load of members of the Commercial Group falls into the DS-3 and  
38 DS-4 classes of Ameren.

39 **Q. What is the purpose of your testimony?**

40 A. The purpose of my testimony in the proceeding is to address the cost and revenue  
41 allocation proposals presented by Ameren<sup>1</sup> in this consolidated proceeding. Specifically,  
42 I will respond to the testimony of Ameren witness Leonard M. Jones. I also reviewed

---

<sup>1</sup> In my Direct Testimony I will use "Ameren" to refer to all three Ameren Illinois electric utilities, whose rate cases have been consolidated in this proceeding. Those companies are Central Illinois Light Company ("AmerenCILCO"), Illinois Power ("AmerenIP"), and Central Illinois Public Service Company ("AmerenCIPS").

43 Ameren's class cost of service studies that are contained in Schedule E-6 for each of the  
44 three Ameren Illinois utilities.

45 **Q. Before you address Mr. Jones' testimony, please provide a general description of the**  
46 **process of allocating cost responsibility to customer classes using a cost of service**  
47 **study.**

48 A. A class cost of service study allocates and assigns the total cost of providing utility  
49 service to the classes of customers receiving that service. In certain instances, the subject  
50 utility can identify and directly assign costs to customers. For the vast majority of costs,  
51 however, such direct assignments are not possible and a cost of service study is required  
52 so that the remaining costs may be allocated to customers.

53 The development of a class cost of service study consists of three steps: functionalization,  
54 classification, and allocation. Step 1, functionalization, involves separating the utility's  
55 investment and expenses into major functional categories. For integrated electric  
56 utilities, these categories include production, transmission, and distribution. For electric  
57 distribution utilities such as Ameren Illinois companies, this includes the distribution  
58 function. The FERC Uniform System of Accounts provides the method by which costs  
59 are identified and segregated into these various functional categories.

60 Step 2 is classification. Once functionalization is complete, the utility's costs are  
61 classified into demand, energy, and customer components. Since we are dealing with  
62 distribution costs in this proceeding and since these costs do not vary with customers'  
63 energy consumption, total costs are classified into demand-related and customer-related  
64 costs. Demand-related distribution costs are fixed in the short run and are sized based on  
65 the yearly demands of the utility's customers. Much of the distribution system

66 investment is considered demand-related and consists of such items as substations, poles,  
67 wires, etc. Customer-related costs are associated with the number of customers and  
68 include items such as meters and services. It is also appropriate to classify a portion of  
69 distribution investment in FERC Accounts 364 through 370 as customer-related.  
70 However, the Illinois Commerce Commission (“ICC” or “Commission”) has declined to  
71 make such a classification in past Ameren cases.

72 Step 3 is allocation. After costs are classified, they are allocated to customer classes  
73 based on each class’ contribution to the respective cost classifications. Generally  
74 speaking the ICC allocates demand-related distribution costs on the basis of class non-  
75 coincident peak demands. Customer costs are allocated based on the number of  
76 customers or on weighted customer allocation factors.

77 **Q. Why is a class cost of service study important in the ratemaking process?**

78 A. A properly performed class cost of service study assigns and allocates the utility’s total  
79 cost of service to the customer classes that receive that service. Based on current class  
80 revenues, the regulatory commission may then determine whether each customer class is  
81 paying its fair share of costs and can then allocate any revenue increase (or decrease)  
82 accordingly. For example, a customer class that is not paying its fair share of costs  
83 should receive a percentage revenue increase greater than the overall system increase.  
84 Likewise, a customer class that is paying more than its fair share of costs should receive a  
85 lower than average percentage increase. In certain cases, it may be appropriate for such a  
86 class of customers to receive no increase or even a decrease in rates if that class is paying  
87 rates greatly in excess of its allocated cost of service.

88 **Q. Turning now to Ameren’s revenue allocation proposal, please summarize Mr.**  
89 **Jones’ proposed revenue increase allocation to customer classes.**

90 A. Mr. Jones proposed an across-the-board increase for all customer classes for all three  
91 Ameren Illinois companies. This means that each customer class would receive the same  
92 percentage increase as the overall system increase for each company. In justifying this  
93 approach Mr. Jones stated the following on page 5, lines 99 through 108 of his Direct  
94 Testimony:

95 The rates of the Ameren Illinois Utilities have undergone a  
96 significant transition from 2006 bundled rates to tariffs in effect  
97 today. Customers have been served under current rates less than  
98 one year and are likely still adjusting to the new structure and  
99 resultant prices. A large shift in revenue responsibility from one  
100 class to another may exacerbate bill impact concerns that  
101 customers have been managing since January 2, 2007. That is,  
102 while one class may benefit, another will be impacted more  
103 severely, all other things constant. The Commission has recently  
104 established a cost-based revenue allocation for each of the  
105 Company’s existing DS rates. Applying an across-the-board  
106 allocation scales the revenue requirement up based on the prior DS  
107 case results, while helping to minimize the potential for  
108 disproportionate bill impacts to customers.

109 **Q. Did you review the cost of service studies that Ameren submitted in this proceeding?**

110 A. Yes. Ameren included its class cost of service (“CCOS”) studies in Schedule E-6 for  
111 each of the three distribution utilities.

112 **Q. Please summarize the results of the Ameren CCOS studies.**

113 A. I have summarized the results below in Table 1. Columns 1 through 3 show each class’  
114 relative rate of return (“RROR”) index, which measures the class’ rate of return on rate base  
115 to the overall system rate of return on rate base. A relative rate of return greater than 1.0  
116 indicates that a customer class is paying more than its allocated cost of service, while a

117 relative rate of return less than 1.0 shows that a customer class is providing less than the  
 118 system average rate of return and is paying less than its allocated cost of service. Another  
 119 way to view these results is that a RROR index greater than 1.0 indicates that a customer  
 120 class is providing subsidies to other classes and that a RROR index less than 1.0 shows that  
 121 a customer class is receiving subsidies from other customer classes.

	<u>Ameren/ CILCO</u>	<u>Ameren/ CIPS</u>	<u>Ameren/ IP</u>
DS-1	0.82	0.62	0.26
DS-2	1.39	1.93	2.91
DS-3a	1.76	2.10	1.24
DS-3b	1.86	1.87	2.18
DS-4	0.77	0.59	1.62
DS-5	0.84	1.20	2.38

122

123 Table 1 shows consistently that across all of the Ameren Illinois utilities, the DS-2 and  
 124 DS-3 classes are all paying rates that are significantly greater than their allocated cost of  
 125 services. The RROR indexes for DS-2 range from 1.39 to 2.91, with the latter index  
 126 indicating that the DS-2 class for AmerenIP is paying current rates that are almost three  
 127 times the system average rate of return. The DS-3 classes show similar results, with  
 128 RROR indexes almost twice the system average rate of return.

129 DS-1 is consistently under a RROR of 1.0, with the index for Ameren IP at only 25% of  
 130 the system average rate of return.

131 **Q. Mr. Baudino, do the results from Ameren’s cost of service studies support an**  
132 **across-the-board increase?**

133 A. No. DS-2 and DS-3 rates are grossly in excess of the current cost to serve these  
134 customers. DS-2 and DS-3 customers should receive increases that are substantially less  
135 than the system average increase. DS-4 customers for AmerenCILCO and CIPS should  
136 receive greater than system average increase and should receive a lower than system  
137 average increase for AmerenIP’s DS-4 customers.

138 **Q. What was the direction of the ICC with respect to class revenue increases in**  
139 **Ameren’s last base rate case?**

140 A. In its Final Order in Docket Nos. 06-0070/06-0071/06-0072 (cons.), the Commission  
141 stated the following on page 175:

142 Ideally, rates should be designed in a way that reflects the cost of  
143 service to the various customer classes. Sometimes the actual cost  
144 of service may produce rates that utilities believe will be beyond  
145 the level of customers’ tolerance and will propose rates to mitigate  
146 “rate shock.” The second and third issues mentioned above stem  
147 from the parties’ concerns over the potential for rate shock. Any  
148 rate design that includes recovering less than the cost of service  
149 from a customer class undoubtedly creates the need for one or  
150 more of the other customer classes to shoulder the burden of the  
151 revenue shortfall. In other words, a subsidy is created. The  
152 Commission acknowledges that rate shock is a valid concern.  
153 However, circumstances in this case lead us to believe that no  
154 customer class here should subsidize the delivery services rates of  
155 another. The Commission directs the Ameren companies, in  
156 compliance filings, to file tariffs based on cost of service using the  
157 NCP allocation method.

158

159

160 **Q. Does the Company's proposed across-the-board increase comport with the ICC's**  
161 **Final Order in the last base rate proceeding?**

162 A. No. Ameren's proposed across-the-board increase would perpetuate the interclass  
163 subsidies that are being paid by DS-2, DS-3, and AmerenIP's DS-4 customers.

164 **Q. Mr. Baudino, earlier in your testimony you mentioned the classification of certain**  
165 **distribution costs as customer-related, but that the ICC had declined to take such an**  
166 **approach in past cases. Please expand on this in terms of how it relates to the**  
167 **results shown in Table 1.**

168 A. In Docket Nos. 06-0070/06-0071/06-0072 (cons.), Wal-Mart sponsored testimony by  
169 James Selecky, who recommended that a minimum size system approach be adopted by  
170 the Commission that classified distribution plant accounts 364 through 368 as both  
171 customer and demand related. The ICC rejected the minimum size approach in that case;  
172 however, if it were applied to the Company's CCOS study in this proceeding, the results  
173 would show that DS-3 customers are overpaying to an even greater extent than Ameren's  
174 studies show. Thus, Ameren's CCOS studies are a conservative measure of the extent of  
175 subsidies currently being paid by DS-2 and DS-3 customers.

176 **Q. What is your recommendation with respect to revenue allocation and customer class**  
177 **rate increases in this proceeding?**

178 A. I recommend that the Commission order Ameren to allocate customer class revenue  
179 increases based on its cost of service studies presented in Schedule E-6 for each of the  
180 distribution utilities. This means lower than system average increases for DS-2, DS-3,  
181 and AmerenIP's DS-4 customer class.

182 **Q. Beginning on page 11 of his Direct Testimony, Mr. Jones described Ameren's**  
183 **approach to the development of meter, customer, delivery, and other rates for DS-3**  
184 **and DS-4 customers. Do you agree with his proposed approach?**

185 A. Yes. Proposed Meter and Customer charges were developed based on the overall class  
186 increase percentage applied to existing rates. Delivery charges were developed by  
187 applying a uniform percentage increase, unique to each company, to recover the  
188 remaining revenue requirement. A different approach may be reasonable based on cost  
189 of service results in the Company's next delivery service rate case.

190 **Q. On page 3 of his Direct Testimony, Ameren witness Cisel offered a rate mitigation**  
191 **measure for AmerenIP's residential class that would cap the increase in overall**  
192 **bundled rates to 8.5%. Please respond to his proposal.**

193 A. Mr. Cisel's proposal does not support the Commission's expressed desire to set rates in a  
194 way that reflects the cost of service to the various customer classes, and I recommend that  
195 it be rejected by the Commission. If the ICC decides that some form of rate cap is  
196 appropriate in this proceeding, then it should be applied equally to all of Ameren's  
197 customer classes and not be limited to just one class.

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

199 A. Yes.