

Exhibit No.
Issue: 4CSR 240-10.020, EEInc
Witness: Michael L. Brosch
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: State of Missouri
Case No. ER-2007-0002
Date Testimony Prepared: January 31, 2006

BEFORE THE PUBLIC SERVICE COMMISSION

STATE OF MISSOURI

REBUTTAL TESTIMONY

OF

MICHAEL L. BROSCHE

ON BEHALF OF

STATE OF MISSOURI

FILED³

APR 25 2007

**Missouri Public
Service Commission**

NP

State Exhibit No. 503-NP
Case No(s). ER-2007-0002
Date 3/27/07 Rptr MV

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


In the Matter of Union Electric Company d/b/a)
AmerenUE for Authority to File Tariffs Increasing)
Rates for Electric Service Provided to Customers)
in the Company's Missouri Service Area.)

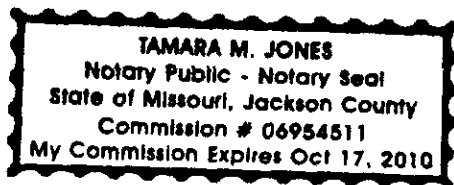
Case No. ER-2007-0002

AFFIDAVIT OF MICHAEL L. BROSCH

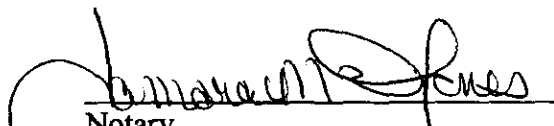
STATE OF MISSOURI)
) ss
COUNTY OF JACKSON)

Michael L. Brosch, being of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form to be presented in the above case; that the answers in said Rebuttal 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.


Michael L. Brosch



Subscribed and sworn to before me this 29th day of January, 2007.


Notary

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
REBUTTAL TESTIMONY OF MICHAEL L. BROSCHE
ON BEHALF OF THE STATE OF MISSOURI
CASE NO. ER-2007-0002**

1 Q. Please state your name and business address.

2 A. My name is Michael L. Brosch. My business address is 740 North Blue Parkway, Suite
3 204, Lee's Summit, Missouri 64086.

4

5 Q. Are you the same Michael L. Brosch who submitted Direct Testimony in this Case on
6 December 15, 2006 addressing revenue requirements and on December 29, 2006
7 addressing Fuel Adjustment Clause issues?

8 A. Yes. My qualifications were described in the previous revenue requirement submission.

9

10 Q. On whose behalf are you appearing in this proceeding?

11 A. As before, I am appearing on behalf of the State of Missouri ("State"). My firm,
12 Utilitech, Inc., was retained by the State of Missouri to examine the rate case filing of
13 AmerenUE ("UE" or "Company") and to sponsor expert testimony resulting from this
14 work.

15

16 Q. What is the purpose of your rebuttal testimony at this time?

17 A. My rebuttal testimony is responsive to AmerenUE's request for additional revenue
18 requirement amounts due to the provisions of 4 CSR 240-10.020 Income on Depreciation
19 Fund Investments, as set forth in the Supplemental Direct Testimony of AmerenUE
20 witness Mr. Weiss at pages 29-10. I also respond to the Direct Testimony of Company

1 witness Mr. Moehn regarding past ratemaking treatment of the Company's investment in
2 EEInc. My recommendation is that no additional revenue requirement be authorized for
3 AmerenUE as a result of application of the provisions within 4 CSR 240-10.020, and that
4 the Company's investment in EEInc. be treated in the manner prescribed in my earlier
5 Direct Testimony filed in this Case on December 15, 2006.

6
7 **IMPACT OF 4 CSR 240-10.020**

8 Q. What is proposed by AmerenUE with respect to 4 CSR 240-10.020?

9 A. In his Supplemental Direct Testimony, AmerenUE witness Mr. Weiss asserts that the
10 Company has justified a rate increase of \$638,896,000, which is approximately \$264
11 million larger than otherwise calculated, due to the impact of a Commission rule set forth
12 at 4 CSR 240-10.020. According to Mr. Weiss, "This rule generally requires that in the
13 process of setting a utility's rates, the Commission must provide the utility's customers
14 with a 3% annual credit to reflect income from investment of the money in the utility's
15 depreciation reserve account. This rule applies regardless of whether the utility's
16 depreciation reserve account is represented by a fund earmarked for that purpose."¹ Mr.
17 Weiss has interpreted 4 CSR 240-10.020 and provided calculations of his asserted
18 "Revenue Requirement Difference" from these provisions at Schedule GSW-E38, in the
19 amount of \$264,147,000.

20
21 Q. Does the Company propose to collect any additional revenues from its customers based
22 upon Mr. Weiss' interpretation and calculation of the provisions within 4 CSR 240-
23 10.020?

¹ Supplemental Direct Testimony of Gary S. Weiss, page 29.

1 A. Yes. According to Mr. Weiss, "...application of the rule provides additional support of
2 the \$360,709,000 in additional revenue requirement that the Company is requesting. In
3 other words, if the Commission were to find that adjustments to AmerenUE's revenue
4 requirement are warranted, the Company would still be entitled to the full amount of the
5 revenue requirement it is seeking due to the application of the rule."² Therefore, since
6 the State of Missouri, the Commission Staff and other parties have recommended
7 substantial downward adjustment to the Company's asserted \$360.7 million revenue
8 requirement, application of 4 CSR 240-10.020 in the manner proposed by Mr. Weiss
9 could significantly increase the revenue requirement in direct proportion to each of these
10 downward adjustments that is found reasonable by the Commission. The effect could be
11 to render moot any Commission consideration of the alternative recommendations of the
12 parties to this proceeding and approval of up to \$264 million in ratemaking adjustments,
13 by replacing such adjustments with incremental asserted revenue requirements from 4
14 CSR 240-10.020. Thus, AmerenUE seeks to use its interpretation of the rule at 4 CSR
15 240-10.020 to backstop each instance where the Company is found to have overstated its
16 traditionally measured revenue requirement.

17
18 Q. How has Mr. Weiss interpreted and applied the provisions of 4 CSR 240-10.020 to
19 calculate the incremental \$264 million in revenue requirement entitlement?

20 A. With reference to Schedule GSW-E38 at lines 1 through 9, Mr. Weiss first summarizes
21 the Company's asserted "Revenue Requirement Associated with Return" under
22 traditional regulation as normally practiced before the Commission, producing a return on

² Id. page 30.

1 investment requirement of \$519,652 thousand at line 9.³ Then, at line 11, Mr. Weiss adds
2 about \$4.5 billion of AmerenUE "Total Depreciation Reserves" back into test year rate
3 base and recalculates a much higher required return on this resulting much higher rate
4 base amount at line 13. From this amount, Mr. Weiss subtracts a 3 percent "return on
5 depreciation reserves" at line 14, based on his interpretation of 4 CSR 240-10.020. This
6 yields the asserted "Allowed Return Under 4 CSR 240-10.020" value that is shown at
7 line 15 in the amount of \$783,799 thousand, which amount is \$264,147 thousand higher
8 than the \$519,652 thousand calculated under the traditional regulatory approach. Thus,
9 the additional revenue requirement arises from 4 CSR 240-10.020 because Mr. Weiss
10 would charge ratepayers an 8.876 percent rate of return on Depreciation Reserves of \$4.5
11 billion (by adding the reserves back into rate base), while allowing a return credit on the
12 same reserves of only 3 percent. This Company result can be "proven" by noting that the
13 percentage return difference of 5.876 percent (i.e., 8.876% minus 3.0%), when multiplied
14 by Depreciation Reserves of \$4.5 billion produces the revenue requirement difference
15 asserted by Mr. Weiss of \$264 million.

16
17 Q. Does 4 CSR 240-10.020 require that ratepayer be charged the utility's overall cost of
18 capital on Depreciation Reserve Balances, offset by a credit of 3 percent on Depreciation
19 Reserve Balances?

20 A. No. 4 CSR 240-10.020 is silent with regard to how rate base is to be determined and with
21 regard to how a cost of capital is to be applied to any particular rate base components. In
22 fact, this regulation appears to provide for an accounting for presumed amounts of

³ The \$519.7 million amount is not the total revenue requirement. Other elements of the asserted AmerenUE revenue requirement include Operating and Maintenance Expenses, Depreciation and Amortization and Taxes, as shown in combination with the return requirement at Schedule GSW-E-37, lines 2 through 7.

1 income on depreciation reserve accounts, as if such depreciation reserves are invested
2 and producing an income stream for the utility. It states:

3 **4 CSR 240-10.020 Income on Depreciation Fund Investments**

4 *PURPOSE: This rule prescribes the use of income on investments from*
5 *depreciation funds and the means for accounting for that income.*

6 (1) In the process of determining the reasonableness of rates for service,
7 income shall be determined on the depreciation funds of the gas, electric,
8 water, telegraph, telephone and heating utilities pertaining to their
9 properties used and useful in the public service in Missouri and shall be
10 applied in reduction of the annual charges to operating income of those
11 utilities.
12

13 (2) The income from the investment of moneys in depreciation funds
14 shall be computed at the rate of three percent (3%) per annum of the
15 principal amount of the depreciation funds.
16

17 (3) The principal amount of depreciation funds of any such utility, for
18 the purposes of this rule, shall be deemed to be equivalent to the balance
19 in the depreciation reserve account of any such utility regardless of
20 whether or not any such depreciation reserve account may be
21 represented by a segregated fund ear-marked for that purpose; provided,
22 however, that the principal amount of the depreciation funds may be
23 adjusted by the portion(s) of funds which may have been provided under
24 circumstances other than by charges to operating income or otherwise,
25 these adjustments to be subject to the approval of the commission. The
26 terms depreciation funds and depreciation reserve retirement funds and
27 retirement reserve accounts shall be deemed to include the terms
28 retirement funds and retirement reserve accounts.
29

30 (4) The rate of three percent (3%) per annum referred to in section (3)
31 shall be applied in the case of each gas, electric, water, telegraph,
32 telephone and heating utility of Missouri; provided, however, that
33 modification of the rate may be made upon the commission's own
34 motion or upon proper showing by a utility that the rate is not reasonably
35 and equitably applicable to it.
36

37 (5) Affected utilities shall prepare and include in their annual reports to
38 the commission commencing with their annual reports for the year 1945,
39 and in such other reports that may be required by the commission from
40 time-to-time, schedules showing for the year or period covered by such
41 reports, the income from the investment of moneys in depreciation
42 funds. The schedules referred to shall be in the form prescribed by this
43 commission and shall include, among other things that may be
44 prescribed: the principal amount of depreciation funds as represented by

1 balances in depreciation reserve accounts; any adjustments of such
2 depreciation funds and accounts with complete details and explanations
3 thereof; and, the amount of the income from the investment of moneys
4 in depreciation funds computed at the rate of three percent (3%) per
5 annum, or such other rate as may be prescribed by order of this
6 commission.

7
8 (6) The commission shall retain jurisdiction in this matter for the
9 purpose of making any change(s) in the interest rate prescribed in
10 section (2) that may be warranted.
11

12 The calculations in Schedule GSW-E38 appear to provide for presumed income on
13 depreciation reserves at 3 percent at line 14, but inexplicably increase the required return
14 on rate base by adding back such reserves to calculate a higher rate base return at 8.876
15 percent. Thus, AmerenUE has interpreted 4 CSR 240-10.020 to require an accounting for
16 the Depreciation reserve at two different rates of return, a credit at 3 percent and a charge
17 to customers at 8.876 percent. This is an outcome not required by 4 CSR 240-10.020.
18

19 Q. Please explain what AmerenUE's Depreciation Reserve at line 11 of Schedule GSW-E38
20 represents.

21 A. The Depreciation Reserve represents the accumulated amount of investment cost that has
22 been returned to AmerenUE by its ratepayers, as a result of the Company's collection of
23 depreciation expense as an element of the revenue requirement. Because the
24 Depreciation Reserve balance represents the cumulative recovery of AmerenUE's
25 investment in Plant in Service, the Depreciation Reserve account is normally reflected as
26 a reduction to Plant in Service balances when calculating Rate Base.⁴ The effect of this
27 accounting is to charge ratepayers a return on the Company's actual net investment in

⁴ See Schedule GSW-E36, where Original Cost of Plant in Service is included in AmerenUE's asserted Original Cost Rate Base at line 1, with a subtraction of "Reserves for Depreciation" at line 2.

1 Plant in Service, which is the Plant in Service balance less the cumulative recovery of
2 such investment – that is, the Depreciation Reserve.

3
4 Q. Does it make any sense to eliminate the rate base reduction for the Depreciation Reserve,
5 effectively increasing return requirements payable by ratepayers in the amount of the
6 overall rate of return (8.876% in AmerenUE's filing) times \$4.5 billion, while then
7 crediting ratepayers for fictional "income" on the same Depreciation Reserve amount at
8 only 3 percent?

9 A. No. As noted previously, there is no support within 4 CSR 240-10.020 for adding back
10 the Depreciation Reserve as suggested by Mr. Weiss. The result of such calculations
11 would be an overstatement of the Company's return requirement, because ratepayers
12 would pay a net return of 5.876 percent (8.876% less 3.0%) on investment balances that
13 have already been returned to investors via depreciation recoveries in prior years. More
14 importantly, AmerenUE has no capital investment remaining in plant that has already
15 been recovered through depreciation, as reflected in the Depreciation Reserve balance,
16 and should not be allowed to charge ratepayers a return as if there is any remaining
17 capital cost to be recovered. There is no economic justification for including any capital
18 costs within revenue requirements for the Depreciation Reserve balance that is, by
19 definition, capital that has already been returned to the Company by its ratepayers.

20
21 Q. Is it possible to interpret 4 CSR 240-10.020 in a manner that reduces, rather than
22 increases the Company's revenue requirement?

1 A. Yes. Since the rule does not specify any accounting for rate base, the more direct
2 application of 4 CSR 240-10.020 would be to impute income for depreciation reserves at
3 3 percent and do nothing else. Using information from AmerenUE's filing to illustrate,
4 this would simply lower the asserted revenue requirement by \$134,861 thousand, as
5 depicted at line 14 of Schedule GSW-E38. According to 4 CSR 240-10.020(1), this
6 amount of income "...shall be applied in reduction of the annual charges to operating
7 income of those utilities," implying such a direct reduction to costs was intended.
8 However, since this approach would tend to understate the Company's actual cost of
9 service, it is not being recommended by the State at this time.

10
11 Q. Pursuant to 4 CSR 240-10.020(6), the Commission has retained jurisdiction "for the
12 purpose of making any change(s) in the interest rate prescribed in section (2) that may be
13 warranted." What change could be made under this provision to ensure that AmerenUE
14 collects a return on investment only upon the capital amounts that remain invested in
15 serving Missouri customers?

16 A. If the "interest rate prescribed" is modified to be equal to the cost of capital found
17 reasonable for AmerenUE by the Commission, the Company would be allowed to collect
18 from utility customers the same rate of return on Plant in Service that it credits as
19 "income" on Depreciation Reserves. Not surprisingly, this approach would ensure the
20 Company an opportunity to earn a reasonable return on its actual net investment while
21 continuing to calculate revenue requirements, using the traditional methods successfully
22 employed by this Commission and other state regulators for many years.

1

2 **REGULATION OF ELECTRIC ENERGY INC. INVESTMENT**

3 Q. At page 12 of his Direct Testimony, AmerenUE witness Mr. Moehn states that,
4 "AmerenUE's stock in EEInc. was purchased with shareholder, not ratepayer funds, and
5 has always been treated as a 'below-the-line' item for ratemaking purposes." What is the
6 significance of this statement?

7 A. Mr. Moehn appears to be suggesting that EEInc. has always been treated as non-
8 jurisdictional when AmerenUE's revenue requirements were determined by the
9 Commission. He also states, "By 'below-the-line' I mean the investment in the stock is
10 not and has never been on AmerenUE's books as an asset on which a return is figured in
11 calculating the rates paid by AmerenUE's Missouri ratepayers. This is unlike an 'above-
12 the-line' investment, such as a power plant or transmission line, which are put into rate
13 base." This testimony is technically accurate, but potentially misleading. In reality, the
14 Company's investment in EE Inc. has been consistently treated as jurisdictional by this
15 Commission in all prior rate cases because the long-term cost-based purchased power
16 agreements obligating Missouri ratepayers to pay for the cost of Joppa Plant output have
17 been treated as jurisdictional. It was never necessary to literally put the "investment in
18 the stock" into the AmerenUE rate base in order to treat the AmerenUE share of the
19 Joppa Plant as jurisdictional, because the purchased power contract accomplished this
20 end result, as more fully discussed in my Direct Testimony.

21

22 Q. Mr. Moehn seems to dismiss the importance of the long history of cost-based purchased
23 power contracts, where he states at page 12, "Rather, with regard to EEInc., ratepayers

1 have simply paid the cost of power purchased by AmerenUE from EEInc. as provided for
2 under power supply agreements between AmerenUE and EEInc.” How do you respond?

3 A. It should be recognized that AmerenUE’s investment in EEInc. has consistently been
4 secured by long-term power sale agreements with the federal government and with the
5 sponsoring utility owners of EEInc. Under these long-term power sale arrangements,
6 prices were set and adjusted based upon full cost recovery, including a full return on and
7 return of capital invested in the Joppa Plant. Owning the stock in EEInc. represented
8 little if any risk of loss to the owners, given these power sale arrangements and the
9 financial guarantees and repayment commitments that were secured by AmerenUE, with
10 Commission approval, in Case No. 12,064 and Case No. EF-77-197, as described in my
11 Direct Testimony.

12
13 Q. Does AmerenUE, as an owner of EEInc., have a responsibility to “maximize the return
14 on that investment” as indicated at page 13 of Mr. Moehn’s Direct Testimony?

15 A. Yes, but not at ratepayers’ expense. As a regulated public utility, I believe that
16 AmerenUE management has a dual responsibility to both its investors and its ratepayers.
17 The adjustment I propose to impute a revenue credit to Missouri ratepayers is based upon
18 the AmerenUE share of the extraordinary returns now being earned by EEInc. as a result
19 of selling Joppa Plant output at higher market prices. This ratemaking adjustment⁵
20 acknowledges that management has acted to maximize its return on that investment,
21 while denying the Company’s unsupported regulatory position that it can do so at
22 ratepayer expense by unilaterally removing the Joppa Plant from jurisdictional treatment
23 in Missouri.

⁵ See State Joint Accounting Schedules at Schedule C-4.

1
2 Q. At page 14 of his Direct Testimony, Mr. Moehn indicates that AmerenUE and Ameren
3 Energy Resources each own 40% of EEInc. stock, with a minority 20% interest held by
4 Kentucky Utilities. Does this ownership structure excuse Ameren Corporation from
5 protecting the financial interests of Missouri ratepayers when voting its ownership
6 interests at EEInc.?

7 A. I am not an attorney and cannot offer any legal opinion on this matter. However, I
8 understand that Ameren Corporation has a controlling interest in EEInc. and that the
9 EEInc. Bylaws provide that *** _____
10 _____
11 _____
12 _____

13 _____.” *** With a cumulative 80% voting interest among all
14 Ameren affiliates, there was nothing to preclude the voting of EEInc. shares to provide
15 for continued equitable power supply arrangements beneficial to AmerenUE Missouri
16 ratepayers when the 1987 Power Supply Agreement with AmerenUE expired in
17 December 2005. Notably, the ratemaking adjustment that I propose is not dependent
18 upon Commission action to compel more reasonable EEInc. voting action by Ameren
19 management. Instead, the State’s recommended ratemaking adjustment recognizes and
20 corrects for the inequitable outcome created in Missouri by management actions that
21 were actually taken.
22

1 Q. Mr. Moehn states at page 15 that the EEInc. Power Supply Agreement with AmerenUE
2 was similar to other power supply agreements at that time and, "In 1987 the power supply
3 agreements typically being used throughout the country and approved by FERC were cost
4 plus contracts." Does this mean that Missouri ratepayers have less entitlement than
5 Ameren shareholders to continued realization of the value of the Joppa Plant when the
6 AmerenUE Power Supply Agreement was allowed to expire?

7 A. No. There has been no demonstration by AmerenUE that its shareholders ever absorbed
8 any significant risks, costs or losses associated with Joppa that were not fully mitigated
9 by long-term power supply agreements and other financial guarantees extended by
10 EEInc.'s utility sponsors. Under the principal that financial rewards should accrue to the
11 party absorbing risks and cost responsibility for an investment, shareholders should not
12 be allowed to now reap windfall profits, simply by removing the Joppa Plant from
13 Missouri jurisdictional ratemaking.

14

15 Q. Does this conclude your rebuttal testimony?

16 A. Yes.