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

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|---|---|---|
| In the Matter of the Union Electric | ) | |
| Company d/b/a Ameren Missouri's | ) | |
| Tariffs to Increase its Revenues for | ) | **Case No. ER-2014-0258** |
| Electric Service | ) | |

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# INITIAL POST-HEARING BRIEF OF THE MISSOURI INDUSTRIAL ENERGY CONSUMERS

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**REPLY BRIEF OF THE**
**MISSOURI INDUSTRIAL ENERGY CONSUMERS**

Come now Anheuser-Busch Company, Ardagh Glass, BioKyowa, The Boeing Company, Doe Run, Enbridge Energy, General Motors Corporation, GKN Aerospace, Hussmann Corporation, JW Aluminum, Monsanto, Nestlé Purina PetCare , Noranda Aluminum, Procter & Gamble and SunEdison Semiconductors (the "Missouri Industrial Energy Consumers" or "MIEC"), and for their reply brief state as follows:

## I. REVENUE REQUIREMENT

### A. Amortizations

Recovery of deferred costs can be allowed only upon a consideration of all relevant factors, and the "earnings level of a company is the initial and primary focus."[1] *See In the matter of the application of Missouri Public Service*;[2] *In re Mo. Pub. Service, a Division of UtiliCorp United Inc.*[3] And in *Missouri Gas Energy v. Public Service Commission,*[4] the Court of Appeals was clear that one purpose of an AAO was to protect the utility from earnings shortfalls ("The

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[1] MIEC Br., pp. 1-5.

[2] Case No. EO-91-358 and 360, 1991 Mo. PSC Lexis 56 (page 4) .

[3] Case No. ER-93-37, 152 P.U.R.4th 333 (Mo. P.S.C. 1994).

[4] 978 S.W.2d 434 (Mo. Ct. App. 1998).

AAO technique protects the utility from earnings shortfalls and softens the blow which results from extraordinary construction programs").[5]

Ameren Missouri ignores these authorities and engages in some misdirection, arguing that the MIEC's position here amounts to a retroactive taking of Ameren Missouri's property.[6] That argument is disingenuous at best. Each time Ameren Missouri seeks a deferral it is quick to note that the granting of a deferral is not ratemaking. Rather, it has convinced the Commission, and the appellate courts, that whether it recovers any of these costs in future rates will be determined in a rate case. That is why appeals of those deferrals have failed. *See State ex rel. Office of Public Counsel v. Public Service Comm'n of Missouri*[7] ("The Commission's order did not presume to determine a new rate but effectively permitted MPS the option to file a rate case"). And this Commission, and the courts, are clear that "AAOs are not a guarantee of an ultimate recovery of a certain amount by the utility."[8] In short, Ameren Missouri should have no expectation of recovery unless, and until, the Commission allows recovery in the rates its sets to be charged. Therefore, the MIEC is not seeking to retroactively deprive Ameren Missouri of anything. Rather, Ameren Missouri's past overearnings are one relevant factor for consideration in setting rates to be charged. In *State ex rel. Util. Consumers' Council of Missouri, Inc. v. Pub. Serv. Comm'n*[9] the Missouri Supreme Court stated the role of past "excess recovery:"

> The commission has the authority to determine the rate [t]o be charged, § 393.270. In so determining it may consider past excess recovery insofar as this is relevant to its determination of what rate is necessary to provide a just and reasonable return in the future, and so avoid further excess recovery.[10]

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[5] 978 S.W.2d at 436.

[6] Ameren Missouri Br., pp. 10-13.

[7] 858 S.W.2d 806 (Mo. Ct. App. 1993).

[8] 978 S.W.2d at 436.

[9] 585 S.W.2d 41 (Mo. banc 1979) (striking down an automatic fuel adjustment surcharge not authorized by statute at the time).

[10] *Id*. 585 S.W.2d at 58.

For the deferral periods at issue, the undisputed facts show that Ameren Missouri needed no earnings protection from a deferral or any other mechanism. Indeed, Mr. Meyer's testimony is abundantly clear that Ameren Missouri earned more than its authorized return for all periods since the setting of its current rates as of the time he filed his testimony. But Ameren CEO Moehn noted that for the twelve months ended December 31, 2014, Ameren Missouri missed its authorized ROE, barely, earning 9.71 percent rather than 9.8 percent.[11] But that figure is extremely misleading. Below is a compilation of Ameren Missouri's FAC reports from December 2013 to December 2014 (Exs. 524-528). As one can clearly see, the reported ROE for the December 2014 report was influenced greatly by a significant jump in ending rate base from September 2014 to December 2014 (ending rate base for the period is used to determine ROE). Ameren Missouri's ROE was 10.30 percent using its average rate base for 2014.

[11] Moehn Testimony, Tr. p. 216, ll. 5-8, Ex. 528.

Ameren Missouri
ER-2014-0258
2014 Earned ROE

| | | | |
|---|---|---|---|
| 2014 Operating Income | | $ 544,822 | Ex. 528 |
| Average 2014 Rate Base | ÷ | $ 6,761,771 | |
| ROR - Average Rate Base | = | 8.06% | |
| Less Avg Wtd Cost of Debt | - | 2.62% | |
| Less Avg Cost of Pref. | - | 0.05% | |
| Avg. Weighted Cost of Eq. | = | 5.39% | |
| Avg Equity Percentage | ÷ | 52.32% | |
| Average Earned ROE<br>( 5.39%/ 52.32%) | | **10.30%** | |

| | Actual Amounts | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Ex. 528 | | Ex.527 | | Ex. 526 | | Ex. 525 | | Ex. 524 | | | | | |
| | December 2014 | | September 2014 | | June 2014 | | March 2014 | | December 2013 | | Average | | | |
| | Amount | Cost | Amount | Cost | Amount | Cost | Amount | Cost | Amount | Cost | Amount | % of Capital (1) | Cost (2) | Wtd Cost (1)*(2) |
| Rate Base | $ 7,080,913 | | $ 6,742,000 | | $ 6,643,147 | | $ 6,650,688 | | $ 6,692,109 | | $ 6,761,771 | | | |
| Capital Component | | | | | | | | | | | | | | |
| Long-Term | $ 3,614,494 | 5.56% | $ 3,612,836 | 5.54% | $ 3,611,355 | 5.54% | $ 3,366,400 | 5.76% | $ 3,364,610 | 5.78% | $ 3,513,939 | 46.59% | 5.63% | 2.62% |
| Preferred | 81,828 | 4.18% | 81,828 | 4.18% | 81,828 | 4.18% | 81,828 | 4.18% | 81,828 | 4.18% | $ 81,828 | 1.08% | 4.18% | 0.05% |
| Common | 3,965,440 | | 4,040,597 | | 3,930,498 | | 3,882,655 | | 3,912,961 | | $ 3,946,430 | 52.32% | | |
| Total | $ 7,661,762 | | $ 7,735,261 | | $ 7,623,681 | | $ 7,330,883 | | $ 7,359,399 | | $ 7,542,197 | 100.00% | | |

Ameren Missouri argues that the practical effect of MIEC's position here is that Ameren Missouri's authorized ROE is "a ceiling (without a floor)" on earnings.[12] But that is not the practical effect. The practical effect of the MIEC's position is adherence to the guidance given by the Missouri Supreme Court in *UCCM*:

> The utilities take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval. To permit them to collect additional amounts simply because they had additional past expenses [is prohibited retroactive ratemaking]. … Past expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses.[13]

Here, Ameren Missouri's rates during the deferrals were obviously adequate, even without deferral. There is no need to set future rates higher than needed to serve tomorrow's ratepayers in order "to avoid further … future losses." There were no losses. There wasn't even an under-recovery of profit, even without engaging in the deferral fiction. Yet Ameren Missouri has persuaded this Commission to allow it to pretend that some of the expenses it incurred while providing service under those more-than-adequate rates should be considered for recovery from tomorrow's ratepayers even though those costs will not be incurred to serve tomorrow's ratepayers. At least in a situation where the deferral was necessary to "protect earnings" Ameren Missouri might have an argument, but that is not the case here. For this reason, the adoption of the MIEC position here, following Missouri Supreme Court precedent and Missouri statutes, is good public policy, Mr. Reed's reservations notwithstanding.[14]

Nor will denying amortization and recovery here effectively eliminate the Commission's ability to use AAOs to allow deferrals because Ameren Missouri's auditors will be unable to

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[12] Ameren Missouri Br., p. 12.

[13] *Id*. 585 S.W.2d at 59.

[14] Discussed in Ameren Missouri Br., pp. 13-14.

conclude that there is “probable” recovery.[15] Allowing deferral is different than allowing recovery, as Ameren Missouri repeatedly notes when it is seeking deferral. Where a deferral is truly needed to protect Ameren Missouri’s earnings, as opposed to enhancing already bloated earnings, Ameren Missouri’s auditors will know it, and will be able to find that recovery is probable and, accordingly make the appropriate accounting entries.

Ameren Missouri notes that if recovery is denied, it will have to reverse the deferrals on its books and records resulting in a reduction to earnings in 2015.[16] But isn’t that simply the logical and reasonable consequence of asking for, and obtaining, something that was never needed in the first place? By deferring these expenses, Ameren Missouri overstated its already bloated earnings during the deferral periods.

Ameren Missouri argues that “raw” per book earnings should not be used as a basis to deny recovery.[17] Of course Ameren Missouri does not mention the many times that it has used such reported earnings as a basis for seeking extraordinary regulatory treatment. Indeed, in Ameren Missouri’s last case, Case No. ER-2012-0166, it cited such “raw” earnings as a basis for seeking plant in service accounting (“PISA”). Of note, however, in its Report & Order in that case, this Commission cited then-recent “raw book earnings” as a basis for denying PISA:

> Indeed a surveillance report that Ameren Missouri supplied to Staff showed that for the 12 months ended June 30, 2012, within the true-up period for this case, Ameren Missouri’s actual earned return on equity was 10.53 percent, which is above the 10.2 percent return on equity allowed in its last rate case.[18]

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[15] Responding to Ameren Missouri Br., pp. 15-17.

[16] Ameren Missouri Br., p. 16.

[17] Id., pp. 17-19.

[18] Case No. ER-2012-0166, Report & Order, p. 35 para 15 (December 12, 2012).

And, Ameren Missouri does not explain why the FAC regulation would require it to prepare such a report, and file it quarterly, if it was of no value in determining a continued need for an FAC, or any special rate relief for that matter because of the reported earnings.

Accordingly, this Commission should consider Ameren Missouri's over-earnings in deciding whether to allow recovery of any of the deferred costs at issue. As this Commission is well aware, particularly from participating in the many public hearings on this case, many ratepayers are hurting financially. Following Missouri law to deny Ameren Missouri the excess revenues that it seeks here is but one small way to protect ratepayers. For these reasons, this Commission should deny recovery of deferred solar rebate costs, Fukushima study costs, Pre-MEEIA costs, and vegetation management costs.

MIEC notes that Ameren Missouri devotes a substantial portion of its Initial Brief to challenging the MIEC's ability to contest the solar rebate recovery. This issue is a legal one dependent on the interpretation of the Stipulation. If this Commission determines that the words "not to object to Ameren Missouri's recovery in retail rates of prudently paid solar rebates" as used in the Stipulation mean "not to object to Ameren Missouri's recovery in retail rates set in a subsequent rate case of prudently paid solar rebates," then the MIEC is precluded from contesting this issue.[19] However, to reach that conclusion this Commission would read the above-emphasized words into the Stipulation and, in addition, find that the parties' intent was to preclude such challenge even where the utility had earned in excess of its authorized return during the relevant period. Such a finding would be inconsistent with Missouri's well-settled rule of contract interpretation that parties intend the to incorporate and apply the controlling law

[19] Stipulation, paragraph 7(d), page 6.

in place at the time of their contract. At the time the Stipulation was entered, as well as now, the controlling law is the Missouri Supreme Court's decision in *UCCM*[20].

**B. Vegetation and Infrastructure Inspection Trackers**

Ameren Missouri's primary argument for retaining these trackers is that they have, in Ameren Missouri's opinion, worked well and worked as intended. Part of the opposition to trackers is that they remove the incentive for a utility to be efficient. So while Ameren Missouri's recovery of every dime spent on vegetation management and infrastructure inspections might seem preferable, that could be said about all of the utility's costs. If regulated utilities have no incentive to be efficient, ratepayers, and in many cases the utility, lose. The trackers simply have outlived their usefulness. They should be withdrawn and a reasonable, normalized base should be built into rates. Quite simply, vegetation management and infrastructure expenses do not represent a large percentage of Ameren Missouri's operating expenses and the variations from rate case levels of those expenses are even smaller. Vegetation management costs represent approximately 2.8% and infrastructure inspections represent .3% of Ameren Missouri's operation and maintenance expenses.[21]

The Commission in its Order in Case No. ER-2012-0166 stated on page 107: "However, as the Commission has indicated in previous rate cases, it does not intend for this tracker to become permanent."[22] Trackers merely allow one aspect of a utility's operations to be measured during a period of time when all other relevant factors are not considered. They are single-issue ratemaking mechanisms. These trackers have served their initial purpose and now need to be discontinued; they are not and should not be permanent.

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[20] 585 S.W.2d 41 (Mo. banc 1979).

[21] Meyer Direct, Ex. 513, p. 22, ll. 18-21; Meyer Surrebuttal, Ex. 514, p. 31, ll. 9-21 .

[22] Meyer Surrebuttal, Ex. 514, p. 22, ll. 4-13.

MIEC proposes that the proper level of annual expense for vegetation management costs is $54 million and the proper level of annual expense for infrastructure inspections should be $5.8 million.[23] Ameren Missouri recommends that vegetation management expenses should be set at $56 million and infrastructure inspections should be set at $6.4 million.[24] These figures are the levels of expense incurred through the true-up period in this case.[25]

The MIEC, Staff, and OPC all propose levels of expense based on multiple year averages. Multiple year averages are used frequently to normalize a level of expense for ratemaking purposes. Ameren Missouri proposes the level based on what was spent at the end of the true-up period. The use of a multiple year average is appropriate and should be adopted in this case. Merely seeking what was last expensed does not meet the standards for normalizing an expense, as that expense could either be too high or low. The level of annual expense for vegetation management activities has fluctuated over the years. The interaction between trimming rural versus urban routes can influence the level of costs. Therefore, a multiple year average is appropriate and should be adopted, as proposed by MIEC, Staff, and OPC.

## C. Storm Tracker

In Ameren Missouri's last rate case, the Commission approved a cost tracker for major storms. Prior to that rate case, Ameren Missouri filed requests for AAOs to defer and then recover extraordinary major storm costs when they occurred. The Commission's Report and Order in Case No. ER-2012-0166, recognized that AAOs can serve Ameren Missouri's interests:

> 4. The Commission has frequently approved such AAOs and has allowed Ameren Missouri to recover its extraordinary storm recovery costs through an AAO and subsequent five year amortizations. In fact, the company's current revenue

[23] Meyer Surrebuttal, Ex. 514, p. 20, ll. 10-11.

[24] Meyer Surrebuttal, Ex. 514, p. 20, ll. 2-7.

[25] *Id*.

requirement contains four separate amortizations related to extraordinary storm restoration costs.
5. The current system has allowed Ameren Missouri to recover all of its major storm recovery costs in recent years.[26]

The past recovery of major storm costs has worked well for Ameren Missouri and has been supported by ratepayers. A storm tracker is not needed.[27] A tracker allows for every dollar of recovery, regardless of the nature of the storm event and whether it was extraordinary. Ameren Missouri's primary argument against AAOs for this purpose is that they are not guaranteed and must be material.[28] This is precisely why a tracker should not be continued in this case. A tracker would essentially be the granting to Ameren Missouri of a credit card to use whenever a major storm occurred, regardless of the materiality of the costs or Ameren Missouri's then-current earnings. But Ameren Missouri does not need guaranteed recovery of every major storm expense because when there is an extraordinary storm event, Ameren Missouri will likely receive an AAO, typically without objection from consumers. For these reasons the storm tracker should be discontinued.

**D. Noranda AAO - Recovery of the Noranda AAO Would Constitute Illegal Retroactive Ratemaking**

Ameren Missouri argues that, having granted an AAO for Ameren Missouri's costs (actually disappointing earnings disguised as "unrecovered fixed costs"), this Commission is bound to grant Ameren Missouri recovery of those amounts absent imprudence or a miscalculation of the amount.[29] Ameren does not contend that it will incur these "costs" to serve tomorrow's ratepayers, or explain how these "costs" are a "relevant factor" in determining a "just and reasonable" rate "to be charged" to serve tomorrow's ratepayers. It cannot contend or

[26] Meyer Surrebuttal, Ex. 514, p. 23, ll. 12-28 (referring to page 94 of the Report & Order).

[27] Meyer Surrebuttal, Ex. 514, p. 23, ll. 5-11.

[28] Ameren Missouri Br., p. 111.

[29] Ameren Missouri Br., p. 30.

explain those things because what it seeks, purely and simply, is prohibited retroactive ratemaking. Every party other than Ameren Missouri that has weighed in on this issue in its brief-- MIEC, Staff and OPC -- cites the Missouri Supreme Court decision in *UCCM*,[30] which condemns retroactive ratemaking on both constitutional principles and as a matter of statute.[31] Granting Ameren Missouri recovery for these "costs" violates the rule against retroactive ratemaking, which is "the setting of rates which permit a utility to recover past losses … under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established."[32]

Ameren Missouri, citing Court of Appeals decisions,[33] argues that prospectively charging tomorrow's ratepayers for past unrecovered costs -- costs that will not be incurred to serve them -- is "prospective only" and, thus, does not constitute retroactive ratemaking. But our Supreme Court addressed a similar situation in *UCCM.* There, after this Commission changed a rule regarding an FAC's calculation, utilities went several months without collecting the extra rates owed under the FAC. This Commission imposed an order to collect the shortfall as a surcharge to future ratepayers ("The commission also ordered that any 'uncollected fuel adjustment revenues' … would be collected, over a period of not less than twelve months, under a surcharge collection plan to be submitted by each utility").[34] The Supreme Court rejected that surcharge and ordered the surcharged monies refunded as illegally collected because the surcharge constituted "an [a]dditional recovery to that which had been allowed under the rates in force

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[30] MIEC Br., pp. 15-16; Staff Br., pp. 20-21, 24-30; OPC Br., p. 9.

[31] 585 S.W.2d at 59 (The Commission may not "redetermine rates already established and paid without depriving the utility (*or the customer if the rates were originally too low*) of his property without due process.") (emphasis added).

[32] *Id.*

[33] *State ex rel. AG Processing v. Public Serv. Comm'n*, 340 S.W.3d 146, 148 (Mo. Ct. App. 2011) and *State ex rel. Mo Gas Energy v. Pub. Serv. Comm'n*, 210 S.W.3d 330, 336 (Mo. Ct. App. 2006).

[34] *UCCM*, 585 S.W.2d at 46.

during the relevant period. The result was to require consumers to pay monies which should not have been paid."[35] The Supreme Court stated:

> The utilities take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval. To permit them to collect additional amounts simply because they had additional past expenses not covered by either clause is retroactive rate making, i. e., the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established .... Past expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses, but under the prospective language of the statutes, §§ 393.270(3) and 393.140(5), they cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses.[36]

The Missouri Supreme Court could not have been clearer: "[p]ast expenses … cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses." In support of that passage, the Court cited *Detroit Edison Co. v. Mich. Pub. Serv. Comm.*[37] There, the Michigan Court of Appeals denied recovery of an accounting deferral on the grounds of retroactive ratemaking. There, the Michigan PSC approved the equivalent of an AAO in its case no. F-647, which, like the Noranda AAO case, was not a rate case. F-647 permitted fuel costs greater than a base of "5.87 mill per KWH" in one month to be billed to customers in subsequent months. "[T]he income the company expected to receive [for the increased fuel costs] one or two months later was now listed as an asset on the company's books even though nothing had been changed except the bookkeeping system."[2] The utility set the deferred charge, which the court described as "a paper asset," for future collection.[3] The

[35] *See id.* pp. 58 - 59.

[36] *See id.* pp. 59.

[37] 82 Mich.App. 59, 266 N.W.2d 665 (Mich. App. 1978).

[2] *Id.* at 670.

[3] *Id.* at 671.

Michigan court found that this billing lag was illegal as allowing recovery would "permit retroactive rate making to recover past costs."[4]

*UCCM* is the controlling decision for this Commission because it is a decision of Missouri's highest court. "An opinion of the Supreme Court on a proposition of law controls all subordinate tribunals." *Thompson v. Columbia Mut. Ins. Co.*[38] The Commission is bound by *UCCM* on all points of law and its holdings about retroactive ratemaking. Although *UCCM* is controlling, and although Ameren Missouri admits that Noranda, MIEC and OPC all cite it in support of their position, Ameren Missouri fails to address *UCCM* in its Initial Brief.[39]

Moreover, and significantly, Ameren Missouri's own accounting actions belie its arguments in this regard and call into question whether there is even any deferred asset to amortize and recover. Certainly, if the law were clear that recovery was legal so long as the "costs" were prudent and properly calculated as Ameren Missouri asserts in its brief, it would not have hesitated to book the deferred "costs" to a "regulatory asset." Exhibit 244 consists of Ameren Missouri's response to Staff DR 0166, asking whether, after Commission authorization of the AAO, Ameren Missouri had in fact reflected the Noranda AAO "costs" on its books and records as a "regulatory asset." Ameren Missouri's answer is telling:

> In accordance with GAAP, Ameren Missouri did not record a regulatory asset or revenue for financial reporting purposes in the fourth quarter of 2013 because it could not conclude that recovery of these fixed costs was probable. See attached memo that represented correspondence to PriceWaterhouseCoopers on this matter.

In that "attached memo," grounds for finding recovery was <u>not probable</u> were:

> (1) the unrecovered fixed "costs" could be characterized as "lost revenues (rather than recovery of fixed costs);"

[4] *Id.* at 673.

[38] *See id.* pp. 59.

[39] Ameren Missouri makes only a passing reference to *UCCM* on page 25 of its Initial Brief.

(2) the AAO order stated that "deferred recording does not guarantee recovery in any later rate action; recovery may be granted in whole, partially, or not at all;"

(3) Commissioners have made public statements that "they are undecided on the ultimate recovery of the costs;" and

(4) the Chairman is publicly opposed to allowing Ameren Missouri to recover the Noranda AAO.

In short, although authorized by this Commission, Ameren Missouri did not book, as a deferred asset, any amount of "costs" under the AAO. How can the Commission allow amortization and recovery of a deferred asset that does not exist because it was never recorded as such on Ameren Missouri's books and records? On this basis alone, the Commission should deny relief.

In conclusion, the law is clear that recovery of the subject "costs" from tomorrow's ratepayers would be illegal retroactive ratemaking. All parties to weigh in on this issue, other than Ameren Missouri, have so concluded. Indeed, in spite of its bravado in its Initial Brief, even Ameren Missouri has serious doubts about the propriety of recovery, as clearly reflected in Exhibit 244. Moreover, and significantly, there appears to be no deferred "cost" asset to amortize and recover from tomorrow's ratepayers.

**E. Return On Equity**

Based on the evidence and arguments presented by the parties in this case, the Commission should authorize a return on equity ("ROE") for Ameren Missouri of 9.3 percent, the midpoint of the range of 9.0 percent to 9.6 percent, as recommended by MIEC witness Michael Gorman.[40] The testimony of Ameren Missouri witness Hevert should be rejected as unpersuasive because it is based on unreasonable assumptions concerning growth rates, dividend

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[40] MIEC's Initial Brief incorrectly states that Gorman recommended an ROE of 9.4 percent. *See* MIEC Br. pp. 22 and 31. Gorman's recommended ROE in this case is actually 9.3 percent, the midpoint of his recommended range of 9.0 percent to 9.6 percent. *See* MIEC Br. p. 18.

payout ratios, and market risk premiums.[41] Hevert's conclusions ignore the material and verifiable decline in capital market costs since the last rate case, as well as the decline in Ameren Missouri's investment risk since the last case. In addition, Ameren Missouri's criticisms of MIEC witness Gorman's analyses and the arguments included in Ameren Missouri's opening brief are unpersuasive for the following reasons.

### 1. Ameren Missouri Erroneously Asserts that Costs of Capital Have Not Declined By Citing Short-Term Anomalous Stock Price Movements That Are Not Relevant to the Measurement of Its Cost of Equity

Despite substantial evidence to the contrary, Ameren Missouri asserts that the cost of capital has not declined since 2012.[42] In support of this erroneous view, Ameren Missouri places particular emphasis on what it describes as "steep declines in stock prices,"[43] and a "dramatic fall in utility stock prices,"[44] which have led to dividend yields that are "moving up 'steeply.'"[45] Ameren Missouri implies that this "sudden and significant decline in stock valuations" is the beginning of a trend that is certain to continue indefinitely.[46] But, as noted in MIEC's opening brief, Ameren Missouri is focusing on anomalous utility stock price movements in January and February 2015, not changes in stock prices since the last rate case. The evidence concerning stock prices cited by Ameren Missouri is both misleading and irrelevant. Utility stock prices are higher now than they were at the time of Ameren Missouri's last rate case, and dividend yields are lower.[47] Growth rates are up slightly, but not significantly.[48] These facts demonstrate

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[41] Gorman Rebuttal, Ex. 511, p. 2, ll. 9-16.

[42] Ameren Missouri Br. p. 53.

[43] Ameren Missouri Br. p. 52

[44] Ameren Missouri Br. p. 68

[45] Ameren Missouri Br. p. 60

[46] Ameren Missouri Br. p. 71

[47] Gorman Surrebuttal, Ex. 512, p. 7, ll. 7-17.

[48] Tr. p. 1269, ll. 3-4 ("Growth has increased a little bit . . . but not much.") and ll. 6-10.

conclusively that Ameren Missouri's cost of capital has declined since its last rate case when the Commission authorized an ROE of 9.8 percent.[49]

In response to questions by Commissioner Rupp, MIEC Witness Gorman explained in detail exactly why the aberrant move in stock prices that is the linchpin of Ameren Missouri's arguments should have no bearing on the Commission's decision in this case:

> **Q [by Commissioner Rupp]. Looking at your surrebuttal testimony, page 7, following up on a question that Commissioner Hall, had where you stated, further, utility stock – utility stock prices have increased and their dividend yields have gone down.**
>
> **Since you filed this, we've had testimony [by Ameren Missouri Witness Hevert] that there's been a 10 percent reduction in utility stock prices of the index, which would then do the reverse on the dividend yield. So if that is the case, would you then need to increase your numbers of what an -- for a higher ROE?**
>
> A. [by Michael Gorman] Well, no, because [Hevert's] testimony dealt with changes from January to February of this year. My analysis in this case dealt with a 13-week period last summer where ***the prices used there are still lower than they are today***. So even if I reflected those lower prices available right now, ***the dividend yields right now are lower than they are as reflected in my DCF studies.***
>
> Even still, ***the dividends in my DCF studies were lower than they were two years ago when [Ameren Missouri was awarded] a 9.8 percent return on equity.*** So it's important to distinguish what you're comparing it to. ***Stock prices got really high for utility companies in January, and they did come back down. But even the decline in the stock price from February over January is still higher priced than what's reflected in my testimony.*** My testimony prices are from last year.
>
> **Q. Do you in your personal opinion view that that drop in utility stock prices is a trend or as a correction or is just a normal market glitch over the last several weeks?**
>
> A. Well, when I do the study, I try to measure what investors think, not what I think, but I think the run up in stock prices beginning in January was unsustainably high. I think the prices have come down to a level where they still

[49] Gorman Surrebuttal, Ex. 512, p. 7, ll. 16-17 ("When stock prices increase, all else equal, utilities' cost of capital declines.")

> might decline a little bit. ***But the prices I used in my study I believe reflect dividend yields that reflect the current cost of capital. They weren't biased by those run ups in the prices in January and February.***[50]

As Gorman's testimony makes clear, the short-term aberrant market price movements in utility stocks from January through February 2015 did not occur during the time period he and the other witnesses used to measure Ameren Missouri's cost of equity.[51] There was a run up in utility stock prices at the end of December 2014, followed by the drop in prices in early 2015 noted by Ameren Missouri.[52] But even after this drop, utility stock prices remained ***higher*** than they had been in the summer of 2014, when Gorman analyzed Ameren Missouri's cost of capital. More importantly, stock prices were ***higher*** (and dividend yields were correspondingly lower) following the "steep" and "dramatic" decline in stock prices cited by Ameren Missouri than they were at the time of Ameren Missouri's last rate case.[53] Thus the change in stock prices noted by Ameren Missouri provides no support for a finding that Ameren Missouri's cost of capital has not declined since its last rate case. Nor is there any reasonable basis for concluding that this drop in prices reflects a trend that will continue indefinitely.

As Ameren Missouri recognizes in its brief, "it is critical that the return on equity incorporate a broader understanding of market conditions and that temporary aberrations in price affected by short-term investor activity not form the basis of measuring the cost of equity."[54] MIEC agrees. Nevertheless, Ameren Missouri makes arguments based on changes in stock prices during a one-month time period (from January 29 through February 27, 2015), as if these changes were one of the most important determinants of the cost of capital in this case. Ameren

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[50] Tr. p. 1288, l. 1 – p. 1289, l. 18 (emphasis added).

[51] Tr. p. 1289, ll. 14-18. .

[52] Tr. p. 1288, ll. 24-25.

[53] Tr. p. 1288, ll. 20-22.

[54] Ameren Missouri Br., p. 72.

Missouri also misuses this information to attempt to impeach the accuracy and reliability of the estimates provided by Gorman and the other non-Ameren-rate-of-return witnesses, despite the fact that the stock prices from this aberrant time period were not included in the witnesses' analyses.

In sum, Ameren Missouri's arguments concerning stock prices and dividend yields ignore the pertinent facts, and would have the Commission focus instead on irrelevant and misleading data. The record clearly establishes by competent and substantial evidence that capital market costs have ***decreased*** since Ameren Missouri's last rate case.

### 2. Interest Rates Have Declined Since Ameren Missouri's Last Rate Case

As further support for its erroneous contention that the cost of capital has not declined since the last rate case, Ameren Missouri states that "[a]s Ameren Missouri witness Robert Hevert pointed out at hearing, interest rates are relatively consistent with and in fact are slightly higher than they were in 2012."[55] This statement incorrectly implies that interest rates in general, including interest rates on bonds issued by utility companies, have increased slightly. However, as explained in MIEC's opening brief, utility bond interest rates ***declined*** by approximately 37 basis points between the date of this Commission's Report and Order in Ameren Missouri's last rate case and the date of Gorman's direct testimony in this case.[56]

Ameren Missouri's brief further distorts the evidence showing a decline in utility bond interest, stating that "an updated analysis" of utility bond yields, shows that "rates have recently pivoted and increased."[57] The data included in Exhibit 62, which was introduced at the hearing in this case, shows an increase in utility bond yield during a ***three-week*** period from January 30,

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[55] Ameren Missouri Br., p. 51, citing, Hevert Surrebuttal, Ex. 18, p. 7, Tr. p. 1150, l. 12 – p. 1151, l. 17.

[56] Gorman Surrebuttal, Ex. 511, p. 6, Table 1.

[57] Ameren Missouri Br., p. 70, citing Ex. 62.

2015 to February 13, 2015. But Gorman's analysis takes the reasonable approach of considering average bond yields for ***13-week periods***—he does not base his conclusions on very short term changes. If the additional data points included in Exhibit 62 are taken in context and added to Gorman's analysis, they provide further support for his conclusion that utility bond yields are lower now than at the time of the last rate case, as demonstrated by the table below.[58]

**Public Utility Bond Yields**

| Description | Exhibit 62 | Surrebuttal Testimony[1] | Direct Testimony[2] | Case No. ER-2012-0166[3] |
|---|---|---|---|---|
| "A" Rated | 3.78% | 3.90% | 4.13% | 4.27% |
| "Baa" Rated | 4.55% | 4.63% | 4.71% | 5.01% |
| 13 Week Period Ending | 2/13/2015 | 1/23/2015 | 11/7/2014 | 6/15/2012 |

Sources:
[1]Schedule MPG-SR-2.
[2]Schedule MPG-14, page 1 filed with Gorman direct testimony.
[3]Case ER-2012-0166, Schedule MPG-14, page 1.

As with stock prices, Ameren Missouri's arguments here focus on incomplete and misleading information about current interest rates. The evidence in this case concerning interest rates demonstrates that Treasury bond interest rates are not a reliable gauge of Ameren Missouri's cost of capital at the current time. Changes in utility bond yields, utility stock prices, and utility stock dividend yields all support the conclusion that Ameren Missouri's cost of capital has declined since its last rate case.

[58] Gorman Surrebuttal, Ex. 511, p. 6, Table 1.

### 3. <u>In Considering Average Industry Commission-Authorized ROEs, this Commission Should Include All Decisions Involving Electric Companies With Similar Risk to Ameren Missouri and Exclude Cases Resolved Through Settlement.</u>

Ameren Missouri criticizes MIEC witness Gorman's analysis of recent Commission-authorized ROEs based on two points: his inclusion of authorized returns for electric distribution companies and his exclusion of cases resolved through settlement.[59] Ameren Missouri contends that the distribution companies should not be included in this analysis because the business risks of these companies are not comparable to the business risks faced by vertically-integrated electric companies.[60] However, as explained in MIEC's opening brief, all of the companies included in Gorman's analysis have similar levels of total investment risk (rather than only comparable business risk as Ameren Missouri proposes). MIEC witness Gorman's reliance on total investment risk is consistent with the way in which all rate-of-return witnesses selected proxy companies to measure a fair rate of return for Ameren Missouri in this case. In measuring total investment risk, Mr. Gorman relied on companies with comparable credit ratings.[61] There is no dispute that a company's credit rating reflects its total investment risk – which encompasses business as well as financial risk.[62] The selected companies thus have comparable investment risk levels to Ameren Missouri's and were appropriately included in Gorman's analysis of recent authorized ROEs for utilities that have investment risk comparable to Ameren Missouri's.

In response to questions from Commissioner William Kenney, Gorman explained in detail why cases resolved through settlement do not provide an appropriate benchmark for

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[59] Ameren Missouri Br., pp. 76-77.

[60] Ameren Missouri Br., p. 76.

[61] MIEC Br., p. 30; Gorman Surrebuttal, Ex. 512, Schedule MPG-SR-1, p. 1.

[62] Tr. p. 1141, ll. 20-23; Tr. p. 1142, ll. 10-17.

evaluating the recommendations concerning ROE in this case.[63] From the customers' standpoint, the reasonableness of a settlement turns on the rates the customers agree to pay.[64] Indeed, in a case that is resolved by settlement, a customer's electric rates may have no connection whatsoever to the ROE included in the final order.[65] This is because, unlike in a litigated case such as the instant case, settlement rates are not determined by first building a revenue requirement and then using the revenue requirement to calculate rates.[66]

The Colorado and Nevada cases cited by Ameren Missouri that included ROEs of 9.83 and 9.8, respectively, illustrate this point.[67] In both cases, Gorman advised his clients to agree to the settlement, but that advice was not based on the ROEs included in those cases. Instead, Gorman advised his clients to settle because "the settlement rate structure was judged to be reasonable."[68] The ROEs did not figure into his evaluation of the rates; in fact, he did not find that the settlement rates reflected the ROE included in the orders.[69] These cases illustrate that there may be a complete disconnect between the ROE included in a case resolved through settlement and the electric rates the parties agree to pay pursuant to the settlement.

Ameren Missouri is also critical of Gorman's inclusion of two Illinois cases, noting that the ROEs in these cases were determined under a "formulaic rate plan."[70] But as Gorman noted, the parties to these Illinois cases had an opportunity to challenge the ROE formula prescribed by

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[63] Tr. p. 1274, l. 11 – p. 1276, l. 11.

[64] Tr. p. 1275, ll. 3-7.

[65] Tr. p. 1275, ll. 12-19.

[66] Tr. p. 1275, ll. 12-19.

[67] Ameren Missouri Br., p. 78.

[68] Tr. p. 1305, ll. 1-2.

[69] Tr. p. 1305, ll. 6-10.

[70] Ameren Missouri Br., p. 77.

the Illinois Commission.[71] Moreover, the inputs to the formulas used by the Illinois Commission in these cases include market-based data.[72] There is no basis for concluding that the ROEs determined by the Illinois Commission in these cases were the result of any sort of settlement or compromise, and thus these cases were appropriately included in Gorman's analysis of authorized returns.

As shown by the analysis included in Gorman's surrebuttal testimony, considering all electric companies with comparable total investment risk, and excluding cases resolved through settlement, the industry average authorized return on equity has declined significantly since Ameren Missouri's last rate case, and has averaged around 9.63 percent through year-end 2014.[73] This decline in authorized returns on equity is consistent with the very low capital costs of the current capital markets.

#### 4. **This Commission's Decisions in Recent Gas Utility Rate Cases Provide No Support For Ameren Missouri Witness Hevert's Recommended ROE in this Case.**

Ameren Missouri cites two recent gas utility rate cases decided by this Commission -- *In the Matter of Liberty Utilities*[74] and *In the Matter of Summit Utilities*[75] -- and notes that in these cases the Commission authorized ROEs of 10.0 percent and 10.8 percent, respectively. These cases, however, are not on point with Ameren Missouri's rate case, and provide no support for Ameren Missouri witness Hevert's recommended ROE of 10.4 percent in this case.

In the *Liberty Utilities* case, Hevert testified on behalf of the utility on the issue of ROE. The only other testimony on this issue was provided by a Staff witness. This Commission found

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[71] Ameren Missouri Br., p. 77-78; Tr. p. 1302, l. 12 – p. 1304, l. 7.

[72] Tr. p. 1303, l. 25 – p. 1304, l. 7.

[73] Gorman Surrebuttal, Ex. 512, Schedule MPG-SR-1, p. 1.

[74] Report and Order, File No. GR-2014-0152 (January 2, 2015).

[75] Report and Order, File No. GR-2014-0086 (November 28, 2014).

Staff's recommended ROE of 8.7 percent to be "more than 60 basis points lower than any return on equity at any state Commission in at least 30 years."[76] Based on this finding, the Commission determined that the Staff witness' testimony was unpersuasive.[77] This left the Commission no alternative to relying on Hevert's testimony regarding ROE. In setting Liberty's ROE, the Commission chose the bottom of the range of ROEs proposed by Hevert.[78]

In contrast, the record in the instant case includes testimony by three witnesses in addition to Hevert. The testimony of MIEC witness Gorman has consistently been found by this Commission to be reliable and persuasive. The Commission should adopt Gorman's recommended ROE of 9.3 percent in this case.

The *Summit Utilities* case involved a company that the Commission noted is "the smallest gas utility in Missouri."[79] The company had few industrial or commercial customers.[80] The company's business plan included the extension of service into remote areas of the state that had never before been served.[81] The Commission expressly found that this plan presented a number of risks to the company's profitability, including "competition, high construction costs, lower revenue and delayed returns."[82] In recent periods, the company's earnings had been substantially below expectations.[83] Given these facts, the risk associated with an investment in Summit is obviously very high. It is thus not surprising that this Commission concluded that 10.8

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[76] Report and Order, File No. GR-2014-0152, p. 19, FOF 22.

[77] Report and Order, File No. GR-2014-0152, p. 19, FOF 22.

[78] Report and Order, File No. GR-2014-0152, p. 29.

[79] Report and Order, File No. GR-2014-0086, p. 14, FOF 1.

[80] Report and Order, File No. GR-2014-0086, p. 14, FOF 1.

[81] Report and Order, File No. GR-2014-0086, p. 10.

[82] Report and Order, File No. GR-2014-0086, p. 14, FOF 2.

[83] Report and Order, File No. GR-2014-0086, p. 14, FOF 3.

percent—the high end of Staff's recommended range—was a reasonable amount for Summit's ROE.[84]

The facts noted above make it clear that Summit Utilities has little in common with Ameren Missouri. Ameren Missouri does not share the many significant business risks noted in the *Summit Utilities* case. For these reasons, *Summit Utilities* provides no support for an authorized ROE above 10 percent for Ameren Missouri.

### 5. Ameren Missouri's Criticisms of MIEC Witness Gorman's DCF Studies Are Not Well-Founded

Ameren Missouri cites a number of criticisms of MIEC witness Gorman's DCF analyses, including its contentions that: the long-term growth rate used in Gorman's multi-stage growth DCF analysis is too low; Gorman's analyses assume that current stock prices will continue in perpetuity; and the growth rate used in Gorman's sustainable growth DCF analysis is too low. Ameren Missouri's critique of Gorman's multi-stage and sustainable growth DCF analyses ignores the fact that the results from these analyses are outside Gorman's recommended range of 9.0 percent to 9.6 percent. Gorman chose to round up the result of his constant growth DCF analysis from 8.95 percent to 9.0 percent, and include only this estimate – the high end of his DCF range – in his recommendation.[85] This represents a conservative approach, and obviates any concerns about his multi-stage and sustainable growth DCF estimates.

#### (a) Ameren Missouri's Arguments Mischaracterize the Long-Term Growth Rate Used in Gorman's Multistage Growth DCF Analysis and the Disputed Issue Between the Experts.

Ameren Missouri asserts that Mr. Gorman's multi-stage growth model reflects an unrealistically low long-term growth rate of 4.4 percent.[86] As shown on his Schedule MPG-9,

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[84] Report and Order, File No. GR-2014-0086, p. 50.

[85] Gorman Direct, Ex. 510, p. 26, ll. 4-12.

[86] Ameren Missouri Br., pp. 72-73.

Gorman used a long-term steady-state growth rate of 4.6 percent, not 4.4 percent. This represents Gorman's estimate of nominal GDP growth. There is no dispute between experts in this case that nominal GDP growth should be used to estimate the long-term sustainable growth rate in a multi-stage growth DCF model. Both Hevert and Gorman use nominal GDP growth as the long-term steady-state growth rate in their multi-stage DCF model.[87] They disagree, however, on how to determine this growth rate.

As Gorman notes in his surrebuttal testimony, Hevert's reliance on historical real GDP growth is misplaced.[88] Consensus analysts' outlooks are a more reliable predictor of future nominal GDP growth. These independent consensus economists provide relevant information to investors, and their projections take into account the many factors that indicate that U.S. GDP growth is unlikely to continue at the rates experienced in the past.[89] For these reasons, Gorman's long-term steady-state growth rate is appropriate, but Hevert's analysis should be rejected since it is based on an unrealistically high growth outlook for the future.

**(b) Contrary to Ameren Missouri's Assertions, Gorman's DCF Analyses Take Into Account Possible Future Changes in Stock Prices and Growth Rates.**

In discussing Gorman's constant growth DCF analysis, Ameren Missouri asserts that Gorman "claims that high stock valuations and low dividend yields will continue indefinitely" but that he fails to offer evidence to support this claim.[90] Ameren Missouri's arguments misrepresent Gorman's testimony. Specifically, Gorman did recognize the expectation that current valuations and the metrics driving these valuations can change over time. This is precisely why Gorman included a multi-stage growth DCF study in his analyses, in addition to

[87] Gorman Direct, Ex. 510, p. 24, ll. 1-18; Gorman Rebuttal, p. 6, ll. 15-20..

[88] Gorman Surrebuttal, Ex. 512, p. 12, l. 16 – p. 13, l. 10.

[89] Gorman Surrebuttal, Ex. 512, p. 12, l. 16 – p. 13, l. 10.

[90] Ameren Missouri Br., p. 71.

his constant growth DCF analysis using analysts' three- to five-year growth rates. In his multi-stage growth assessment, Gorman noted that analysts' three- to five-year growth rates may not be sustainable indefinitely.[91] Because of this uncertainty, Gorman conducted his DCF studies using analysts' growth rates, a sustainable growth rate methodology, and also a multi-stage growth approach.

Gorman used multiple DCF analyses specifically because of the difficulty in understanding how utility stocks will be valued over time, as well as the difficulty of properly capturing the various market expectations for valuing utility stocks into the future. In testing the underlying assumptions of Gorman's DCF models, Gorman considered the analysts' three- to five-year growth rates in comparison to long-term GDP growth, he compared historical growth periods to sustainable long-term growth rates;[92] and he constructed alternative DCF methodologies designed to capture long-term growth rates and sustainable growth rates using alternative outlooks and assumptions.

Ameren Missouri's arguments also fail to recognize that in his final review of his analyses, Gorman concluded that his DCF analyses supported an ROE of 9 percent.[93] He did not rely on the DCF analyses that Ameren Missouri contend were based on unreasonably low growth rates in making his recommendation, so these arguments are moot. Gorman's DCF analysis estimate is nearly identical to the constant growth DCF model estimate produced by Hevert's approach (when corrected to exclude his unreasonably high growth rate estimates.)[94] Both Gorman's constant growth DCF studies and Hevert's corrected constant growth DCF study support a DCF finding for Ameren Missouri in this case of approximately 9 percent.

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[91] Gorman Direct, Ex. 510, p. 21, ll. 3-18.

[92] Gorman Direct, Ex. 510, p. 18, l. 3 – p. 19, l. 9.

[93] Gorman Direct, Ex. 510, p. 26, ll. 6-12.

[94] Gorman Rebuttal, Ex. 511, p. 3, Table 1.

Ameren Missouri further asserts that the current price to earnings ("P/E") ratio of utility stocks undermines the reliability of the constant growth model.[95] Gorman responded to these concerns during the hearing in this case. He explained that elevated P/E ratios warrant the use of a multi-stage growth DCF analysis in this case. Expectations of non-constant P/E ratios are one of the factors that drive the need for considering a multi-stage growth DCF analysis in this case.[96] Thus elevated P/E ratios provide no basis for rejecting Gorman's DCF studies.

Gorman further explained that while P/E ratios are relatively elevated now, the prospect for changes in P/E ratios over time shows that current valuations are not excessive and a constant growth model should not be set aside on this factor alone. Indeed, on a prospective basis, P/E ratio for the proxy group in three to five years is 13.5x, which is below the normalized P/E valuation identified by Mr. Hevert of around 16.0x.[97]

#### 6. Ameren Missouri Offers No Reasonable Basis for Rejecting MIEC Witness Gorman's Bond Yield Plus Risk Premium Analysis.

Ameren Missouri also takes issue with Mr. Gorman's bond yield risk premium study. Ameren Missouri states that the Commission has previously found this analysis to be flawed due to the selective exclusion of certain data.[98] But as Ameren Missouri notes, in this case Gorman offered more evidence on bond yield risk premiums than in previous cases.[99] Specifically, in this case, Gorman's analysis included an alternative expanded risk premium study based on 5- and 10-year rolling average risk premium estimates.[100] The average period risk premiums were produced to judge the accuracy and reasonableness of Gorman's risk premium estimate findings.

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[95] Ameren Missouri Br., p. 71.

[96] Tr. p. 1299, ll. 10-18.

[97] Gorman Surrebuttal, Ex. 511, p. 8, l. 20 – p. 9, l. 2.

[98] Ameren Missouri Br., p. 75.

[99] Ameren Missouri Br., p. 75.

[100] Gorman Rebuttal, Ex. 511, p. 16, ll. 3-21.

Gorman's testimony also included a revision of Hevert's analysis. All three of these analyses (Gorman's original and revised analyses, plus his revision of Hevert's analysis) yielded an estimated ROE in the range of 7.6 percent to 10.4 percent.[101] Gorman reasonably concluded that these risk premium analyses all support his recommended ROE of 9.3 percent for Ameren Missouri.[102]

Ameren Missouri's argument concerning Gorman's bond plus risk premium analyses simply amounts to an assertion that Gorman's results are too low. These arguments are not well founded and should be rejected.

### 7. Ameren Missouri's Arguments Fail to Recognize that Gorman's CAPM Analysis Includes a Forward-Looking Estimate of Market Risk Premium

Gorman developed two estimates of market risk premium as a part of his CAPM analysis: one forward-looking and the other historically-based.[103] These analyses resulted in risk premiums of approximately 7.3 percent and 6.2 percent – with an average risk premium of 6.75 percent.[104] Gorman then compared his findings with published analyst findings to gauge their reasonableness. He determined that his average market risk premium estimate falls within the range of estimates published by analysts.[105]

Ameren Missouri criticizes Gorman for taking a "backward looking view to develop his risk premium" and then combining that result with "a projected Treasury rate."[106] But as noted above, Gorman used both forward-looking and historically-based approaches in developing his risk premiums. His highest market risk premium estimate of 7.3 percent was developed based on

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[101] Gorman Rebuttal, Ex. 511, p. 16, ll. 20-21.

[102] Gorman Rebuttal, Ex. 511, p. 16, l. 22 – p. 17, l. 2.

[103] Gorman Direct, Ex. 510, p. 34, l. 20 – p. 35, l. 20.

[104] Gorman Direct, Ex. 510, p. 35, ll. 1-20.

[105] Gorman Direct, Ex. 510, p. 36, l. 1 – p. 37, l. 11.

[106] Ameren Missouri Br,. pp. 75-76.

market return outlook.[107] He combined his forward-looking risk premium estimate with analysts' projected 30-year Treasury bond yield of 4.10 percent, which he determined represents the risk-free rate for his analysis. This projected 30-year Treasury bond yield is higher than the current 30-year Treasury bond yield of 3.14 percent.[108] Ameren Missouri's criticisms provides no basis for rejecting Gorman's reasonable approach. Gorman's CAPM analysis produced a return in the range of 8.82 percent to 9.66 percent with a midpoint of 9.24 percent—just slightly below his recommended ROE for Ameren Missouri.

### 8. All Properly Applied Rate of Return Analyses In this Case Prove that Ameren Missouri's Current Market Cost of Equity Is In the Range of 9.0 percent to 9.6 percent.

The testimony of MIEC witness Gorman, OPC witness Schafer, and Staff witness Murray all support an ROE in the range of 9.0 to 9.6 percent in this case. When corrected to include reasonable assumptions concerning growth rates, dividend payout ratios and market risk premiums, the testimony of Ameren witness Hevert also supports an ROE in this range.[109] As explained above and in MIEC's opening brief, this range is also consistent with recent Commission authorized ROEs for electric utilities with investment risk similar to Ameren Missouri's.

Although Ameren Missouri may be of the opinion that capital market costs will increase in the future, the timing and extent of these future increases are highly uncertain.[110] In contrast, the decline in capital market costs since the last Ameren Missouri rate case, as evidenced by increased utility stock prices, lower utility stock dividend yields, stable growth rates and lower

[107] Gorman Direct, Ex. 510, p. 35, ll. 1-14.

[108] Gorman Direct, Ex 510, p. 33, ll. 17-21.

[109] Gorman Rebuttal, Ex. 511, p. 3, Table 1.

[110] Gorman Surrebuttal, Ex. 512, p. 9, ll. 12-15.

utility bond interest rates, is observable and verifiable. Gorman's analyses in this case confirm that decline in capital costs since the last rate case.

Customers must bear the burden of Ameren Missouri's increasing fuel and other costs. A just and reasonable rate in this case should reflect cost decreases as well as cost increases. Here, the evidence is clear that Ameren Missouri's cost of capital has decreased. Customers should receive the benefit of those savings through a reduction in Ameren Missouri's ROE that reflects this decrease in the cost of capital. This Commission should adopt Gorman's recommendation and authorize an ROE of 9.3 percent for Ameren Missouri.

**F. Noranda Load**

Ameren Missouri proposes to "normalize" Noranda's load by proposing a three-year average of Noranda's load factor from 2012-2014.[111] Ameren Missouri justifies this position by presenting a table that lists Noranda's annual load factors from 2005 to 2014. Ameren Missouri notes that the load factors fluctuate during this time period and that using a 98.2% load factor would be contrary to a normalization process. But Ameren Missouri is telling only half of the story. Clearly a number of the historical load factors In Ameren Missouri's table are outliers and should not be considered. For instance, Ameren lists load factors from 2009, 2010, and 2014. These load factors are below the 98.2% load factor proposed in this case only because of extraordinary events, including the 2009 ice storm.

As a result of this major storm, Noranda lost two pot lines from its production capacity. Obviously, without two pot lines operating, the power Noranda used was greatly reduced and thus the load factor was severely impacted. Likewise, in 2014 Noranda experienced an abnormal level of pot failures, which reduced the power consumption at the smelter. Again, this incident

[111] *Id.*, p. 47.

resulted from losing the two pot lines from the 2009 ice storm. MIEC notes that, in dealing with the "supposed" recovery of lost fixed costs from the 2009 ice storm, Ameren Missouri claims the 2009 ice storm was an extraordinary event and thus recovery of those "fixed costs" is justified. Yet, in addressing a normalized load factor for determining Noranda's annual load, Ameren seeks to include events that were the result of the extraordinary ice storm in the normalization process.

If the years affected by the 2009 ice storm are removed from Ameren Missouri's table (2009, 2010 & 2014), the annual load factor of 98.2% for Noranda is entirely in order. In fact, after eliminating those years, the remaining years have load factors greater than 98% for five of the seven years. Clearly a load factor of 98.2% is the most reasonable load factor to determine Noranda's annual power requirements. In its direct case, Ameren Missouri proposed an annual power level of 4.2 million MWhs, thus reflecting that load factor. The evidence in this case is undisputed that by the operation of law date Noranda will be at full capacity, namely at a 98.2 percent load factor.

## G. Income Tax Allocation Issues

### 1. Accumulated Deferred Income Tax/Affiliate Transaction Rule

Staff's and MIEC's Initial Briefs support the view that the affiliate transaction policy and rule require that the ADIT adjustment to rate base be calculated as if Ameren Missouri's income tax liability were computed on a stand-alone basis. Ameren Missouri opposes that position in its Initial Brief. No other party has briefed this issue. This reply will thus focus on Ameren Missouri's arguments.[112]

[112] Ameren Missouri Br., pp. 31-43.

Ameren Missouri devotes 13 pages of its Initial Brief to this issue. It discusses federal tax law, financial accounting, and what it calls "economic reality." The issue here is not whether Ameren Missouri should or should not have participated in a consolidated income tax filing, whether that was or wasn't favorable to Ameren Missouri, or whether historically ratepayers benefitted from a tax allocation agreement among the Ameren consolidated tax group members. The issue, plainly and simply, is how to fairly allocate today the benefits of that consolidated tax filing to the various corporations that are members of the Ameren consolidated group of corporations. That issue ultimately boils down to how this Commission will apply those benefits to Ameren Missouri and whether ratepayers will receive their fair share of those benefits. The members of the Ameren Corporation consolidated tax group entered into a Tax Allocation Agreement ("TAA"). Ameren Missouri apparently believes that this Commission cannot challenge the allocation of losses or resulting ADIT deferred tax assets under the TAA.[113]

Ameren Missouri claims that:

> There is no dispute as to the actual quantity of ADIT Ameren Missouri possessed at any point in time (including as of the end of the trued-up test year). The Company based its rate base calculation upon precisely that quantity. In other words, its rate base calculation provided customers with 100% of the benefit of the cost-free capital it had in its possession. That is the economic reality of its situation. MIEC and Staff are unwilling to accept this reality. Instead, they have proposed to calculate rate base using the higher level of ADIT the Company would have possessed had it filed its income tax returns on a basis upon which it does not file.[114]

Actually, the amount of NOL-related ADIT that Ameren Missouri supposedly "possessed" is not dispositive. What Ameren Missouri has identified for rate base inclusion is the amount <u>calculated under a TAA</u> essentially negotiated by Ameren with itself. In fact, it is equally

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[113] The MIEC notes that the Commission has never approved the TAA and that Staff intends to "thoroughly vet the [TAA]" in the next rate case. Staff Br., p. 11.

[114] Ameren Missouri Br., pp. 33-34.

undisputed what the allocation of the NOL-related ADIT is under Mr. Brosch's approach using a stand-alone calculation. Both undisputed amounts are listed in the table appearing on page 37 of Ameren Missouri's brief. It is equally undisputed that the difference between the two approaches means $51.08 million of rate base value to ratepayers.[115] The "economic reality" is that this Commission can, and must, review Ameren Missouri's self-negotiated allocation under the TAA to determine if it is fair to ratepayers. It is not.

Ameren Corporation's TAA requires the allocation of consolidated annual income-tax responsibility among the members of Ameren's consolidated tax group and defines the amounts of income tax that are recorded on the utility's books.[116] The TAA allocates to Ameren Missouri using a share of the consolidated losses from the parent company's income tax filing each year. It could, and should, for purposes of this case have allocated Ameren Missouri's tax loss carryforward ADIT amount on a stand-alone basis, as Mr. Brosch contends. There is no dispute that Ameren's TAA is a contract among corporate affiliates or that the TAA is now producing financial outcomes that are detrimental to Ameren Missouri and its ratepayers.[117] Ameren Missouri's witness, Mr. Warren, agrees that Ameren Missouri and its ratepayers will be better off currently, and for each of the last two years, by applying the stand-alone method.[118] He also agrees that, by using the consolidated method, Ameren Missouri seeks to attribute greater cumulative tax losses to its ratepayers than would be attributed under the stand-alone method.[119]

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[115] Rate Base amounts are subject to application of the Commission's approved rate of return in determining revenue requirement impacts.

[116] Brosch Surrebuttal, Ex. 502, p. 6.

[117] Warren Rebuttal, Ex. 48, p. 27, ll. 20-22: "It was only as of the end of 2013 that Ameren Missouri on a consolidated basis finally shifted into a slightly disadvantageous position."

[118] Warren Rebuttal, Ex. 48, p. 11, ll. 1-3.

[119] Tr. p. 334, ll. 13-22.

He agrees that if the carry-forward loss were calculated on a stand-alone basis, then it would offset less of Ameren Missouri's ADIT liability balance, thus producing a lower rate base.[120]

When none of the members of an income tax filing consolidated group are regulated utilities, it is entirely up to them to determine how the tax losses and resulting ADIT deferred tax assets are allocated. However, when one of the members of the consolidated group is a regulated utility in Missouri, this Commission has a right, indeed a duty, to determine whether the allocation of income tax losses and resulting ADIT deferred tax assets is fair to ratepayers. This Commission is not bound by Ameren Missouri's TAA with its parent. In fact, Ameren Missouri witness Warren admitted that "[t]he allocation of losses you [the Commission] have discretion over."[121] The legal issue here arises from the Commission's understandable policy that prevents regulated utilities, like Ameren Missouri, from using unreasonable affiliate arrangements that disadvantage the regulated utility and its ratepayers. Indeed, as Staff notes in its Initial Brief, "one of the most important functions of Public Service Commissions" is "[t]o prevent injury to the public, in the clashing of private interest with the public good in the operation of public utilities[.]"[122]

Mr. Brosch explained that utility holding companies are free to invest in both regulated and non-regulated subsidiaries and to structure cost allocation and affiliate-transaction arrangements between the controlled subsidiaries that may be more beneficial to shareholders than to ratepayers. He noted that "[i]n particular, Ameren Corporation's TAA produces extremely adverse consequences for Ameren Missouri's ratepayers in 2013 by crowding out the utility's taxable income in that year with tax losses from Ameren Corporation's divestiture of its

[120] Tr. p. 350, l. 18 – p. 351, l. 2.

[121] Warren testimony, Tr. p. 359, ll. 3-5.

[122] Staff Br., pp. 10-11 (quoting *State ex rel. City of St. Louis v. Public Service Commission*, 73 S.W.2d 393 (Mo. 1934).

merchant generation and energy marketing subsidiaries." Mr. Brosch added that it is entirely reasonable for the Commission to employ affiliate-transaction policies and safeguards that protect against unreasonable utility transactions with affiliates.[123] Changed circumstances in this test year justify a different allocation of Ameren Corporation's tax loss carryforwards than results from the TAA, even though the results of the TAA were more reasonable and not objectionable in prior years.

To be clear, the MIEC's and Mr. Brosch's position here is that good public policy requires the Commission to closely monitor affiliate transactions so that ratepayers are not burdened to the benefit of Ameren's shareholders. As is evident from the table in Ameren Missouri's Initial Brief at page 37, ratepayers are $51.08 million[124] worse off in 2014 calculating the tax benefit under the TAA (on a consolidated basis) rather than as Mr. Brosch proposes (on a stand-alone basis).

In addition, the Commission's regulation recognizes that good public policy. Under 4 CSR 240-20.015(2)(A), a regulated electrical corporation cannot provide a financial advantage to an affiliated entity (the "Affiliate Transaction Rule"). The Commission has specified the purpose for this rule:

> This rule is intended to prevent regulated utilities from subsidizing their nonregulated operations.… The rule and its effective enforcement will provide the public the assurance that their rates are not adversely impacted by the utilities' nonregulated activities.

Clearly Ameren Missouri's application of the TAA violates the clearly stated purpose of the Affiliate Transaction Rule in that it allocates less of a tax benefit asset to Ameren Missouri than

[123] Brosch Surrebuttal, Ex. 502, p. 7.

[124] The MIEC notes that on p. 38 of its Initial Brief it incorrectly reported that amount as $50.9 million. These amounts are rate base dollars, to which a return on investment to be determined by the Commission will be applied.

it should "by crowding out the utility's taxable income in [2013 and 2014] with tax losses from Ameren Corporation's divestiture of its merchant generation and energy marketing subsidiaries."[125] Section (2) sets forth the "Standards" under the rule and provides some examples. It provides that:

> (A) [a] regulated electrical corporation shall not provide a financial advantage to an affiliated entity. For the purposes of this rule, a regulated electrical corporation shall be deemed to provide a financial advantage to an affiliated entity if—
>
> > [i]t compensates an affiliated entity for goods or services above the lesser of— [t]he fair market price; or … [t]he fully distributed cost to the regulated electrical corporation to provide the goods or services for itself; or
> >
> > [i]t transfers information, assets, goods or services of any kind to an affiliated entity below the greater of …[t]he fair market price … or [t]he fully distributed cost to the regulated electrical corporation.
>
> (B) Except as necessary to provide corporate support functions, the regulated electrical corporation shall conduct its business in such a way as not to provide any preferential service, information or treatment to an affiliated entity over another party at any time.

Ameren Missouri misreads the regulation as providing a limitation on this Commission's regulatory authority rather than a limitation on utilities and their corporate affiliates. Ameren Missouri argues that neither the "fair market price" nor the "fully distributed cost" of the tax

[125] *Id.*

asset at issue can be determined, so therefore the Affiliate Transaction Rule cannot apply.[126] Such a claim is inconsistent with the clear purpose of the rule, which is to further the understandable public policy to police affiliate transactions so that ratepayers are not burdened to the benefit of shareholders. Moreover, nothing in section 2 provides that the listed examples are exclusive. In other words, Ameren Missouri seeks to rewrite the rule to read "[f]or the purposes of this rule, a regulated electrical corporation shall be deemed to provide a financial advantage to an affiliated entity if, and only if—."

As explained in MIEC's Initial Brief, Ameren Missouri proposes to include overstated NOL carry-forward ADIT balances based on its preferred "consolidated group" method of allocating carry-forward losses to Ameren Missouri. Use of that method would impose higher electric rates on ratepayers because rate base will be $51 million higher than results from calculating such NOLC amounts based solely upon Ameren Missouri's cumulated tax losses on a stand-alone basis. Applying good public policy, as recognized in 4 CSR 240-20.015, to the undisputed facts demonstrates that Ameren Missouri cannot use its consolidated-group NOLC calculation approach to overstate rate base.

Ameren Missouri claims that the MIEC, Mr. Brosch, and Staff all accepted use of the TAA when it benefitted ratepayers but seek to depart from the TAA when it harms ratepayers. That is true. But that is the nature of the policy favoring ratepayers when a regulated utility does business with an affiliate. Allocating tax benefits favorably to the non-regulated entities impacts ratepayers no less than overpaying an affiliate for supplies. If, for instance, an affiliate had provided a favorable price to a regulated utility for coal for many years does that mean that the affiliate is justified in overcharging the utility for coal today?

[126] Ameren Missouri Br., pp. 41-43.

Ameren Missouri claims that "[t]he allocation of the consolidated tax liability does not involve the transfer of anything."[127] That statement is at odds with Ameren Missouri's claim that it "possesses" less ADIT than MIEC and Staff seek to include in rate base. What the TAA does is to determine the value of Ameren Missouri's share of the consolidated group's NOL-related ADIT deferred tax asset in Ameren Missouri's rate base. The allocation can fairly be characterized as a transfer, the results of which Ameren Missouri claims that it possesses.

Ameren Missouri claims that the allocation of taxes under its TAA is an "ongoing process" and that it is inappropriate to evaluate that process in one year or in one rate case.[128] Ameren Missouri cites no authority for its position in that regard. The fact is that the TAA produced an acceptable result in one time frame but became unreasonable in application now. The affiliate transaction policy forbids favoring affiliates of a regulated utility at any time. That is what is now happening under Ameren Missouri's TAA. Ameren Missouri would clearly be better off, and its ratepayers would be better off, if the ADIT were not allocated according to the TAA and rather allocated based upon Ameren Missouri's actual taxable income and NOLs on a stand-alone basis as Mr. Brosch, the MIEC and Staff advocate.

**2. <u>Section 199 Domestic Production Income Tax Deduction</u>**

Although Ameren Missouri would like to have this Commission believe that this issue is limited to it and the MIEC alone, like the last NOL deferred income tax issue, both the Staff and the MIEC have proposed to compute Ameren Missouri's Domestic Production Deduction ("DPD") as Ameren Missouri historically has.[129] Ameren Missouri seeks to alter the way it calculates the DPD. As explained below, Ameren Missouri's position is not well taken.

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[127] Ameren Missouri Br., p. 41.

[128] *Id*., p. 42.

[129] Staff Br., pp. 12-14.

The DPD is limited to income. If a taxpayer has no income, it will have no DPD. With no DPD, taxable income will be greater, income tax liability will be greater, the revenue requirement will be greater, and rates will be higher. The long-standing practice is to calculate the DPD for ratemaking purposes[130] by reflecting the forward-looking level of revenues after implementing the proposed rate increase and all test-year adjusted operating expenses allocated to the production part of Ameren Missouri's business, including Ameren Missouri's tax deductions, without consideration of the prior year's net operating loss.[131] Ameren Missouri now seeks to depart from that long-standing practice and have this Commission consider prior-year net operating losses.[132] Predictably, Ameren Missouri's approach will lead to higher rates for ratepayers.

As explained in the MIEC's Initial Brief, at p. 42:

> With Ameren Missouri's traditional approach, the Commission can determine whether there is sufficient taxable income to claim a deduction; and, there has consistently been a deduction.[133] There is also a degree of predictability in the formula and clarity for ratepayers.
>
> Ameren Missouri's new approach completely eliminates any DPD tax deduction for ratemaking purposes by inserting large cumulative NOLC amounts within the calculation of the deduction. This outcome is inappropriate and inconsistent with the methods used to calculate the DPD and should be rejected.

Ameren Missouri claims that the federal tax law requires the consideration of NOLs in determining the DPD and that, therefore, this Commission must consider the NOLs allocated to Ameren Missouri and thus assume that it will have no reportable income and no DPD <u>for ratemaking purposes</u>.[134] Ameren Missouri's Table VII on page 37 of its Initial Brief shows that

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130 Tr. p. 408, l. 20 – p. 409, l. 7.

131 Tr. p. 395, l. 17 – p. 396, l. 2.

132 Tr. p. 371, ll. 6-12.

133 Tr. p. 396, ll. 2-4.

134 Ameren Missouri Br., p. 45.

on a stand-alone basis, Ameren Missouri has had positive taxable income in every year since 2010 (See column 1). There is no basis to assume that Ameren Missouri would not have taxable income prospectively, when the new rates and revenues included in the DPD calculation are in effect. Mr. Brosch explained it this way:

> In fact, Ameren Missouri has had a positive taxable income recently, including the last two years when there was bonus depreciation allowed as a deduction.
>
> And I think one could assume, extrapolating from that, the possibility at least of enough positive income in the future for Ameren Missouri to realize its stand-alone NOL in the near future.[135]

This is why the Commission should for ratemaking purposes use the formula that has been consistently used by Ameren Missouri. That long-used DPD calculation formula in rate cases assumes that Ameren Missouri, on a going forward stand-alone basis, and after the rate increase awarded in this rate case, will have sufficient taxable income to benefit from a DPD deduction.

Ameren Missouri claims that MIEC's position hinges on the uncertainty of Ameren Missouri's future taxable income and what is certain are the amounts of NOLC recorded on "Ameren Missouri's books.[136] But the uncertainty mentioned by Brosch arises from Congressional action regarding tax issues (like bonus depreciation), not Ameren's business operations which, as mentioned earlier in this brief, have yielded large profits for shareholders while attributing tax losses unfairly to its regulated utility subsidiary. It is disingenuous for Ameren Missouri to argue that tax deductions should be ignored, to ratepayers' disadvantage, because of this tax law uncertainty. It is also incorrect to assume that amounts for NOLC recorded on the financial statements are "correct" for ratemaking purposes when they are based

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[135] Brosch testimony, Tr. p. 411, ll. 2-14.

[136] *Id*., p. 46.

upon the TAA that is at issue and produces results inconsistent with the affiliate transaction policy.

Mr. Brosch was clear that should this Commission reject MIEC's and Staff's position on this issue, it should nevertheless allocate NOLCs to Ameren Missouri on a stand-alone basis. If the Commission believes some recognition of NOLC inputs to the DPD calculation is necessary, over the objections of MIEC and Staff, the template at MIEC Schedule MLB-4 REVISED should be used, including only Ameren Missouri's stand-alone NOL amounts as of December 31, 2014.[137]

## II. CLASS COST OF SERVICE, REVENUE ALLOCATION AND RATE DESIGN

### A. Class Cost of Service and Revenue Allocation

In its Initial Brief,[138] Staff states that because the class cost of service results offered by all parties are generally directionally consistent on inter-class revenue allocation, the Commission need make no specific findings as to cost of service methodology in this case. MIEC agrees with that observation. MIEC is signatory to the Nonunanimous Stipulation and Agreement regarding Economic Development, Class Cost of Service, Revenue Allocation and Rate Design. That Stipulation, which is now a joint recommendation, supports an equal percentage across-the-board increase for all customer classes, except for the LTS (Noranda) class which is treated separately because of its request for rate relief in this case. That Stipulation as to the equal percentage is consistent with the positions of both Ameren Missouri and the MIEC. Alternatively, should the Commission not accept the equal percentage across-the-board increase for the majority of customer classes, MIEC supports Staff's inter-class allocation (but not its cost

[137] Brosch Surrebuttal, Ex. 502, p. 22.

[138] Staff Br., pp. 76-77.

of service method) as outlined in the testimony of Commission Staff witness Michael Scheperle.[139] Mr. Scheperle's recommendation deals with some specific details and results in almost an equal percent increase to all customer classes.

Should the Commission wish to make specific findings on cost of service methodology and sub-issues, then the MIEC urges the Commission to reaffirm its endorsement of the A&E-4NCP cost allocation methodology, used by Ameren Missouri and the MIEC, as still the most reasonable approach to allocating generation-related fixed costs to customer classes.

## B. The Commission Specifically Should Reject the Three Methods Presented by Staff

The three studies offered by Staff are outside of the mainstream, conflict with prior Commission rulings, and do not reliably reflect cost-causation.[140] The studies offered by Staff are identified as a detailed base-intermediate-peak ("BIP") study, a modified BIP study, and a market-based study.

## C. Modified BIP Study

Although Staff stated in its rate design and class cost of service report[141] that the modified BIP study was similar to the one the Staff used in the previous rate case, the evidence shows that it is vastly different from the modified BIP study that Mr. Scheperle offered in Ameren Missouri's previous rate case. In fact, Staff's Response to MIEC Data Request No. 513[142] identifies no fewer than 34 major differences in the details of the modified BIP study between the last case and the current case. With the exception of the allocation of off-system sales (which is common to all three of Staff's studies), neither the Staff's report nor the testimony of any of its witnesses explains why the other 33 allocations were changed from what

[139] Scheperle Direct, Ex. 232, p. 3, l. 1 – p. 4, l. 32.

[140] Brubaker Rebuttal, Ex. 504, p. 2, ll. 31-33.

[141] Exhibit 201, p. 9.

[142] Exhibit 519.

was used in the prior case. The results of the two studies are dramatically different. In the prior rate case, the results of the modified BIP study were very close to the results of the traditional A&E-4NCP method. In this case, they are dramatically different.

**D. Market Study**

Staff's market study does not use embedded cost (revenue requirement) information to perform the generation function allocators; rather it uses hourly LMP data that substantially increases the component of the allocations that is based on energy use, again without any justification for doing so. Ameren Missouri's revenue requirement is based on embedded cost, not on hourly LMPs; hourly LMPs have no place in the embedded cost allocations.[143]

**E. Detailed BIP Study**

Staff places heavy reliance on the detailed BIP study. The BIP methodology has not found a home in mainstream cost-allocation techniques. In fact, as Mr. Brubaker testified,[144] it was initially conceived because it was thought it might be useful in developing time-differentiated rates, but that did not prove to be true, and it is rarely used in the industry. The only known recent use of a detailed BIP allocation study was by Kansas City Power & Light Company ("KCPL"), which had used it to fulfill a promise concerning developing time-differentiated rates. But, KCPL never actually used the study to support its revenue allocation recommendations, and in fact has completely abandoned the BIP methodology in its current rate case filing before the Commission in Case No. ER-2014-0370.

According to the BIP theory, base load plants have higher capital costs per kW of capacity than do other plants, intermediate plants have the next highest capital cost per kW, and peaking plants have the lowest. When Staff tried to apply the detailed BIP methodology to

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[143] Brubaker Rebuttal, Ex. 504, p. 22, ll. 11-17.

[144] *Id.*, p. 15, ll. 2-6.

Ameren Missouri's generation fleet, it found that the plants it designated as intermediate plants had a higher cost per kW than the base load plants, which is totally at odds with its BIP theory. Rather than recognize that the BIP theory is inconsistent with reality, Staff instead removed $115 million of capital investment from the intermediate plants by taking them out of the capital investment.[145] This effectively had the impact of increasing the costs assigned to base load plants, to the significant disadvantage of LTS and LPS customer classes. Staff's response to MIEC Data Request No. 585[146] shows that this adjustment allocated an additional $10 million of cost to LTS and over $7 million to LPS customers. The fact that the realities of the Ameren Missouri system do not conform to BIP theory speaks volumes about the deficiencies in the BIP concept.

One of the primary deficiencies of the BIP method is that it is inconsistent with least cost utility planning that is done on a system basis. While the BIP method attempts to associate particular generating stations with particular parts of customer load curves, the actual planning process is much different. The actual planning process looks at the overall system needs and develops that combination of plants that will reasonably meet the expected requirements on a least cost basis. The way that the BIP method has been implemented, the fixed costs associated with base load generation are essentially allocated to customer classes on a measure of class energy consumption. Although Staff attempted to avoid admitting this was the case, both MIEC witness Brubaker[147] and Ameren Missouri witness Warrick[148] noted that Staff's detailed BIP study results in the allocation of approximately 66% of Ameren Missouri's production plant fixed costs on an energy usage basis. This is a much greater allocation based on energy than

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[145] *Id.*, p. 19, ll. 13-15.

[146] Exhibit 523.

[147] Brubaker Rebuttal, Ex. 504, p. 17, l. 10.

[148] Warrick testimony, Tr. pp. 1465-1466.

even occurred in Case No. ER-2010-0036 where the Commission rejected the methodology under consideration because it over-relied on energy in allocating generation-related fixed costs.[149]

Staff's witness on this issue appeared defensive about the study and how others characterized it, going so far as to characterize as factually inaccurate Mr. Brubaker's statement that "[i]n Staff's Detailed BIP study, 100% of the fixed costs associated with plants designated as base load are allocated to customer classes using the customer class energy requirement factor as the basis for the allocation."[150] Yet Staff's claim of inaccuracy was disproved when it was tested in discovery[151] by referring to the allocation of base capacity shown on page 2 of Staff witness's surrebuttal testimony and comparing that allocation to an energy allocation.,. Staff's witness had to admit that the allocation of base capacity costs and an allocation on class kWh are "similar," but persisted in claiming they were not identical.[152] To accept this point of view requires one to consider the following differences in class cost allocation percentages to be material: (1) for the residential class, the difference between 36.42% and 36.46%; (2) for the SGS class, the difference between 9.48% and 9.47%; (3) for the LGS/SPS class, the difference between 31.95% and 31.89%; (4) for the LPS class, the difference between 10.26% and 10.29%; (5) for the LTS class, the lack of any difference between 11.29% and 11.29%; and (6) for the lighting class, the difference between 0.61% and 0.60%. The fundamental equivalency of these percentages is not seriously contestable, and thus Staff's claim that Mr. Brubaker's statement was "factually inaccurate" was itself inaccurate and highly misleading. After all the facts are reviewed, it appears that Staff's objection and disagreement is really not about the substantive end results of

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[149] Brubaker Rebuttal, Ex. 504, p. 16, l. 18 - p. 17, l. 10.

[150] S. Kliethermes Surrebuttal, Ex. 222, p. 4, fn. 4.

[151] Exhibit 520, Staff's Response to MIEC Data Request No. 574.

[152] *Id*.

the studies, but the fact that Mr. Brubaker and Mr. Warrick chose to describe the studies in terms of their overall findings, rather than in terms of the less meaningful mechanical steps that were applied to achieve those findings.

Furthermore, when Staff's witness responded to Mr. Brubaker's claim that the detailed BIP study over-allocates production capacity cost to high load factor classes, Staff chose to completely ignore in the narrative the impact on the class with the highest load factor, the LTS class. While the detailed BIP study allocates marginally lower (2%) generation fixed costs to the LPS class than does the A&E-4NCP study, the LPS class load factor, while above average, is much lower than the LTS class load factor. That the detailed BIP study allocates significantly more generation-related fixed costs to the LTS class than does the A&E-4NCP study is vividly demonstrated in Staff's surrebuttal testimony.[153] Staff's own calculations show that the detailed BIP study allocated $48 million more fixed costs to the LTS class than did the A&E-4NCP study. And, despite the claim that high load factor customers benefit more than others from the lower fuel cost of base load units, the table on page 23 of the surrebuttal testimony shows that the fuel cost to the LTS class under the detailed BIP study would be only slightly less than under A&E-4NCP.[154] The 0.0037 (0.37%) difference in the allocation factor, when applied to the roughly $1 billion of fuel and variable costs in Staff's study produces a benefit of only $3.7 million, just a small fraction of the $48 million extra fixed costs allocated.

In addition to the conceptual problems and anomalies pointed out above and the fact that Staff's studies are not only theoretically incorrect but are outside the mainstream, conflict with prior Commission rulings, and contain deficiencies, the studies have additional problems. One such serious deficiency is the allocation of administrative and general ("A&G") expense.

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[153] S. Kliethermes Surrebuttal, Ex. 222, p. 20 (table).

[154] *Id.*, p. 23 (table).

Typically, these costs are allocated on labor or on plant investment. Staff, however, allocated a significant portion of A&G expense to customer classes on the basis of other operation and maintenance ("O&M") expenses. But O&M expenses include significant amounts of fuel and purchased-power expense which, because they are largely incurred externally by third parties, do not lead to the incurrence of a commensurate level of A&G expense. On the other hand, labor and other costs of maintaining the generation, transmission, distribution, and other functions of the utility are internal and do give rise to the incurrence of A&G expense, which is why A&G expense is traditionally allocated on the basis of either salaries or of O&M expense (exclusive of A&G expense). Staff used this inappropriate methodology in each of its three studies.[155]

Another glaring problem is the fact that Staff's allocation of off-system sales and off-system sales margins is inconsistent with prior Commission rulings and with how both Ameren Missouri and MIEC have allocated off-system sales margins in this case. The appropriate allocation is on class energy because off-system sales are non-firm, meaning that no capacity is reserved in order to make the sales, and the majority of the cost supporting the sales is variable fuel and some purchased power expense. The methodology used by Ameren Missouri and by MIEC in this case follows rulings of the Commission in KCPL Case No. ER-2006-0314 and Ameren Missouri Case No. ER-2010-0036. In both cases, the Commission affirmatively held that allocation of off-system sales, including margin, on an energy basis was the appropriate allocation methodology.[156]

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[155] Brubaker Rebuttal, Ex. 504, p. 23, l. 3 - p. 24, l. 13.

[156] Report & Order in ER-2006-0314, p. 39; Report & Order in ER-2010-0036, pp. 86-87.

## F. OPC's Cost of Service Studies

OPC offers two cost of service studies: (1) one using the A&E-4NCP method; and (2) the other using a peak and average ("P&A") method that double-counts average demand and, in fact, gives a 59% weighting to annual energy consumption in the allocation of generation-related fixed costs.[157] The Commission has repeatedly rejected this allocation methodology in prior cases, and should continue to do so in this case. OPC's allocation of revenues and margins from off-system sales is even more flawed than Staff's. OPC allocates all of the revenues, not just the margins, using the production demand allocation factor. Thus, not only did OPC allocate the margins on a demand basis, but also allocated the remaining revenues (which cover the cost of energy) on a demand basis. This compounds the error, and substantially under-allocates the benefit of these sales to high load factor customer classes because fuel expense was allocated to classes on an energy basis.[158]

Another problem with OPC's studies was the failure to recognize an appropriate customer component in the allocation of distribution facilities. Here, OPC stands alone, and at odds with the allocations applied by Ameren Missouri, by Staff, and by MIEC.[159]

As shown by Mr. Brubaker's testimony,[160] the effect of OPC's P&A study is to allocate above-average capital cost to high load factor customers (especially LTS) but not give them any of the benefit of the lower fuel cost that is associated with the higher cost base load capacity. The Commission should continue to reject the OPC P&A cost of service study.

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[157] Brubaker Rebuttal, Ex. 504, p. 4, ll. 16-18.

[158] *Id.*, p. 9, ll. 1-7.

[159] Warrick Amended Rebuttal, Ex. 50, p. 10, ll. 13-16.

[160] Brubaker Rebuttal, Ex. 504, Schedule MEB-COS-R-1.

## G. Transmission Costs for Self-Generated Power

While MIEC's emphasis in pre-filed testimony and at hearing was on a reasonable reading and application of section 386.266, the only authority allowing Ameren Missouri to surcharge anything under the FAC, Ameren Missouri's Initial Brief on this point[161] makes only a passing reference to this statute. Section 386.266 provides:

> Subject to the requirements of this section, any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge, or periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including transportation[.]
>
> ***
>
> .4 … The commission may approve such rate schedules after considering all relevant factors which may affect the costs or overall rates and charges of the corporation, provided that it finds that the adjustment mechanism set forth in the schedules:
>
> (1) Is reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity…[162]

The General Assembly was thus clear that this Commission has the power to grant an FAC, but is not required to do so. In fact, this Commission initially denied Ameren Missouri an FAC in Case No. ER-2007-0002. But Ameren Missouri was persistent, and obtained one in its next rate case. This Commission therefore has the power to grant in whole, in part, or not at all an FAC after considering all relevant factors and determining whether the FAC "[i]s reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity[.]" In short, even if this Commission were to conclude that power Ameren Missouri generates to serve its load is "purchased power" under section 386.266 because Ameren Missouri belongs to MISO, this Commission still "may" deny recovery, through FAC surcharge, of the increases in MISO transmission charges at issue. But a finding that this power is "purchased power" would be

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[161] Ameren Missouri Br., pp. 94-103.

[162] Emphasis added.

inconsistent with both Ameren Missouri's own representations made during the FAC rulemaking (that "purchased power" is "power needed to supplement the energy and capacity available from the utility-owned generation"), and with Ameren Missouri's financial reports, made under the FAC regulations, stating that only a small part of its fuel purchases are for off-system sales and that the purchased power costs are only a fraction of its fuel to serve native load.

Predictably, Ameren argues that it sells all of its self-generated power to MISO and buys back what it needs to serve its load. Therefore, it argues, all MISO transmission charges are for purchased power and thus surchargeable. It also argues that this Commission denied a related claim in the last rate case, so it should do so again. It last argues that it has always surcharged the MISO transmission costs, so it should continue to do so. The Commission should reject each of these arguments.

As indicated in MIEC's Initial Brief, Ameren Missouri's position here is at odds with any reasonable construction of the statute, with FERC Orders, and with its financial reporting too. Can anyone seriously contend that the Missouri General Assembly intended Ameren Missouri's construction of "purchased power?" Had that been the case, the mechanism at issue would be called the PPAC (purchased power adjustment clause) and there would have been no need in section 386.266 to allow surcharges of increased fuel costs since none of the generation fuel costs that Ameren Missouri incurs would be to produce power to serve ratepayers. Moreover, the FAC reports would not emphasize fuel as they now do since the focus would be entirely on purchased power costs.

The gross clearing of generation and load by Ameren Missouri in the MISO energy market does not amount to Ameren Missouri: (i) selling all of its generation as off-system sales to MISO and (ii) supplying all of its load with purchased power from MISO. Ameren Missouri

does not assign all of its generation fuel costs to off-system sales in its own accounting; it assigns the vast majority of it to its load.[163] Ameren Missouri's own direct testimony workpapers in this proceeding show that Ameren Missouri does not assign all of its generated MWh to off-system sales and instead assigns the vast majority of its generated MWh to its load.[164] FERC was clear in its Order No. 668 why it requires electric utilities to net in their accounting their gross Regional Transmission Organization ("RTO") cleared generation and load in each hour as either an off-system sale or purchased power, but not both:

> Recording RTO energy market transactions on a net basis is appropriate as purchase and sale transactions taking place in the same reporting period to serve native load are done in contemplation of each other and should be combined. Netting accurately reflects what participants would be recording on their books and records in the absence of the use of an RTO market to serve their native load. Recording these transactions on a gross basis, in contrast, would give an inaccurate picture of a participant's size and revenue producing potential. The Commission will, therefore, adopt the proposed accounting for RTO energy market transactions with certain modifications and clarifications as discussed below.[165]
>
> Additionally, we clarify that transactions are to be netted based on the RTO market reporting period in which the transaction takes place. For example, if the RTO market in which the transaction takes place uses an hourly period for determining energy market charges and credits, then non-RTO public utilities purchasing and selling energy in the market must net transactions on an hourly basis. Requiring participants to net transactions over the RTO market's reporting period leads to consistent and comparable energy market information for decision making purposes by the Commission and others.[166]
>
> Further, we clarify that the netting of purchases and sales in an RTO energy market is appropriate not only for transactions where participants are required to bid their generation into the market and buy generation from the market to supply their native load, but also in cases where an RTO offers an energy market in

[163] Dauphinais Surrebuttal, Ex. 509, p. 9, ll. 1-13; Laura Moore Direct, Ex. 30 at Schedule LMM-17, ll. 1-7; and MIEC Exhibits 524 through 528 (FAC surveillance reports).

[164] Dauphinais Direct, Ex. 508, p. 11, ll. 5-18, and Schedule JRD-2; Dauphinais Surrebuttal, Ex. 509, p. 11, ll. 1-12.

[165] Exhibit 66 (FERC Order No. 668 at paragraph 80).

[166] *Id*. at para. 81.

> which participants may choose to offer all generation to and buy all power from the energy market.[167]
>
> We also clarify that if a participant is a net seller, rather than a net buyer, during a given market reporting period it must credit such net sales to Account 447, Sales for Resale, instead of Account 555, Purchased Power.[168]

FERC was also clear in its Order No. 668 with respect to the limited purpose for which it requires electric utilities to maintain records of their gross RTO cleared generation and load even though it requires netting in electric utility accounting:

> The Commission does expect public utilities, however, to maintain detailed records for auditing purposes of the gross sale and purchase transactions that support the net energy market amounts recorded on their books.[169]
>
> Finally, one purpose of this rule is to establish uniform accounting requirements for the purchase and sale of energy in RTO markets. The purpose of reporting of gross information in EQRs, in contrast, is to provide the Commission and the public with a more complete picture of wholesale market activities which affect jurisdictional services and rates, thereby helping to monitor for any market power and to ensure that customers are protected from improper conduct. These are not necessarily the same criteria and principles that should be used in establishing uniform accounting requirements.[170]

In its own September 7, 2006 comments to the Commission in Docket No. EX-2006-0472, which were made well after Ameren Missouri's integration into MISO and the April 1, 2005 start of the MISO Day 2 energy markets, Ameren Missouri itself stated:

> FACs allow utilities to timely pass through the necessary costs (subject to full prudence review and other consumer protections discussed below) associated with obtaining the fuel needed to fire the generation that serves customers, as well as the costs associated with purchased power needed to supplement the energy and capacity available from the utility-owned generation."[171]

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[167] *Id*. at para. 82.

[168] *Id*. at para. 83.

[169] *Id*. at para. 80 (emphasis added).

[170] *Id*. at para. 84 (emphasis added).

[171] Docket No. EX-2006-0473, Comments of Union Electric Company d/b/a/ AmerenUE, September 7, 2006 at page 2, (emphasis added); Dauphinais Surrebuttal, Ex. 509, p. 9, l. 14 – p. 10, l. 6.

Ameren Missouri's claim that it does not self-supply power to its customers from its generation is simply untrue. Chairman Kenney's question, and Mr. Dauphinais' answers, show this:

> **Q. If Ameren -- and I want to -- as I understand Mr. Haro's testimony and the distinction between self-scheduling and self-supply, my interest is more in self-supplying. If Ameren's bidding into the market all of its generation and then it's buying out of the market all of its needs to supply its native load, how would you differentiate between that energy that is generated from its own generators versus energy that comes from any other generator that participates in the MISO market?**
>
> A. I think the key here is that for self -- we do have self-supply going on here because the MISO market is a tool that the company has available to it in addition to its own generation resources to serve its own customers. And so -- and the company decides how to utilize its generation resources, how to schedule them, whether that's to offer them into the MISO market or to self-schedule them, actually specify it will operate in this hour at this megawatt level or to specify I'm going to operate on this day and give MISO this dispatch range. They make those types of decisions. But it's really a tool. Ultimately [Ameren Missouri] generation is being utilized to serve the customers. That's the purpose of that generation. That's why it was invested in. And I think that's important. I think just because we clear it through an RTO market wasn't meant to change this from a self-supply situation. It doesn't do that. It's just a mechanism to aid the company.
>
> **Q. So then based upon what you're saying, there should be a mechanism by which to differentiate those transmission costs incurred to transport its own generation to its native load from those transmission costs that are associated with purchased power?**
>
> A. There should be. In fact, I argue there is because we already do this for fuel. We don't say all the fuel is for off-system sales. We determine how much of the fuel is for customers and how much of the fuel and their generation was for off-system sales. And, therefore, the same mechanism can be used to calculate how much of the transmission charges that they incur for the load is associated with moving power from their own generation facilities to their own load versus -- versus power that's for - or transmission costs that are incurred for other purposes, like bringing [purchased] power to the load.[172]

The mechanism that Mr. Dauphinais alludes to in his response with respect to splitting transmission costs incurred for load between power from Ameren Missouri's own generation and

[172] Tr. p. 2081, ll. 12-25; Tr. p. 2082, ll. 1-25; Tr. p. 2082, ll. 1-12.

purchased power was discussed in detail in Mr. Dauphinais' direct testimony where he concludes that 96.5% of the transmission charges that Ameren Missouri incurs for it load are for the transmission of power from its generation to its load and only 3.5% are for the transmission of purchased power to its load.[173] This is in fact the basis of the split that will be applied to Ameren Missouri's transmission charges if MIEC prevails on this issue and, as a result, "(i) the Commission does not decide that all transmission charges should be included in the FAC and (ii) the Commission does not decide that all transmission charges other than those incurred to transmit off-system sales should be included in the FAC." See Nonunanimous Stipulation and Agreement Regarding Class Kilowatt-Hours, Revenues and Billing Determinants, Net Based Energy Costs, and Fuel Adjustment Clause Tariff Sheets, March 5, 2015 or "Non-Unanimous NBEC Stipulation" at Paragraph 6.

What Ameren Missouri regularly reports to this Commission in its numerous filings under the FAC regulation belies its argument that all power it generates is for off-system sales and all of the power that serves its load is purchased power. Exhibits 524-528, Ameren Missouri's last five FAC Surveillance Monitoring Reports, show that the fuel expense for native load is significantly larger than the fuel expense for off-system sales. Similarly, its reported expense for purchased power for native load is far less than its fuel expense for native load. If Ameren Missouri were selling off-system its entire production of energy, it certainly would not be buying it back for one-tenth of just one component (fuel) of the cost to produce it. If Ameren Missouri's substantial generating plants are used solely to make off-system sales, then why are ratepayers paying for them? This is the point that Mr. Dauphinais made:

> If we ignore the fact the Company generates almost all the power it sells to its customers, and instead engage in the fiction that it sells all of its generated

[173] Dauphinais Direct, Ex. 508, p. 11, ll. 1-18.

> power to MISO as off-system sales and buys it back for its customers as purchased power:
>
>> The fuel and purchased power cost for power paid by customers would be equal to the wholesale market price for power -- not the Company's cost to produce power in its own generating units supplemented by occasional wholesale market purchases; and
>>
>> The entire output of the Company's generation facilities would be dedicated to the production of off-system sales -- not to serving the Company's customers.
>
> Under this scenario, the Company's accounting with the Commission would not assign any generation fuel costs to customers -- only purchased power costs would be assigned to customers. In addition, there would be grounds for the Commission to remove from the Company's rate base the entire net plant of the Company's generation facilities since those facilities would no longer be serving the Company's customers.

Fn (Obviously, if this was done, the fuel expenses, O&M expenses and off-system sales revenues associated with the Company's generation facilities would also be removed from rates.)[174]

The reality here is that Ameren Missouri is essentially selling to itself, and that is why it reports its MISO transactions on a net basis. That basis reflects the economic reality of the transactions. It is the economic reality that the General Assembly likely contemplated upon its passage of section 386.266 and that is why it addresses fuel. The economic reality is that utilities burn fuel to generate power to serve their load, not solely to make off-system sales. The economic reality is that sometimes utilities need more power than they can generate to serve their load. That is purchased power.

Contrary to Ameren Missouri's claim,[175] Mr. Dauphinais did more to rebut Ameren Missouri's position here than to simply, yet appropriately, label Ameren Missouri's position "absurd." Mr. Dauphinais explained that Ameren Missouri's position is absurd because it would

[174] Dauphinais Surrebuttal, Ex. 509, p. 8, ll. 7-21 (including fn).

[175] Ameren Missouri Br., pp. 96-97.

require the Commission to incorrectly assume that Ameren Missouri's generation is devoted entirely to making off-system sales, not serving Ameren Missouri's customers.[176] Mr. Dauphinais further explained that if Ameren Missouri's generation facilities were in fact entirely devoted to making off-system sales and not serving Ameren Missouri's customers, there would be grounds for the Commission to remove from Ameren Missouri's rate base the entire net plant of the Ameren Missouri's generation facilities since those facilities would no longer be serving Ameren Missouri's customers.[177] Mr. Dauphinais also explained that Ameren Missouri's contention that all of its generation production is devoted to off-system sales to MISO is also counter to Ameren Missouri's own accounting schedules in this proceeding.[178] He further noted that Ameren Missouri in its own comments to the Commission in the Commission's FAC rulemaking in Docket No. EX-2006-0472 admitted that it did not purchase power for all of its load, but instead purchased power to supplement the energy and capacity available from its own generation.[179] He walked through what FERC Order No. 668 requires with respect to hourly netting and why FERC requires it.[180] He also responded to Mr. Haro's rebuttal testimony arguments with respect to whether Ameren Missouri's direct testimony workpapers demonstrate that Ameren Missouri only supplies a small portion of its load from purchased power.[181] He also explained that he never suggested in his direct testimony that Ameren Missouri does not bid its load and offer its generation into the MISO market on a gross basis or that these items are not cleared on a gross basis on Ameren Missouri's MISO settlement statements. However, he also

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[176] Dauphinais Surrebuttal, Ex. 509, p. 8, ll. 6-18.

[177] *Id.*, p. 8, ll. 18-21.

[178] *Id.*, p. 9, ll. 1-13.

[179] *Id.*, p. 9, l. 14 – p. 10, l. 6.

[180] *Id.*, p. 10, ll. 7-22.

[181] *Id.*, p. 11, ll. 1-12.

made clear that this does not change the Order No. 668 requirement that Ameren Missouri either have an off-system sale or a power purchase, but not both, in each hour.[182] Finally, Mr. Dauphinais explained why Mr. Haro was incorrect in his rebuttal testimony with respect to certain language in the MISO Tariff.[183]

Ameren correctly notes that a variant of this issue was presented to this Commission in the last case, and the Commission found in Ameren Missouri's favor.[184] But even Ameren Missouri concedes, as it must, that the issue there is different than the issue here. Unlike the second time that Ameren Missouri asked that the Commission allow it an FAC after this Commission rejected its first attempt, the argument here is different than as presented in the last case.[185]

Last, Ameren Missouri argues that the subject transmission charges have always flowed through the FAC and thus should continue to do so.[186] But as explained in MIEC's Initial Brief, it is undisputed that the key charge at issue here, the Schedule 26-A charge, was not even incurred (or flowed through the FAC) until January 2012.[187] Significantly, however, as the Missouri Supreme Court cautioned in the *UCCM* case, past practice does not matter: "[i]t is for the legislature, not the PSC, to set the extent of the latter's jurisdiction. The mere fact that the commission has approved similar clauses in the past … is irrelevant if they are not permitted under our statute."[188]

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[182] *Id*., p. 11, ll. 13-19; Also, Tr. p. 2077, ll. 13-25; Tr. p. 2078, ll. 1-25; Tr. p. 2079, ll. 1-11.

[183] Dauphinais Surrebuttal, Ex. 509, p. 12, ll. 1-13.

[184] Ameren Missouri Br., p. 102.

[185] *Id*., p. 96.

[186] *Id*., p. 94.

[187] Haro testimony in ER-2012-0166, Tr. p. 1173, ll. 19-23 (Official Notice).

[188] 585 S.W.2d at 54.

## III. NORANDA RATE DESIGN

### A. The Commission Has Authority to Grant Noranda its Requested Relief Because the Rates Sought Are Allowed By Law

In its Initial Post-Hearing Brief, Ameren Missouri contends that the Commission lacks the legal authority necessary to grant Noranda the relief it is seeking, even if it "believes such action is warranted by the evidence in this case."[189] It cites as the basis of this contention the prohibition against "unduly discriminate rates," and judicial decisions that "forbid[] any difference in charge which is not based upon difference of service …."[190] Claiming that Noranda's proposed rate is "based solely upon [its] claim of what it can afford to pay," Ameren Missouri mischaracterizes the proposal as nothing more than "a large subsidy from other customers" that has "nothing to do with differences in the service Ameren Missouri provides to Noranda versus the service provided to other customers."[191]

Ameren Missouri's contentions misapply the law and mischaracterize the evidence that has been presented to the Commission in this case. The statutory limitation imposed upon a utility's rates under § 393.130 prohibits charging any "special rate" or obtaining "less compensation" for electricity than the utility charges other persons "*for doing a like and contemporaneous service … under the same or substantially similar circumstances or conditions.*"[192] The statute further prohibits an electrical corporation from granting "any *undue*

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[189] Ameren Missouri Br., p 161.

[190] *Id.* p. 157.

[191] *Id.* p. 158. Likewise, in its Initial Post-Hearing Brief, United for Missouri ("UFM") states that "[t]he customer's characteristics are not an adequate justification for a rate differential; such characteristics are indications of undue discrimination. … It does not matter that Noranda has a liquidity issue. Many other companies have liquidity issues. A distinction for Noranda would be undue discrimination. Any distinction made on the circumstances of the customer would be undue discrimination." UFM Br., pp. 7-8. This point serves to respond to the contentions in that brief as well.

[192] § 393.130.2 (emphasis added).

*or unreasonable* preference or advantage to any person," or subject any person to any "*undue or unreasonable* prejudice or disadvantage."[193]

These provisions do not demand absolute equality. Rather, they require only that ratepayers *in the same circumstances* be treated equally, and prohibit differences that are "undue and unreasonable."[194] Thus, discrimination as to rates is "not unlawful under the statute where it is based upon a reasonable classification corresponding to actual differences in the situation of the consumers or the furnishing of the service." *State ex rel. Missouri Office of Pub. Counsel v. Missouri Pub. Serv. Comm'n,* 782 S.W.2d 822, 825 (Mo. Ct. App. 1990). (*See also,* Priest's authoritative treatise on utility regulation: "As a practical matter a utility must fix different rates for different classes of customers. Undue discrimination can be avoided if like customers are classified alike and the classifications are not arbitrary and unreasonable.") *A. J. G. Priest, Principles of Public Utility Regulation*, 295 (1969).[195]

Thus, there are two distinct issues before the PSC in determining whether the rate proposed in the Nonunanimous Stipulation fits within the strictures imposed by law: (A) whether the "circumstances and conditions" relating to the service provided to Noranda are sufficiently different to allow it to be placed in a separate class from other ratepayers; and (B) whether the rate proposed in the Nonunanimous Stipulation for Noranda's class of ratepayers is "*unduly* preferential. " *State ex rel. The Laundry, Inc. et al. v. Pub. Serv. Comm'n*, 34 S.W.2d 37, 44 (Mo. 1931). Ameren Missouri conflates these two issues in arguing that the rate relief Noranda seeks cannot be approved "as a matter of law" because it is "justified solely by [Noranda's] own

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[193] § 393.130.3 (emphasis added).

[194] *Id.*

[195] See also, Scott Hempling, *Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction*, 288 (2013) ("The prohibition against undue discrimination distills to this golden rule: Treat similar customers similarly; dissimilar customers dissimilarly.").

business characteristics."[196] That contention does not just miss the mark as a legal matter, since the issue of whether a rate is unduly preferential is a question of fact to be determined by the Commission.[197] But when considered under the two-step analytical framework created by the statute, it is *also* clear that Ameren Missouri's contention is wrong on the facts as they have been established in this proceeding, and previously found by the PSC.

### 1. **Noranda's circumstances and conditions are so dissimilar from all other customers that it is within its own class.**

The first question before the Commission – whether Noranda may be charged for electricity at a rate that is different from other ratepayers – was answered in the affirmative by the Commission years ago, when it first created the Large Transmission Service Class of ratepayers. *See, e.g., In the Matter of the Application of Union Electric Company*, Order Approving Stipulation and Agreement, Case No. EA-2005-0180, p. 6 (accepting Ameren Missouri's argument that a separate tariff for Noranda was proper because of, among other things, Noranda's high load factor and the magnitude of its purchases); *see also In the Matter of Union Electric Company*, Report and Order, Case No. EC-2014-0224 pp. 81-82 (noting Noranda's unique circumstances and that it is the only consumer in its class). Moreover, in this proceeding both the Commission and Ameren Missouri have recognized that Noranda is in its own class. *See* Evidentiary Hearing, File No. ER-2014-0258, March 10, 2015, 2389:22 – 2390:3 (Noting that Chairman Kenny asked Ms. Tatro if Noranda is "the only one in their class currently, correct?", to which Ms. Tatro responded "They are, and I think that's appropriate because they are a very different customer than most customers.").

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[196] Ameren Missouri Br., pp. 158-159.

[197] *Office of Pub. Counsel*, 782 S.W.2d at 825 ("Whether a discrimination is unlawful and unjust or the circumstances are essentially dissimilar is usually a question of fact.").

It is clear from the evidence here that Noranda's high load factor and immense usage of power sets it apart from any other consumer in Ameren Missouri's service area. Noranda's aluminum smelter consumes as much power as the City of Springfield, Missouri and uses about 495 MW of power 98% of the hours in a year. The Missouri General Assembly has recognized that there are "highly unique circumstances of aluminum smelting facilities." [198] Because the "quantity of the service or commodity used has long justified different rate structures,"[199] Noranda has properly been placed in a class of its own.

**2. The proposed rate is just and reasonable.**

With respect to the second question before the Commission, Ameren Missouri argues that the different rate proposed in the Nonunanimous Stipulation is unduly preferential because it is based on nothing more than the financial problems of a particular customer. Although Noranda has established in this proceeding that it is in dire need of rate relief and that the New Madrid smelter faces a substantial risk of imminent closure if such relief is not granted, it is *not* claiming that the rate set forth in the Nonunanimous Stipulation should be approved based solely on its ability to pay. Instead, the justification for the proposed rate stands on several legs: (i) Noranda currently pays a substantial amount of Ameren Missouri's fixed costs,[200] (ii) should the New Madrid smelter close, the other ratepayers will pay many millions more per year for power[201], (iii) the proposed rate exceeds the incremental cost of providing service to Noranda,[202] (iv) upon approval of the proposed rate, Noranda would continue to contribute to the embedded costs of

[198] Section 91.026.6.

[199] *Priest* p. 288.

[200] Tr. p. 2261.

[201] Staff has advised the Commission that "should Noranda close its doors, Ameren Missouri's remaining customers would suffer a detriment of about $34 million on an annual basis." Staff Br., p. 101.

[202] Even the Staff believes the proposed rate is above the incremental cost of service. *See Staff Br.*, p. 102.

serving Ameren Missouri's load, and (v) as a result, approval of the proposed rate would benefit not just Noranda, but the other ratepayers as well.[203]

In its Initial Post-Hearing Brief, Staff stated its "position that, if the Commission finds that Noranda is experiencing a liquidity crisis such that is likely to cease operations … the Commission could lawfully grant a load retention rate to Noranda so long as the additional costs imposed thereby on Ameren Missouri's other customers are less than the additional costs they would experience if Noranda ceased operations."[204] Such a "load retention rate," according to Staff, although below cost of service, is nonetheless reasonable and non-discriminatory if it confers a commensurate benefit on other ratepayers and marginal costs are recovered."[205]

This Commission has previously rates that that reflect less than the fully embedded cost of service, including economic development and load retention rates[206]. The Commission has approved economic development rates that provide recovery of less than the fully embedded cost of service for many Missouri utility companies. In one such case, the Commission considered the validity of an economic development rider ("EDR") tariff that Office of Public Counsel

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[203] Brubaker Direct, Ex. 503, p. 43.

[204] Staff Br., p. 93.

[205] *Id.*

[206] Report and Order, *In the matter of a special contract filed by Kansas City Power & Light Company,* Case No. EO-95-181 at pages 19-20 ((November 22, 1995) (approving tariff sheet and special contract for the purpose of retaining load of customer with unique needs and finding "as long as the incremental costs of providing the service are covered by the pricing in the special contract and some contribution to fixed costs, the utility's customers benefit from the customer remaining on the system); Report and Order, *In the Matter of Kansas City Power & Light Company's Tariffs for Standby Service and Special Contracts*, Case No. ET-97-113 at pages 17-22 (June 13, 1997) (approving tariffs allowing discounted rate for economic development and load retention including, among other conditions, the requirement that the price be over the expected marginal cost economic development benefits to the area) Report and Order, *In the matter of Missouri Gas Energy's Tariff Sheets Designed to Increase Rates for Gas Service in the Company's Service Area*, Case no. GR-98-285 (approving special contract rate for customer retention on certain conditions including that the contract recovered variable costs plus a reasonable contribution to fixed costs).

asserted "would force residential and small customers to subsidize industry discounts."[207] The Commission rejected this argument and approved the EDR, noting that "a new customer will generate revenues and defray fixed costs" and in so doing, provide a benefit to the utility's shareholders and ratepayers.[208] In another case, the Commission approved a "Special Contract Service tariff" that authorized an electric utility company to negotiate special contracts with certain customers. The tariff required the utility to offer a price that would recover the "expected average marginal costs incurred" to serve the customers—but not the fully allocated embedded cost of service. The Commission expressly found that this tariff complied with the requirements of §§393.130, 393.140 and 393.150, RSMo 1996, and established "just and reasonable rates" that were not unduly discriminatory.[209]

Similarly, the Commission approved a water rate reflecting a 30 percent discount for an industrial consumer that was expanding its Missouri operations.[210] The Commission expressly found that "net benefits will accrue to the state" from the industrial consumer's expansion, "in the form of an increased annual payroll subject to income taxes and in the form of other benefits to [Missouri's] citizens."[211] The Commission found that despite the 30 percent discount, the special rate provided a reasonable contribution toward the water company's costs, and "this contribution will constitute a benefit to the other customers of the [water utility's] district

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[207] Report and Order, *In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Consolidate Rates and Implement a General Rate Increase for Natural Gas Service in Missouri Service Area of Atmos*, Case No. GR-2006-0387 (Feb. 22, 2007) at p. 38.

[208] *Id.*

[209] Report and Order, *In the Matter of Kansas City Power & Light Company's Tariffs for Standby Service and Special Contracts,* Case No. ET-97-113 (June 13, 1997).

[210] Order Approving Agreement, Granting Waiver of Tariff Provision and Approving Tariff, *In the Matter of the Application of Missouri-American Water Company for Approval of an Agreement with Nestle Purina PetCare for Retail Sale and Delivery of Water,* Case No. WO-2009-0043 (Sept. 3, 2008).

[211] *Id.*

because it will serve to reduce the revenue requirement of the district as a whole."[212] The Commission has also approved rates below full embedded cost of service for certain ratepayers for reasons other than economic development.[213] These cases illustrate that: (1) economic development and the economic impact of rates on consumers are valid considerations of the Commission in setting rates; and (2) the Commission is authorized to approve utility rates that do not reflect the full cost of providing service to a customer.[214]

Utility regulators in other jurisdictions have similarly recognized that the authority to set "just and reasonable" electric rates encompasses the prerogative to establish "load retention tariffs" for large industrial customers experiencing economic distress. The Louisiana Public Service Commission, for example, approved an agreement setting a tariff that would provide "economic retention credits or other discounted rates" for certain electric customers in order "to facilitate continued operation of [the customers'] facilities for the foreseeable future, thereby

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[212] *Id.*

[213] *State of Missouri ex rel. City of Joplin v. Public Service Commission,* 186 S.W.3d 290 (Mo. App. 2005), Report and Order on Second Remand, *In the Matter of Missouri-American Water Company's Tariff Sheets Designed to Implement General Rate Increase for Water and Sewer Service Provided to Customers in the Missouri Service Area of the Company,* Case No. WR-2000-281 (Dec. 4, 2007) (on second remand from the Court of Appeals, the Commission reiterated its approval of water rates that exceeded the cost of service for Joplin ratepayers, which it established for the purpose of subsidizing ratepayers in other districts).

[214] *See* Report and Order, *In the Matter of Missouri Gas Energy's Tariff Sheets Designed to Increase Rates for Gas Service in the Company's Service Area,* Case No. GR-96-285 (Jan. 22, 1997) (approving an EDR that allowed a 30 percent discount in rates and provided that other ratepayers would bear 25 percent of the cost of this discount); Order Concerning Agreement and Tariffs, Application to Intervene, and Motions to Suspend Tariffs, *In the Matter of the Application of Missouri-American Water Company for Approval of an Agreement with Premium Pork, L.L.C., for the Retail Sale and Delivery of Water,* Case No. WT-2004-0192 (Nov. 20, 2003) (approving a 30 percent discount for Premium Pork LLC under Missouri-American's EDR); Report and Order, *In the matter of St. Joseph Light & Power Company's proposed tariffs to increase rates for electric service provided to customers in the Missouri service area of the Company,* Case No. ER-93-41 (June 25, 1993) (noting that the EDR proposed by SJLP "is similar to economic development riders granted to other utilities. The purpose of the economic development rider is to encourage economic development. . . ."); Report and Order, *In the Matter of Missouri Public Service, a Division of Utilicorp United Inc.'s Tariff Designed to Increase Rates for Electric Service to Customers in the Missouri Service Area of the Company, et al.,* Case Nos. ER-97-394, ET-98-103 and EC-98-126 (March 6, 1998) (concluding that the EDR proposed by UtiliCorp "is of benefit to the state of Missouri and the ratepayers.")

retaining their associated employment and tax benefits."[215] The Louisiana Commission noted that "[t]he base revenue contributions of these customers also serve to mitigate the base rate increases to other retail customers."[216]

Similarly, the North Carolina Utilities Commission approved rates slightly above incremental cost to a major electricity consumer in *In Re Carolina Power and Light Company*, 151 P.U.R.4th 180 (N.C.U.C. 1994). There, DuPont had a high load factor and constituted approximately 14% of CP&L's revenues. The commission upheld the rates because, *inter alia*, "the proposed rate covers CP&L's incremental cost of providing service and makes a contribution to CP&L's fixed costs, including a return on common equity."[217] Likewise, in *Re Burlington Electric Light & Power Co.*, PUR 1915B, 117, 133 (Wisc. R.R. Comm'n 1915), the Commission rejected an argument that a certain contract should be abrogated, finding that "[i]nasmuch as this particular company at times has consumed more than one third of the entire sales of the utility, such a loss would materially affect the operation expenses so as to result in necessary increases in rates to the remaining consumers. Where such a condition is the result of loss of business, the allowance of a rate differential in order to retain the same may be justified."

In *In Re Pub. Serv. Co. of Colo.*, P.U.R.1929D 342, 345 (Colo. P.U.C. 1929) the Colorado Public Utilities Commission approved below-cost rates for smelters and mines, where the lower rates were necessary to "insure that these customers could keep on operating" because even though other customers would have to effectively subsidize the smelters, it was in the

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[215] *Approval of Agreement for Electric Service by and between Cleco Power LLC and Boise Packaging & Newsprint, L.L.C., DeRidder, LA,* Special Order No. 50-2010 (Louisiana Public Service Comm'n, October 14, 2009).

[216] *Id., see also In the Matter of the Public Utilities Act, et al.,* Case Nos. NSUARB-NSPI-P-892, NSPI-P-202 and 2011 NSUARB 184 (Nova Scotia Utility and Review Board, Nov. 29, 2011) (concluding that the Board had jurisdiction to create a "load retention tariff" or "LRT," under statutory authority similar to the Missouri Public Service Law, and noting that "the establishment of an LRT based on economic distress is grounded on long-established and well accepted ratemaking principles applied in various jurisdictions. . . .").

[217] *CP&L*, 141 P.U.R.4th 180.

public interest.[218] The Commission reasoned that "utility acts generally throughout the United States … prohibit *unreasonable* or *undue* discrimination and preference. Unless the discrimination is unreasonable, it is not unlawful."[219] It went on to observe that lower rates to large consumers can at times be in the public interest because "there are certain fixed charges which a utility has and that if … large customers are lost the remaining consumers will have to bear not only all of the fixed charges but also the small profit that the utility may earn in serving the large customers; that therefore, the smaller customers, instead of suffering from the lower rates to the larger ones, are benefited thereby."[220]

Thus, there is abundant precedent around the country to support the approval of a "load retention rate" where – as here -- a uniquely large consumer would otherwise drop out of the rate base, and the rate is set at a level that will benefit the other ratepayers with some continuing contribution to fixed costs.[221] This approach is also consistent with established and generally accepted regulatory principles. In his authoritative treatise on Public Utility Rates, James C. Bonbright observes that all customers may benefit where "low rates are granted for types or quantities of service which could not otherwise be attracted, but which will make some contribution to total revenue requirements over and above mere incremental costs."[222] Far from condemning this practice, or asserting that it is unlawful or bad public policy, Bonbright

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[218] *Id.* pp. 345, 352 (quotation marks removed).

[219] *Id.* p. 346.

[220] *Id.* p. 348.

[221] *See In Re Public Service Company of Colorado,* P.U.R. 1929D at 348-351 (detailing and quoting from a number of cases in which commissions have followed this maxim).

[222] Bonbright, Danielson & Kamerschen, *Principles of Public Utility Rates (2d ed. 1988) p. 531.*

acknowledges that this approach may serve the public interest.[223] The rate relief requested by Noranda is consistent with the principles set out in this treatise.[224]

*The Laundry, Inc.*[225] is not to the contrary. In that case the "single issue" was whether laundries that use more than 500,000 gallons of water per month "should be classified as manufacturers under this provision of the scheduled rates so as to receive the manufacturers' rate." [226] As a matter of statutory construction, the Court found that laundries were so similar to manufacturers that they had to receive the same rate. In doing so, it rejected the rationale the utility put forward in support of the rate differential – that the numerous employees of factories will live in the area and pay retail water rates -- because it "rests solely upon a possible pecuniary advantage to the water company, in which the various customers and patrons of the water company, at most, are only indirectly and remotely concerned."[227] Such considerations are wholly unlike those before the Commission in this case.

## B. <u>Noranda's Proposed Rate Would Benefit Ratepayers Because It Covers the Incremental Cost of Serving Noranda and Contributes to Ameren Missouri's Fixed Costs to the Benefit of All Ameren Missouri Ratepayers.</u>

### 1. <u>Introduction</u>

The initial briefs of OPC, CCM, DOE, and the MRA support Noranda's stipulated rate request at $34/MWh with the terms and conditions set forth in the nonunanimous stipulation. Obviously, those parties conclude that ratepayers (all ratepayers in the case of the OPC and DOE, residential ratepayers in the case of CCM, and retailer ratepayers in the case of the MRA) are better off with Noranda remaining a customer of Ameren Missouri at an initial rate of

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[223] *Id. at 532*

[224] *Id.*

[225] *See* supra.

[226] *The Laundry, Inc.*, 34 S.W.2d at 40 (parentheses omitted).

[227] *Id.* at 44.

$34/MWh than with Noranda shutting down its smelter. Likewise, the other members of the MIEC support the same conclusion.[228]

These customer groups represent the vast majority of consumers who will be affected by the outcome of this case. The OPC represents all customers in this matter, the Missouri Retailers Association represents small commercial and large commercial customers, the Consumers' Council represents residential and low-income customers, and the Missouri Industrial Energy Consumers represents industrial customers including the majority of Ameren Missouri's industrial usage, among them Anheuser-Busch, Boeing, Monsanto, General Motors and other manufacturers that form the backbone of Missouri's economy. The MIEC companies directly employ over 50,000 Missouri residents, and indirectly employ three times this many Missourians, serve as the base for industrial and retail activity throughout the State). That the OPC and these groups are signatories is compelling evidence of the ultimate reasonableness of the Nonunanimous Stipulation.[229]

Staff, while taking no position on whether Noranda needs rate relief,[230] agrees that "[u]nder test year conditions, at a rate of $32.50[/MWh] with no participation in the FAC, the rates for Ameren Missouri's other ratepayers would be *lower* if Noranda remains on Ameren Missouri's system, than if Noranda ceased service with Ameren Missouri."[231] Obviously,

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[228] Noranda is part of the MIEC and the MIEC's initial brief makes this point clearly. *See also* the testimony of Steven Spinner, Chairman of the MIEC, Tr. p. 2669, l. 23 – p. 2670, l. 11.

[229] The MECG and WalMart were deeply involved in the negotiations of the Nonunanimous Stipulation. Tr. p. 2582 ll. 17-24; Tr. p. 2324 ll. 17-19. Oddly, both parties engaged in extensive negotiations with the signatories for many days prior to its filing, but then suddenly and unexpectedly decided to oppose the Nonunanimous Stipulation on the day before the signatories had agreed to file the document. Both MECG and Walmart specifically negotiated and provided much of the specific language in the Nonunanimous Stipulation, and drafted some of the very terms of the Nonunanimous Stipulation which they now intensely criticize.

[230] Staff does admit that competent and substantial evidence exists to support Noranda's assertion of need (while also noting that the evidence could support a contrary finding). *See* Staff Initial Brief, pp. 92-93.

[231] Staff Br., p. 94 (relying on Sarah Kliethermes testimony). (emphasis original). MIEC notes that Staff calculated a number of different incremental costs at Noranda's meter. The most recent of those calculations was

assuming that the Noranda smelter remains viable at $34/MWh, the rates for Ameren Missouri's other customers would be even lower still at a $34/MWh rate for Noranda. Additionally, Staff noted that "[a] load retention rate, although below cost of service, is nonetheless reasonable and non-discriminatory if it confers a commensurate benefit on other ratepayers and marginal costs are recovered."[232] In other words, a load retention rate is legal if the rate is above the incremental cost to serve.

Like Staff, Walmart takes no position on whether Noranda needs rate relief.[233] While it acknowledges that "the specific and extraordinary circumstances of this docket warrant the Commission's consideration of whether movement away from cost-based rates for Noranda is in the public interest"[234] and that "Walmart does not oppose granting some rate relief for Noranda,"[235] it notes that rate relief should follow the specific conditions outlined in Steve Chriss' testimony under an economic development rider.[236] Walmart acknowledges that Noranda's estimates "of the annual revenue requirement of impact of the lost smelter load" exceed "Noranda's stated impact of [its] proposed relief." Nevertheless, because of Ameren Missouri's likely rate increase in this case, Walmart states that it is "unclear whether the lost load impact exceeds the cost of Noranda's proposed relief."[237]

Ameren Missouri, unlike the other parties in this case, believes that the incremental cost of power for Noranda should be measured by forward energy and capacity prices rather than

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$28.29/MWh at the Noranda meter based upon an updated fuel run (a figure similar to the figures calculated by Mr. Dauphinais: $28.03/MWh and $29.39/MWh).

[232] Staff Br., p. 93, (citing *Public Service Co. of Colorado v. Trigen-Nations Energy Co. L.L.L.P.*, 982 P. 2d 316, 323 (Colo., 1999).

[233] Walmart Br., p. 15.

[234] *Id*. at 16.

[235] *Id*.

[236] *Id*. at 21 – 22 (citing Chriss Rebuttal, Ex. 752, p. 15, l. 1 – p. 16, l. 1).

[237] *Id*. at 21 (citing Chriss Rebuttal, Ex. 752, p. 10, ll. 3 – p. 10).

historical figures.[238] Ameren Missouri, predictably, argues that both Noranda's rate request of a $32.50/MWh initial rate, with one percent annual increases <u>over a seven-year period</u>, and its stipulated rate request of a $34/MWh initial rate, with one-half of each average rate increase in each rate case <u>over a ten-year period</u>, provide no long term benefit to ratepayers versus Noranda closing its smelter.[239]

The MECG, while calling no witnesses on this issue (or on any issue for that matter), supports Ameren Missouri's opposition.[240] MECG focuses on one historical incremental cost calculation, one that Mr. Brubaker says that "everybody else has already concluded isn't representative,"[241] to argue that there is "only a slight benefit to customers associated [with the $34/MWh rate in the Stipulation]."[242] MECG then argues that the slight benefit is lost after allocating to other ratepayers Noranda's share of any rate increase ordered in this case. MECG's arguments fail for the same reason that Ameren Missouri's do.

The following parts of this section will thus reply to Ameren Missouri's and MECG's arguments.[243]

### 2. <u>Ameren Missouri's Arguments Should be Rejected</u>

Ameren Missouri claims that both Noranda's rate request of a $32.50/MWh initial rate, with one percent annual increases <u>over a seven-year period</u>, and its stipulated rate request of a $34/MWh initial rate, with one-half of each average rate increase in each rate case <u>over a ten-year period</u>, provide no <u>long-term</u> benefit to ratepayers versus Noranda closing its smelter.[244]

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[238] Ameren Missouri Br., pp. 183-184.

[239] Ameren Missouri Br., pp. 182-187.

[240] MECG Br., pp. 73-79.

[241] Brubaker testimony, Tr. p. 2775, ll. 4-21.

[242] MECG Br., p. 74.

[243] The MIEC notes that UFM, the Cities of O'Fallon and Ballwin, and the Sierra Club did not brief this issue.

[244] Ameren Missouri Br., pp. 182-187.

But Ameren Missouri's opinion in that regard is largely tempered by its seven-year or ten-year long-term projections of energy prices and capacity charges, each of which Mr. Dauphinais and Mr. Phillips took issue.[245]

Ameren witness Matt Michels opined, contrary to the other witnesses who testified on this issue, that forward market prices should be used to establish the incremental cost of power for a Noranda load retention rate.[246] Mr. Michels then used outdated data to project future incremental costs of power over a seven-year period. He concluded that over a seven-year period, ratepayers would be better off if Noranda closed the smelter.[247] Ameren Missouri and MECG note this in their respective briefs. However, they fail to note that Mr. Michels admitted that he calculated an incremental cost of power for Noranda, using forward power prices, for the period June 2015 through May 2016, of ** ______ **/MWh, and for the period June 2016 through May 2017, ** ______ **/MWh.[248] These figures are below $34/MWh (and $32.50/MWh) for those time periods. Ameren Missouri also fails to note that Mr. Michels used outdated information to perform his forward incremental cost calculation. Mr. Phillips and Mr. Dauphinais noted these flaws in Mr. Michels' analysis, noted that energy prices had declined since Mr. Michels ran his analysis in EC-2014-0224, and noted that his forward energy prices had hedge premiums included.[249] Contrary to Ameren Missouri's assertion in its Initial Brief, Mr. Dauphinais did in fact calculate the forward incremental cost for serving Noranda.[250] After making the proper adjustments to the forward energy and capacity prices, Mr. Dauphinais

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[245] Phillips Surrebuttal, Ex. 516, p. 7, l. 19 – p. 18, l. 19; Dauphinais Surrebuttal, Ex. 509, p. 20, l. 17 – p. 25, l. 18.

[246] Michels Amended Rebuttal, Ex. 26, p. 22, ll. 16-18.

[247] *Id.*, p. 29, ll. 3-5.

[248] Michels testimony, Tr. p. 2946, ll. 6-18.

[249] Phillips Surrebuttal, Ex. 516, p. 7, l. 19 – p. 18, l. 19; Dauphinais Surrebuttal, Ex. 509, p. 20, l. 17 – p. 25, l. 18.

[250] Ameren Missouri Initial Brief, p. 183 (although on the next page of its brief, Ameren Missouri admits that Mr. Dauphinais did run such forward analysis).

estimated that the seven-year average forward incremental cost to serve Noranda was **______**/MWh.[251] That compares to a stipulated starting price of $34/MWh that will increase many times during the multiple rate cases likely to be filed over that seven-year period.

Because Ameren Missouri's analysis and criticisms focus on impacts many years out, both Mr. Brubaker and Mr. Dauphinais noted that this Commission cannot bind future commissions and that, as a practical matter, Noranda's rate can be re-determined every rate case (about every 18 months). Ameren Missouri does not dispute that this Commission can alter Noranda's rate in every future rate case, or more often, but dismisses that protection because relief that will be reviewed in each rate case "cannot offer the long-term, stable rate [Noranda] claims it needs to address its alleged financial problems."[252] So Ameren Missouri would have this Commission deny rate relief to Noranda entirely, for any period of time, even periods where all parties now agree that the incremental cost of power is less than $34/MWh (for instance from June 2015 through May 2017), because the Commission might later determine that it would have to raise Noranda's rate and that would cause rate shock. As Noranda has made abundantly clear in this proceeding, any rate relief is better than no rate relief. Ameren Missouri, like the MECG, offers this Commission false choices. It is not simply whatever Noranda's position in direct testimony, or its position in the stipulation, must be accepted. The question before this Commission is what rate relief for Noranda, if any, is just and reasonable. That question is similar to the underlying question of what relief in the form of a base rate increase for Ameren Missouri, if any, is just and reasonable. No party claims that if Ameren Missouri fails to show that it is entitled to the full relief requested, then it is entitled to no relief at all.

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[251] Dauphinais Surrebuttal, Ex. 509, p. 25, ll. 1-18.

[252] Ameren Missouri Br., p. 184.



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Last, Ameren Missouri argues that periodic review of Noranda's rate is ineffective because the Commission would be unable to raise Noranda's rate sufficiently if warranted because of the possible consequent "rate shock" to Noranda.[253] Indeed, Ameren Missouri cites this Commission's order in Case No. EC-2014-0224 that "[c]learly, Noranda would not be willing, or able, to withstand a 34 percent rate increase in year eleven to return to cost-based rates."[254] But Noranda has been clear that it is willing to accept whatever reasonable terms this Commission may impose on rate relief. Moreover, whether it is or is not able to withstand a significant rate increase later should be no basis for denying it rate relief now, since it is currently unable to withstand its present rate. Relief, even for a shorter term than would be optimal, is better for Noranda, and ratepayers, than no relief at all.

**3. MECG's Arguments Should be Rejected**

Most of MECG's arguments are addressed above. In MECG's zeal to find fault with the Noranda analysis, MECG takes testimony of Mr. Michels completely out of context on page 77 of its brief. In the quoted testimony, Michels Amended Rebuttal, at pages 27-28, Michels addressed Mr. Dauphinais' market price suppression adjustment for the price of power should Noranda close its plant. Both Mr. Dauphinais and Mr. Michels agreed that the loss of demand from a major purchaser like Noranda would cause the price for power to drop, although they differed on the degree of the price drop. The quote set forth on page 77 of the MECG brief addressed modeling that Michels recommended for a more exacting calculation of the power price impact from closure. Contrary to the assertion by the MECG, that testimony did not address the "testing of the rates under any Noranda proposal against 'future expectation of the market,'" as MECG claims.

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[253] Ameren Missouri Br., p. 184.

[254] *Id.*, quoting from the Report & Order at page 15, par. 34.

However, one of MECG's arguments deserves separate attention. MECG maintains that some of its members belonging to the LPS class (like many of the MIEC members) will hardly benefit, even in the short term, if Noranda receives an initial $34/MWh rate versus a smelter closure.[255] MECG relies on Exhibit 534 for that argument. Mr. Brubaker prepared that exhibit to explain the impacts to the various classes of $34/MWh rate relief versus the $32.50/MWh rate relief requested in Direct testimony. On the page marked Schedule MEB-COS-8 of that exhibit ("page 3"), he compared the cost to ratepayers generally, <u>and not by class</u>, from smelter closure at three different calculated incremental costs of power. He maintained that the first or second columns of figures should be used and that the third column results from an incremental cost calculation that "everybody else has already concluded isn't representative."[256] The impact of smelter closure to consumers generally under columns one and two is 2.16 percent and 1.95 percent, respectively. The impact of smelter closure to consumers generally under column three – the calculation that is not "representative" -- is 1.58 percent.[257] Then on the page marked Schedule MEB-COS-9 $34 (1 of 2)("page 4"), Mr. Brubaker sets out the impact to ratepayers of a $34/MWh rate versus Noranda's current rate. He shows the ratepayer impact collectively for all ratepayers, <u>but also by ratepayer class</u>. The impact generally, and not by class, is 1.23 percent, which is lower than any of the above calculated impacts of smelter closure from page 3. However, on page 4 Mr. Brubaker also calculated the impact of the $34/MWh rate <u>by class</u>. The LPS class would see a 1.50 percent impact. MECG, comparing the general <u>not-by-class</u> impact of smelter closure under the non-representative incremental cost calculation on page 3 to the <u>specific by-class</u> impact of the $34/MWh rate to the LPS class concludes that for the LPS class

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[255] MECG Br., p. 74.

[256] Brubaker testimony, Tr. p. 2775, ll. 4-21.

[257] Exhibit 534, Schedule MEB-COS-8.

there is "only a slight benefit to customers associated [with the $34/MWh rate in the Stipulation]."[258]

MECG's reasoning is flawed for two reasons. First, the better calculations of rate impact from smelter closure are 2.16 percent or 1.95 percent, each of which is comfortably above the $34/MWh rate impact (1.50 percent) to the LPS class. Second, nothing on page 3 indicates that the general impact to all classes collectively shown therein is the same for each class, an assumption that the MECG apparently makes. To make a proper comparison to the individual class numbers on page 3 of the exhibit, it would be necessary to make assumptions about how the revenue loss from a smelter shut-down would be distributed to each customer class. If it is assumed that revenue loss would be distributed in the same proportions depicted for Noranda's rate proposal in this case, shown on page 4, then the overall increase to the LPS class under the shut-down scenario could be estimated by multiplying the ratio of 1.50% to 1.23% (1.22 times), shown on page 3, by the overall average increases shown on page 4. The result would be an estimated LPS percentage increase under the smelter shut-down scenario of 2.64% under the 36-month average in column 1, 2.3% under the 36-month scenario shown in column 2, and 1.93% under the inappropriate 48-month average with polar vortex shown in column 3 (these are the columns shown on page 3).

In summary, MECG not only uses the wrong numbers for calculating impacts, but inappropriately applies the results by making an apples-to-oranges comparison of overall impacts in the shut-down scenario to individual class impacts in the reduced-rate scenario. As noted above, MECG's comparisons are flawed for numerous reasons, and the conclusions drawn by MECG are erroneous and entitled to no consideration.

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[258] MECG Br., p. 74.

Because the impact to the LPS class, including some MECG members, from smelter closure is significantly more than 1.58 percent (either 2.64, 2.3, or 1.93 percent), picking up Noranda's share of any likely rate increase awarded in this case will not turn the benefit of the $34/MWh load retention rate negative for the LPS class. If the MECG's contention were true, the MIEC members, many of whom are in the LPS class and have been represented by many of the technical expert witnesses in this case (including Mr. Brubaker, the author of Exhibit 534), would not have stipulated to the $34/MWh rate. Moreover, as shown on page 4, all of the other classes, particularly the residential class, see even greater benefits from keeping the smelter as a customer.

**C. <u>The Smelter Cannot Be Sustained Without Power Rate Relief</u>**

The overwhelming and substantial evidence presented in this case demonstrates that without Noranda's proposed power rate, the smelter is not viable and faces substantial risk of imminent closure. In particular, the evidence demonstrates that:

- Noranda is facing a severe financial crisis as confirmed by the recent downgrade by Moody's;
- Noranda's use of scenarios to stress-test its financial outlook is consistent with what lenders will employ when considering any refinancing of Noranda's debt;
- Without Noranda's proposed power rate, its cash flow is insufficient to pay its routine operating expenses or to support the necessary refinancing of its debt; and,
- Noranda has disclosed the risks of its financial situation to the public, including the possible closure of the smelter.

As a result of existing high power costs, Noranda has relied on its asset based loan ("ABL") to sustain its business – the equivalent of paying for basic operations using a credit

card. The ABL matures in February 2017, and additional borrowings mature in 2019. These loans must be refinanced. However, without the rate relief necessary to generate positive cash flows and liquidity, there is substantial risk that Noranda will be unable to refinance the smelter, will run out of cash, and the smelter faces substantial risk of imminent closure.

The initial briefs of OPC, CCM and the MRA generally support Noranda's position that it has a liquidity crisis, that it will be unable to refinance its debt absent rate relief, and that without power rate relief, there is substantial risk of imminent smelter closure.[259] Staff takes no position on whether Noranda has a liquidity crisis, and Wal-Mart takes no position on whether Noranda needs power rate relief.[260] Ameren Missouri and MECG oppose Noranda's request for power rate relief. In this reply, Noranda addresses arguments raised by Ameren Missouri and MECG.[261]

**1. Noranda's Need to Refinance in 2017 and 2019**

Noranda is experiencing a significant financial crisis that, if not properly and promptly addressed, threatens imminent closure of its smelter. For the smelter to remain open and viable, its power rate must be reduced. Noranda must start the process now to refinance debt coming due in 2017 and 2019. Without a sustainable power rate, Noranda will not have the necessary positive liquidity and cash flow to secure that refinancing, will run of cash, and it will have to close the smelter.[262] Contrary to MECG's bald assertions, these facts are not exaggerated

[259] OPC Br., pp. 41-42; CCM Br., p. 12; MRA Br., p. 2.

[260] Staff Br., p. 92-93; Wal-Mart Br., p. 15.

[261] UFM, the Cities of O'Fallon and Ballwin, and the Sierra Club did not take any position on Noranda's request.

[262] Boyles Direct, Ex. 600, pp. 20-21.

"claims of doom and gloom."[263] Nor are they a cry of "[w]olf" as suggested by Ameren Missouri.[264] They are the reality faced by Noranda.

**(a) Loans Come Due in 2017 and 2019**

Noranda has repeatedly accessed its ABL since June 2014 in order to meet its daily obligations. The ABL comes due in February 2017, and Noranda must start the process of replacing the ABL at the beginning of 2016.[265] Noranda also has a large amount of long-term debt, or what some call a mortgage, that comes due in 2019. Assuming that Noranda is viable and able to refinance its ABL, it expects to begin to replace its remaining long-term debt in early 2018.[266]

If Noranda is unable to renew the ABL or the long-term debt, or is only able to renew parts of this debt, Noranda's liquidity will immediately decline and its viability as a company will be immediately threatened and compromised.[267] Neither Ameren Missouri nor MECG addressed this fact in their briefs.

**(b) The Rod Mill Project**

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263 MECG Br, pp. 54, 80.

264 Ameren Missouri Br, p. 164.

265 Boyles Direct, Ex. 600, pp. 21-22; Smith Surrebuttal, Ex. 612, pp. 5-6.

266 Boyles Direct, Ex. 600, pp. 22-23.

267 Boyles Direct, Ex. 600, pp. 21-22; Smith Surrebuttal, Ex. 612, pp. 5-6.

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______________________________________________ ** Understandably, neither Ameren Missouri nor MECG addressed this fact in their briefs.

**2. Noranda Needs A Sustainable Power Rate to Refinance its Debt**

As Boyles[269] testified, potential lenders rely heavily on a borrower's ability to liquidate collateral to repay a loan, and they are unwilling to extend or refinance existing debt when they perceive a meaningful risk of default and a lack of viability on the part of the borrower. Lenders also look at a company's historical results. Therefore, it is critical that, when it undertakes its refinancing efforts, Noranda have much better cash flows for 2015, 2016 and 2017, and much better projected cash flows for 2018 through 2022. The only way to achieve these positive cash flows is a viable power rate for the smelter.[270]

As Schwartz[271] explained, both Moody's and Standard & Poor's recently downgraded Noranda's credit rating to a "highly speculative" grade of risk.[272] Standard & Poor's pointed to Noranda's liquidity issues and declining operating performance as important factors behind its rating decrease.[273] What makes this particularly problematic is that Noranda was already starting from a junk credit rating. A lower credit rating signals to lenders that there are doubts about the borrower's credit-worthiness. As a result, potential lenders will look skeptically at any optimistic business scenarios presented by Noranda, and they will look at the sensitivity of

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[268] Boyles Direct, Ex. 600, p. 21; Smith Testimony, Tr. pp. 2424-2428.

[269] Boyles is the Chief Financial Officer of Noranda.

[270] Boyles Direct, Ex. 600, pp. 22-23.

[271] Schwartz is an economist and Managing Director at Alvarez & Marsal Global Forensics and Disputes.

[272] *Research Update: Noranda Aluminum Holding Corp. Rating Lowered To 'B-' From 'B'; Outlook Is Stable;* pp. 2-3 Rationale; Oct 13, 2014.

[273] Schwartz Direct, Ex. 610, p. 11.

performance forecasts to changing assumptions.[274] Neither Ameren Missouri nor MECG addressed these undisputed facts in their briefs.

As Harris[275] concluded, Noranda will be unable to raise new capital or secure a loan without first fundamentally improving its cash flow and thereby demonstrating its long-term viability. Potential lenders simply will not invest in a company with Noranda's financial metrics, particularly where they perceive a meaningful risk of financial distress and impairment in long-term viability.[276] He observed that the current drain on cash flow caused by Noranda's unsustainable power rate means it is not attractive to banks or debt investors.[277] With the proposed power rate yielding over $40 million in cost savings annually, however, Harris testified that Noranda would likely be able to refinance its ABL and other indebtedness as well as obtain financing for its important projects in the future.[278] Neither Ameren Missouri nor MECG addressed these facts in their briefs.

## D. Noranda's Financial Condition is Precarious

### 1. Liquidity

Noranda needs a minimum of ** ________ ** in liquidity to have sufficient cash for its operations. Even at this minimum level, Noranda is still borrowing from its ABL to meet its daily obligations. As a result, the target liquidity needed for Noranda to remain a competitive Smelter is at least ** ___________ ** Neither Ameren Missouri nor MECG challenged these facts in their briefs.

[274] Schwartz Direct, Ex. 610, pp. 13-15.

[275] Harris is a banker who specializes in leveraged financing.

[276] Harris Direct, Ex. 604, pp. 4-5.

[277] Harris Direct, Ex. 604, p. 6.

[278] Harris Direct, Ex. 604, pp. 7-8.

[279] Boyles Direct, Ex. 600, pp. 6-7; Smith Testimony, Tr. p. 2409.

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** ______________________________________ **

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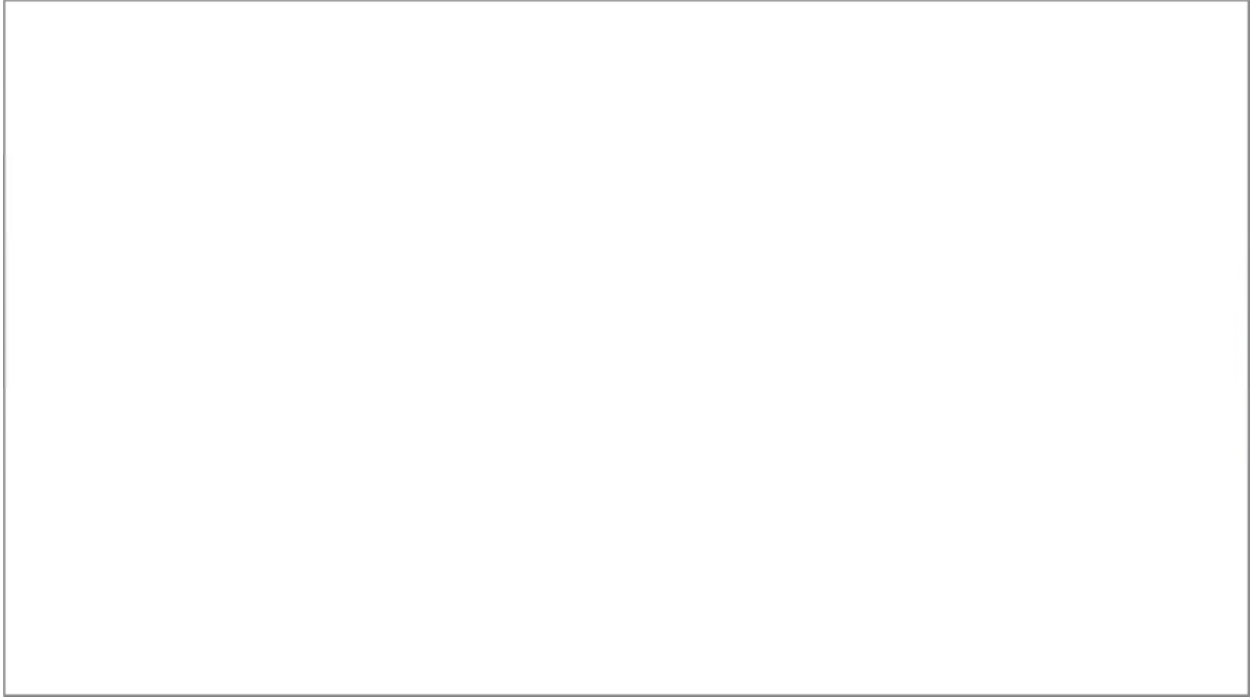

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In response, MECG suggests that Noranda's liquidity is "stable" although it "decreased slightly" by $25 million from September 30 to December 31, 2014.[281] ** __________

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[280] Ex. 532; Smith Testimony, Tr. pp. 2464-2466.

[281] MECG Br., pp. 54-55.

[282] Boyles Testimony, Tr. 2646-2647.

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______________________________ ** Neither Ameren Missouri nor MECG addressed this fact in their briefs.

**2. Noranda's Cash Flows and Thin Margins**

As Schwartz testified, Noranda's cash flow is precarious. Over the last three years, Noranda has drained cash from its cash balances. When it added cash, Noranda has done so only through financing and not from revenue generated from the sale of aluminum. Its operating cash flow is insufficient. Specifically, cash from operations has fallen from over $270 million in 2010 to just above $64 million in 2013. In fact, Noranda's cash balances would have dropped even further but for its borrowings in 2012 and 2013.[284] Neither Ameren Missouri nor MECG addressed this fact in their briefs.

Complicating the picture, Schwartz explained that Noranda operates on generally thin margins at the smelter. There is little Noranda can do to affect the LME price of aluminum and its price tends to be driven down to costs. Thus, any increase in the cost of power that impacts Noranda -- but not its competitors -- puts Noranda in an economically disadvantageous position. Noranda finds itself in that very position as its rising power costs erode its margins, which are already thin.[285] Neither Ameren Missouri nor MECG addressed this fact in their briefs.

Rather than address these concerns, MECG suggests that Noranda was willing in an earlier rate case to agree to a rate increase when its liquidity level was about the same as today.[286] What Noranda was willing to do in the past in order to amicably resolve a contested matter in which there was a risk of an even higher power rate is not relevant to the present case. At that time, Noranda was not faced with debt maturing in 2017 and 2019, or with liquidity and

[283] Smith Testimony, Tr. pp. 2466-2471.

[284] Schwartz Direct, Ex. 610, pp. 10-12.

[285] Schwartz Direct, Ex. 610, pp. 7-8.

[286] MECG Br., pp. 9-10; 52; 59-60.

cash flows insufficient to justify a refinancing of that debt and threatening the closure of the smelter.[287]

## E. Lenders Will Stress-Test Noranda's Financial Outlook Rely and Will Not Rely On the CRU Forecast When They are Asked to Refinance the Debt

Ameren Missouri and MECG argue that the Commission should look only at the CRU price forecast for aluminum and that the smelter will survive.[288] At best, as Pratt[289] testified and even Humphreys[290] agreed, these forecasts provide some guidance up to 12 months into the future. They do not provide reasonable guidance upon which lenders will rely with regard to potential aluminum prices two to five years into the future because of the price volatility in the marketplace. As a result, any argument that Noranda will survive based on the CRU forecast is misguided, risks the closure of the smelter, imperils the livelihoods of Noranda's 880 employees and their families, and risks even higher power rates for Ameren Missouri's other ratepayers than if Noranda's rate relief is granted.

### 1. Great Volatility in the Aluminum Marketplace

As Pratt testified, aluminum prices are highly volatile. While aluminum price forecasts like CRU provide a reasonable starting point for evaluating the future, they are not sufficient to evaluate future risks and, therefore, do not provide a reliable basis to assess the sustainability of a smelter.[291]

As Smith explained, the viability of any business refers to its ability to survive over the course of the business cycle. This issue is particularly acute for Noranda because of the extreme

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[287] Smith Testimony, Tr. p. 2418.

[288] Ameren Missouri Br., p. 164; MECG Br., p. 63.

[289] Pratt is a Managing Consultant of CRU, and is Director of is Valuation Practice Area.

[290] Humphreys testified that he future price of aluminum cannot be known "with any certainty," aluminum prices are volatile year to year, and endorsed much of the testimony provided by Pratt. Humphrey's Rebuttal, Ex 19, pp. 6, 10.

[291] Pratt Direct, Ex. 608, p. 2.

volatility and the steep troughs of an aluminum pricing cycle. If Noranda cannot generate sufficient cash and profits when prices are above cycle average, it will not be able to survive during the periods when prices are below cycle average.[292] Neither Ameren Missouri nor MECG addressed these facts in their briefs.

Instead, Ameren Missouri and MECG point to the CRU forecast and suggest Noranda should simply use those assumptions and its smelter will survive. They are wrong. As Harris testified, when a Chief Financial Officer budgets and plans, particularly in relation to a company's very ability to refinance its debt and remain viable in the long-term, it is prudent to be conservative. Likewise, when lenders evaluate a lender's credit-worthiness, they will discount any assumptions they see as overly rosy or aggressive, and give more credibility to a financing base case with more conservative assumptions.[293] As a result, an aluminum business cannot assume that the average price of aluminum like that provided by CRU will prevail into the future given extreme price volatility. Rather, volatility must be tested explicitly to identify risk. Noranda has a personal responsibility to keep the smelter operational and to make it viable. Therefore, Noranda must take into account the volatility of the aluminum price in planning its sustainability.[294]

As Pratt testified, the CRU forecast may contain implicit volatility but it is meaningless when considering the potential risks faced by Noranda. To be meaningful, one must explicitly consider volatility. For example, using the ship analogy again, the average depth of the channel implicitly contains all of the individual measurements of its depth. However, to be useful for navigation, the individual measurements must be known and considered in order to safely

[292] Smith Surrebuttal, Ex. 612, pp. 7-9.

[293] Harris Surrebuttal, Ex. 605, p. 5.

[294] Smith Surrebuttal, Ex. 612, p. 14.

navigate the channel. Likewise, Noranda must estimate and consider the volatility around the price of aluminum in order to safely navigate its way to a refinancing of its debt and the sustainability of the smelter.

As in the prior case, Ameren Missouri criticizes Noranda for providing a CRU forecast to Moody's when it was reviewing Noranda for possible downgrade.[295] However, Ameren Missouri conveniently omits that even with the CRU forecast with higher aluminum prices, Moody's still downgraded Noranda.[296] In other words, although Ameren Missouri believes that using the CRU forecast means that Noranda has sufficient liquidity and will not experience a liquidity crisis, Moody's determined that Noranda's financial plight was genuine and downgraded it – clear proof that Moody's does not base its judgment on the CRU forecast alone.

**2. The Usefulness of the Scenarios**

While one cannot predict the timing of price cycles, one can use financial scenarios like those offered by Noranda to stress-test business plans in order to make informed business decisions. That is why it is important to regard these price paths as scenarios rather than forecasts, as Noranda readily agrees.[297] While they are not forecasts, they are not unsound, flawed, made-up or specifically created to support Noranda's request in this case, as Ameren Missouri and MECG argue.[298] First, Noranda worked closely with Pratt from CRU to prepare the scenarios, including the underlying assumptions about the future price of aluminum, and to select the scenarios that are most reasonable and representative of the potential risks faced by Noranda in the future. Second, as Pratt explained, the scenarios are important so that one can

[295] Ameren Missouri Br., p. 164-65.

[296] *Research Update: Noranda Aluminum Holding Corp. Rating Lowered To 'B-' From 'B'; Outlook Is Stable;* pp. 2-3 Rationale; Oct 13, 2014.

[297] Ameren Missouri Br., p. 166.

[298] Ameren Missouri Br., pp. 164-65; MECG Br., p. 60.

consider the variance of prices or volatility in assessing business risks.[299] Since aluminum companies face an uncertain and volatile price, it is entirely objective, reasonable, and prudent to rely on representative volatility scenarios based upon historical experience. In fact, as Boyles testified, for purposes of stress-testing Noranda's liquidity and viability, it would be inappropriate and imprudent to assume there will be no aluminum price volatility.[300]

As Schwartz testified, potential lenders will be concerned with the likelihood of a borrower being able to repay its loan, especially its free cash flow. To get a good estimate of free cash flow, potential lenders will focus on future revenues and profitability. Therefore, they will want reasonable estimates of future prices. They want price forecasts that are neither unreasonably optimistic nor pessimistic. As a result, as Schwartz concluded, the CRU forecast would be rejected by potential lenders.[301] Neither Ameren Missouri nor MECG contested this fact at trial or in their briefs.

Instead of relying on the CRU forecast, lenders want to be assured that they will be repaid under a variety of possible outcomes for aluminum prices. Accordingly, they will consider a variety of aluminum price scenarios. In particular, lenders will want a forecast that reflects a price path that captures price volatility movements—both up and down—because Noranda's future financial condition depends importantly on that path. The CRU forward curve is not such a forecast.[302]

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[299] Pratt Surrebuttal, Ex. 609, p. 16.

[300] Boyles Surrebuttal, Ex. 601, p. 5.

[301] Schwartz Surrebuttal, Ex. 611, pp. 8-9.

[302] Schwartz Surrebuttal, Ex. 611, pp. 8-9.

Ameren Missouri and MECG suggest that lenders are likely to assume higher aluminum prices than those assumed in the scenarios simply because CRU is known in the industry and regularly forecasts aluminum prices, and that Noranda itself has relied upon industry analyst forecasts in the past. This is incorrect. While reasonable people can agree that many scenarios for aluminum prices could come to pass for Noranda, this is precisely why potential lenders use conservative forecasts and downside cases to determine the creditworthiness of a borrower. In fact, regardless of what scenario Noranda presents to lenders, they are likely to discount anything they view as overly positive assumptions for aluminum prices.[303] Neither Ameren Missouri nor MECG addressed this fact in their briefs.

**3. Aluminum Prices are not Likely to Rise in the Near Term**

As Pratt testified, the initial conditions and the near-term outlook for aluminum do not suggest a strong likelihood of higher prices in 2016 or 2017. Poor conditions exist now in the aluminum market. CRU's central view in its January 2015 forecast is for very little change in the annual average price in 2015 followed by a 5.5 percent decline in real terms in 2016. CRU also assesses downside risks and produced a downside scenario with prices 15 percent below the base case in 2016 and 2017.[304]

Like CRU's view, Bank of America/Merrill Lynch reported on March 4, 2015, that it was dropping its forecast for aluminum prices by 7.8 percent for 2015, 15.9 percent for 2016, and 19.3 percent for 2017.[305] Boyles described the financial impact on Noranda; the LME is down 7

[303] Harris Surrebuttal, Ex. 605, p. 2.

[304] Pratt Surrebuttal, Ex. 609, p. 12.

[305] Ex. 530; Humphreys Testimony, Tr. pp. 2157-2163.

cents since February 2015 and that equates annually to $49 million less in revenues for Noranda.[306] Neither Ameren Missouri nor MECG addresses these facts in their briefs.

### 4. Noranda's Scenarios Provide a Reasonable and Representative Tool

In this case, Noranda produced a balanced set of 11 different scenarios stress-testing its liquidity and cash flow based on the future price of aluminum.[307] They were not the product of Boyles working alone as Ameren Missouri and MECG suggest.[308] Instead, as Boyles testified, he worked with the entire leadership team at Noranda and its experts in order to determine the price cycle for aluminum and assess the scenarios.[309]

Trying to attack the impact of the scenarios, Ameren Missouri engages in sophistry when it suggests that Noranda did not work "closely" with CRU on their creation and the selection of those scenarios which are most reasonable and representative of the potential risks faced by Noranda.[310] As Pratt and Boyles both testified, Noranda worked closely with CRU on the scenarios and CRU determined that the scenarios are reasonable and a representative set for stress-testing Noranda's business plans.[311] The method chosen by Noranda also has the advantage that it reflects potential volatility in aluminum prices using real historic data, thereby making it more reasonable and representative.[312] Ameren Missouri and MECG conveniently omitted these conclusions by Pratt in their opening briefs.

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[306] Boyles Testimony, Tr. p. 2643.

[307] Pratt Surrebuttal, Ex. 609, p. 16.

[308] Ameren Missouri Br., p. 167; MECG, p. 62.

[309] Boyles Testimony, Tr. pp. 2504-2505.

[310] Ameren Missouri Br., pp. 173-74.

[311] Pratt Surrebuttal, Ex. 609, pp. 16-17; Boyles Testimony, Tr. pp. 2512-2513.

[312] Pratt Direct, Ex. 608, p. 22.

**5. ** **

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As Schwartz also testified, a reduced rate such as the one Noranda proposed is critical to the smelter's viability. ** **

## F. Noranda's Continuing Need for Capital Improvements

As a result of poor cash flow and lower liquidity, Noranda has gone through a stretch of time when it has been unable to make all of the capital expenditures required for its business. It has deferred capital spending, and its capital expenditures are less than its depreciation. As a

313 Schwartz Direct, Ex. 610, p. 19.

314 Schwartz Direct, Ex. 610, pp. 22-23.



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result, its capital expenditures are currently insufficient to sustain the business at its current scale of operations for an extended period of time. In addition, in order to be sustainable, Noranda will have to increase its level of capital expenditures in the future above what would be normal "maintenance" levels.[315]

Noranda has identified projects requiring it to spend over ** __________ ** annually over the next 10 years. These levels are real and needed. As Boyles testified, without that level of capital spending, the smelter is not viable.[316]

In response, Ameren Missouri criticizes what it perceives as a lack of documentation as to Noranda's plans for future capital expenditures.[317] But Noranda has provided a workpaper that lists projects totaling more than $1 billion of sustaining and growth projects, which greatly exceeds ** __________ ** per year.[318] Ameren Missouri still complains that there is no evidence that supports the conclusion that Noranda must and will invest ** __________ ** in capital growth projects.[319] As Boyles testified, however, Noranda needs to spend significant dollars on capital projects put on hold during the great recession, and those projects must be undertaken now and over the next ten years in order for Noranda to maintain its competitive position in the market place.[320] While it need not have its "foot on the gas pedal"[321] with regard to this spending and may have some flexibility around its timing, the capital expenditure needs exist and they must be met.

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[315] Schwartz Direct, Ex. 610, p. 12.

[316] Boyles Direct, Ex. 600, pp. 9-10.

[317] Ameren Missouri Br., p. 175.

[318] Boyles Surrebuttal, Ex. 601, p. 14.

[319] Ameren Missouri Br. 174.

[320] Boyles Direct, Ex. 600, pp. 9-10; Boyles Surrebuttal, Ex. 601, p. 14.

[321] Ameren Missouri Br., p. 176.

Ameren Missouri also points to Noranda's historic levels of capital spending as an indictment of its capital expenditure needs.[322] However, historic levels of spending ignore the impact of the great recession. In addition, neither Ameren Missouri nor MECG undertook its own economic analysis of the condition of Noranda's existing equipment and other assets in order to directly contest Noranda's evidence that the identified capital projects are real and necessary.[323] As a result, their criticisms are without merit.

## G. Noranda has Disclosed its Precarious Financial Situation to the Public

Ameren Missouri and MECG suggest that there is inconsistency between what Noranda has told the PSC and what it had told the public.[324] Neither Ameren Missouri nor MECG must have read Noranda's most recent Form 10-K. As discussed below, Noranda clearly identified in that filing the material risks associated with the high power rate, the pending power rate case, the possible closure of the smelter, and other options available to Noranda in case rate relief is not provided by the Commission. Likewise, during each of its earnings calls, Noranda alerted everyone in writing to review the Form 10-K to learn more about the material risks it faces. These clear public statements belie any claims of inconsistency.

### 1. Noranda's Form 10-K

In its 2014 Form 10-K, [325] Noranda disclosed the possibility of the Smelter closure and the other material risks associated with an unsustainable power rate, including bankruptcy:

> **If we are unable to successfully finalize power issues at our New Madrid facility, we may have to curtail this facility.**

. . .

[322] Ameren Missouri Br., p. 175.

[323] Boyles Surrebuttal, Ex. 601, p. 14.

[324] Ameren Missouri Br., pp. 179-80; MECG Br., pp. 10, 52, 56.

[325] Ex. 533, p. 17 (bold in original and emphasis added); Smith Testimony, Tr. pp. 2472-2476.

> If any production curtailment or other restructuring does not achieve sufficient reduction in operating expenses, we may have to seek bankruptcy protection for some or all of our subsidiaries; we could also be forced to divest some or all of the subsidiaries. If we were to seek bankruptcy protection for any of these subsidiaries, we would face additional risks. Such action could cause concern among our customers and suppliers, distract our management and other employees and subject us to increased risks of lawsuits. Other negative consequences could include negative publicity, which could have an impact on the trading price of our securities and affect our ability to raise capital in the future.

In its Form 10-K,[326] Noranda also disclosed aluminum price volatility as a material factor in its business:

> Our operating results depend substantially on the market for primary aluminum, a cyclical commodity whose prices have historically been volatile […]. Primary aluminum prices are subject to regional and global market supply and demand and other related factors.

These statements are specific and clear.

### 2. Noranda's Earnings Calls

In each of its earnings calls, Noranda presented slides[327] that specifically identify material risks and uncertainties faced by Noranda in terms of any forward-looking statements:

> Forward-looking statement are statements about future, not past, events and involve certain important risks and uncertainties, any of which could cause the Company's actual results to differ materially from those expressed in forward-looking statements, including, without limitation: the cyclical nature of the aluminum industry and fluctuating commodity prices, which cause variability in earnings and cash flows; a downturn in general economic conditions, including changes in interest rates, as well as a downturn in the end-use markets for certain of the company's products; fluctuations in the relative cost of certain raw materials and energy compared to the price of primary aluminum and aluminum rolled products; the effects of competition in Noranda's business lines; Noranda's ability to retain customers, a substantial number of which do not have long-term contractual arrangement with the Company; the ability to fulfill the business' substantial capital investment needs; labor relations

[326] Ex. 533, p. 17 (emphasis added); Smith Testimony, Tr. pp. 2472-2476.

[327] Boyles Testimony, Tr. pp. 2636-58; Exs. 70 and 71 (emphasis added).

> (i.e. disruptions, strikes or work stoppages) and labor costs; unexpected issues arising in connection with Noranda's operations outside of the United States; the ability to retain key management personnel; and Noranda's expectations with respect to its acquisition activity, or difficulties encountered in connection with acquisitions, dispositions or similar transactions.

In addition, Noranda advised[328] that everyone participating in the call should review its filings, especially the Form 10-K, with the SEC.

### 3. Noranda's Future Projections Assumed Rate Relief

Ameren Missouri and MECG suggest that Noranda's statements in the earnings calls indicate Noranda is doing well financially and that its smelter will survive.[329] As Boyles testified, all of Noranda's forward looking statements in these calls, including its business, cash flows, and potential profits, were based on the assumption that Noranda would receive rate relief in the amount of $40 to $50 million.[330] No one ever asked in those calls about the financial impact on Noranda if it did not receive that rate relief.[331] Neither Ameren Missouri nor MECG addressed these facts in their briefs. Simply put, Noranda did not mislead or misstate its future financial condition to anyone.

## H. Apollo is Not the Problem

Dwelling on the past – especially events that took place when Noranda had a different ownership and governance structure – does not and cannot change the fact that Noranda is now in a significant financial crisis. If not properly and promptly addressed, that crisis threatens imminent closure of the smelter, which will in turn trigger financial devastation for its employees and their families, and for a region that is not equipped to sustain the blow.

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[328] Boyles Testimony, Tr. p. 2639; Exs. 70 and 71.

[329] Ameren Missouri Br., p. 180; MECG Brief, p. 56-58.

[330] Boyles Testimony, Tr., pp. 2640-42, 2644-2645; Exs. 70 and 71.

[331] Boyles Testimony, Tr., pp. 2640-42, 2644-2645.

As in the last case, Ameren Missouri complains that Noranda is simply seeking to build shareholder value by requesting a reduced power rate,[332] and criticizes Apollo's current ownership interest in Noranda and the past dividends its board approved. This time, MECG even makes a bald and unsupportable attack on Smith suggesting that his independence as a director of Noranda should be questioned.[333] In its opening statement, Ameren Missouri made a similar veiled attack suggesting that somehow Smith was breaching his fiduciary duties because he would not accept a risky wholesale power relationship with Ameren Missouri.[334]

Notwithstanding these claims, the fact is Apollo's ownership interest in Noranda has dropped from nearly 100 percent in 2007 to 34 percent today.[335] Apollo currently has only four seats on Noranda's 12-member board of directors, and thus no longer controls Noranda's board.[336] Counting Mr. Smith as the fifth board member, the remaining seven seats on the Noranda board are held by "independent" directors.[337] This independence is required by the rules of the New York Stock Exchange, on which Noranda stock is traded. Yet Ameren Missouri still bemoans the fact that Noranda paid out $265 million in dividends to Apollo and other shareholders from 2008 through 2012.[338] Obviously displeased with past dividends properly paid by Noranda to its shareholders, Ameren Missouri tries to suggest that Noranda's dividend history is a sufficient basis to deny its current request for emergency relief.[339] Notably, Ameren Missouri does not present any evidence that the payment of these dividends was improper or that

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[332] Ameren Missouri Br., p. 181.

[333] MECG Br., p. 96.

[334] Ameren Missouri Opening Statement, Tr. p. 2392.

[335] Smith Testimony, Tr. p. 2436

[336] Smith Testimony, Tr. p. 2490.

[337] Smith Testimony, Tr. p. 2490

[338] Ameren Missouri Br., p. 181-182.

[339] *Id.*

Noranda's board did not properly exercise its business judgment. Instead, Ameren Missouri merely identifies the dividends and divines that Noranda should not have paid them but instead directed that money to present or future capital improvements.[340]

Noranda cannot rewrite history or claw back whatever dividends were paid in the past. If the Commission were to reject the rate request because of these past dividends, it would essentially be supplanting the business judgment of Noranda's board in approving those dividends with Ameren Missouri's unsubstantiated view that the dividends were improper.

Ameren Missouri is attempting to make the fact that Noranda paid special dividends to its previous owner, Apollo Management LP ("Apollo") a focal point of this rate case.[341] Thus, counsel for Ameren Missouri announced that the question before the Commission is "not simply whether Noranda has a financial need for a long-term power rate or whether it would close the smelter without it. … To the contrary, the question is, even if Noranda has [such] severe financial problems, how did Noranda get itself into this position?"[342] By thus framing the issues, Ameren Missouri seeks to create the impression that the rate proposed in the Nonunanimous Stipulation would serve only to extricate Noranda from a predicament of its own making;[343]and further enrich Apollo at the expense of Ameren Missouri's ratepayers.[344]

No party to this proceeding expressly disputes that the special dividends made between 2007 and 2012 to Apollo were legal and proper. Moreover, rate-setting under the Public Service Commission Law is not supposed to turn on whether retribution should be exacted from a

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[340] *Id.*

[341] The special dividends were paid between 2007 and 2012. Ex. 33, p. 36, ll. 8-14; tr. p. 2491, ll. 6-7.

[342] See Tr. p. 2359, ll. 18-20.

[343] Ameren Missouri Br., pp. 181-182. MECG made passing reference to similar arguments in a footnote. MECG Br., p. 65, fn. 189.

[344] See Tr. p. 2349, ll. 16-19 (where counsel declares that "[a]sking Ameren Missouri to have its customers pay a dollar so that Apollo can have another dollar in its coffers is just not something my client can stomach…").

utility's consumers for past business decisions. Rather, the task for the Commission is to act *prospectively* to set a rate that will best serve the interests of Ameren Missouri's ratepayers going forward. Thus, the fundamental question that is now before the Commission is not about Apollo. Rather it is whether the public interest is better served by granting the requested relief or risking the consequences that would ensue from the closure of the New Madrid smelter. *State ex rel. Laundry, Inc. v. Pub. Serv. Comm'n*, 327 Mo. 93, 107 (Mo. 1931) (The Commission is to exercise its rate-setting powers "in the interest of the public welfare or convenience.").

Moreover, Apollo no longer either owns or controls Noranda. It is now a minority shareholder owning under 34% of the outstanding stock[345] and holds only four of the twelve seats on Noranda's board.[346] Pursuant to New York Stock Exchange rules, seven out of the twelve board members are independent.[347] While Apollo wields some influence over corporate decision-making, each of Noranda's directors – including those appointed by Apollo – owe fiduciary duties to the company and all of its shareholders. *Johnson v. Duensing*, 351 S.W.2d 27, 32 (Mo. 1961) ("The officers and directors of a corporation occupy a fiduciary relation to the corporation and to the stockholders; their position is one of trust and they are bound to act with fidelity and subordinate their personal interest to the interest of the corporation").

Moreover, under the terms of the Nonunanimous Stipulation, Noranda is specifically prohibited from paying special dividends during the period that a load retention rate is in effect.[348] In light of the existing corporate structure, the legal duties owed by corporate directors, and the safeguards built into the Nonunanimous Stipulation, the suggestion that the rate

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[345] Tr. p. 2490, ll. 8-11, p. 2500, ll. 10-14.

[346] Tr. p. 2490, ll. 8-11. Even if Chief Executive Officer Smith were counted as an Apollo director due to his indirect relationships, the independent directors would remain in the majority.

[347] Tr. p. 2499, l. 23 – p. 2500, l. 25.

[348] Nonunanimous Stipulation and Agreement, para. 18.

requested would enrich Apollo to the detriment of Ameren Missouri's ratepayers has no support in this record.

## I. Conclusion

Without a reduction in the power rate, Noranda's Smelter is simply not sustainable. On the other hand, if requested rate relief is granted, the Smelter is sustainable. Indeed, if the PSC approves the requested power rate, Noranda's financial outlook improves and it can sustain the Smelter because: (1) there is a more favorable picture for refinancing Noranda's outstanding debt as it comes due in 2017 and 2019; (2) the threat from any negative LME volatility is reduced; (3) during peak LME periods, Noranda can husband more cash to make the investments to sustain its business and provide increased resistance to financial and operational shocks; and (4) over the course of the aluminum cycle Noranda will have better capacity to reinvest in its business.[349]

Respectfully submitted,

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[349] Smith Surrebuttal, Ex. 612, pp. 4-5.

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**CERTIFICATE OF SERVICE**

I do hereby certify that a true and correct copy of the foregoing document has been emailed this 10th day of April, 2015, to all counsel of record.

*/s/ Diana M. Vuylsteke*