BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

Noranda Aluminum, Inc., et al.,	)	
	)	
Complainants,	)	
	)	
vs.	)	**Case No. EC-2014-0223**
	)	
Union Electric Company doing business As Ameren Missouri,	)	
	)	
Respondent.	)	

STAFF'S INITIAL BRIEF

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Initial Brief,* states as follows:

Introduction

What is this case about?

This case is a general rate case, initiated by customer complaint.[1] It is a general rate case like any other general rate case as the Missouri Supreme Court's summary description of the statutory scheme makes clear:

> Pursuant to § 393.150, a utility may file a schedule stating a new rate or charge, rule or regulation, which shall become valid unless suspended by the commission, on its own motion or upon complaint of interested parties as authorized by the statute. If suspended, the commission must within a specified period hold a hearing concerning the propriety of the new rate, charge, rule or regulation. **A hearing may also be had without the filing of a new rate, if a complaint is filed, or on motion of the commission, §§ 393.260, 386.390.** The commission may investigate any matter as to which a complaint may be filed, or in order to enable it to ascertain facts requisite to the exercise of any powers conferred upon it. At the conclusion of any hearing and investigation, the

[1] Sections 393.260.1 and 393.270.2, RSMo.

> commission shall set the maximum price to be charged for the electricity, §§ 392.270(2), 393.270(3). * * * [2]

It is the second case of two rate complaints brought by Noranda.[3] This second case is an overearnings complaint. The gravamen of Noranda's *Complaint* is: "Under the circumstances set forth [in the *Complaint* and in Complainants' Direct Testimony], that rate [i.e., Ameren Missouri's current, Commission-approved rate] is now unjust and unreasonable because, with normalized and annualized expenses and revenues, Ameren Missouri is currently overearning at a rate of $44.6 million per year over its authorized rate of return on equity of 9.8 percent."[4] Noranda has also challenged Ameren's Commission-approved return on common equity ("ROE") of 9.8 percent, presenting testimony that it should be no higher than 9.4 percent.[5] Noranda has thus brought a two-count complaint: first, that Ameren Missouri is earning returns in excess of its authorized ROE; second, that its authorized ROE is unreasonably high in the light of changed circumstances. As the complainant, Noranda bears the burden of proof in this proceeding,[6] although normally in a general rate case, the burden of proof is on the utility seeking a rate increase.[7]

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[2] ***State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41, 48 (Mo. banc 1979) (***"UCCM"***) (emphasis added; internal citations omitted).

[3] The first case to be heard, EC-2014-0224, focused on rate design. All of the 38 complainants are referred to collectively as "Noranda."

[4] ***Noranda Aluminum, Inc., et al. v. Union Electric Company d/b/a Ameren Missouri,*** Case No. EC-2014-0223 (***Excess Earnings Complaint and Request for Expedited Review and Relief,*** filed Feb. 12, 2014) at p. 4 (*"Complaint"*). Originally filed as Highly Confidential ("HC"), the *Complaint* has been reclassified as public information.

[5] Noranda has thus brought a two-count complaint: first, that Ameren Missouri is earning returns in excess of its authorized ROE; second, that its authorized ROE is unreasonably high.

[6] "In cases where 'a complainant alleges that a regulated utility is violating the law, its own tariff, or is otherwise engaging in unjust or unreasonable actions,' the Commission has determined that 'the burden of proof at hearing rests with complainant.' This court has affirmed placing the burden of proof on the complainant in such cases, because the burden of proof properly rests on the party asserting the affirmative of an issue." ***State ex rel. GS Technologies Operating Co. v. Public Service Commission,***

What is an overearnings complaint?

An overearnings complaint seeks to achieve a rate reduction by showing that the current rates of the target utility are not "just and reasonable" because they are yielding excessive profits to the shareholders. This is measured by comparing the amount of revenue currently available as a return to common equity shareholders against the ROE set by the Commission in the company's most recent general rate case. If the current return exceeds the Commission-approved ROE, then the company is overearning in the most basic sense. This is the first count of Noranda's two-count *Complaint.*

Of course, the level of profit available to shareholders from utility operations will necessarily fluctuate over the course of a year.[8] At times it may be more than the Commission allowed in the company's previous rate case and at other times, it may be less. Every transient upward oscillation of the utility's earnings should not trigger a rate complaint. In recognition of this reality, the Staff will bring an overearnings complaint only when the excess return is both (1) material and (2) likely to persist.[9] In the present case, although Ameren Missouri's unadjusted surveillance reports suggest that it is overearning, Staff does not believe that the condition is either material or likely to

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116 S.W.3d 680, 693 (Mo. App., W.D. 2003) (*quoting* ***Margulis v. Union Elec. Co.,*** 30 Mo.P.S.C. (N.S.) 517, 523 (1991)).

[7] Section 393.150.2, RSMo.

[8] ***Straube v. Bowling Green Gas Co.,*** 360 Mo. 132, 141-142, 227 S.W.2d 666, 671 (Mo.1950): "The ultimate return to respondent as a result of the rate so fixed and subsequently charged and collected [will] necessarily vary from time to time. 'The law, of course, did not require that the rates at any time yield any particular return.' No maximum or minimum return was determined when the rate was established. The contention and allegation that, if respondent is permitted to retain the said funds, it will result in respondent having charged and collected in excess of the 'maximum return' cannot aid appellants, since the law of the state only provides for the fixing of rates and does not fix the maximum return thereunder." (Citations omitted.)

[9] Oligschlaeger Rebuttal, p. 4.

persist, if it exists at all.[10] For that reason, Staff has not supported the Complainants in this proceeding.

Overearnings complaints such as this one are uncommon. During the proceedings in this case, questions have arisen about how the process should work. Because it is a general rate case, an overearnings complaint case is, at core, much like any other general rate case. Overearnings, just like underearnings, are determined on the basis of an annualized and normalized historical test year:

> The commission has the authority to determine the rate to 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[.][11]

Therefore, as Staff's expert witness John Cassidy testified, "It is the Staff's view that in order to meet the UCCM standard and long-standing directives provided by this Commission, a complete review and audit of the Company's books and records and an assessment of its operations that takes into account all revenues, expenses, investment and rate of return must be addressed when attempting to re-establish permanent rates."

Some parties have questioned whether there is any practical point to bringing an overearnings complaint at all in view of the burden of marshalling "all relevant factors" for the Commission's consideration. An often-cited and fundamental principle of Missouri ratemaking jurisprudence is that the Commission must consider "all relevant factors" when setting rates;[12] this principle is also referred to as the "prohibition on

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[10] *Id.,* pp. 3-7.

[11] ***UCCM,*** *supra,* 585 S.W.2d at 58.

[12] This phrase derives from a line of United States Supreme Court cases which required that utility rate base be valued at "fair value," an approach long-since abandoned in favor of net-investment valuation. In determining the "fair value" of the rate base, regulatory agencies were required to consider "all relevant factors," particularly original cost less depreciation and reproduction cost. *See* C.F. Phillips, Jr., ***The***

single-issue ratemaking."[13] "Single-issue ratemaking is generally prohibited in Missouri because it might cause the Commission to allow a company to raise rates to cover increased costs in one area without realizing that there were counterbalancing savings in another area."[14] In the present case, for example, Ameren Missouri contends that the Complainants cannot possibly prevail because they have not adduced evidence on "all relevant factors."[15]

What is the process an overearnings complaint should follow?

The course that an overearnings complaint should follow may be discerned from the statutes. Such a complaint is authorized at § 386.390.1, RSMo., and also at § 393.260.1, RSMo.:

> Complaint may be made by the commission of its own motion, or by the public counsel or any corporation or person, chamber of commerce, board of trade, or any civic, commercial, mercantile, traffic, agricultural or manufacturing association or organization, or any body politic or municipal corporation, by petition or complaint in writing, setting forth any act or thing done or omitted to be done by any corporation, person or public utility, including any rule, regulation or charge heretofore established or fixed by or for any corporation, person or public utility, in violation, or claimed to be in violation, of any provision of law, or of any rule or order or decision of the commission; provided, that no complaint shall be entertained by the commission, except upon its own motion, as to the reasonableness of any rates or charges of any gas, electrical, water, sewer, or telephone

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Regulation of Public Utilities: Theory and Practice 316 ff. (Public Utilities Reports, Inc.: Arlington, VA, 1993). The Missouri Supreme Court, in ***UCCM,*** *supra,* 585 S.W.2d at 56–58, adopted the phrase from one of its own earlier decisions, ***State ex rel. Missouri Water Co. v. Public Service Commission,*** 308 S.W.2d 704, 718-719 (Mo. 1957), which concerned rate-base valuation, and applied it to the ratemaking process generally.

[13] ***State ex rel. Sprint Spectrum L.P. v. PSC,*** 112 S.W.3d 20, 28-29 (Mo. App., W.D. 2003): "Missouri's prohibition against single-issue ratemaking bars the Commission from allowing a public utility to change an existing rate without consideration of all relevant factors such as operating expenses, revenues, and rates of return." Section 392.240.1, RSMo.; ***Missouri Water Co.,*** *supra;* ***UCCM,*** *supra.*

[14] ***State ex rel. Public Counsel v. Public Service Com'n,*** 397 S.W.3d 441, 448 (Mo. App., W.D. 2013) (internal citations omitted), *quoting* ***State ex rel. Midwest Gas Users' Ass'n v. Pub. Serv. Comm'n,*** 976 S.W.2d 470, 479-480 (Mo. App., W.D. 1998); and see extended discussion in ***UCCM,*** *supra.*

[15] This is also Staff's position.

> corporation, unless the same be signed by the public counsel or the mayor or the president or chairman of the board of aldermen or a majority of the council, commission or other legislative body of any city, town, village or county, within which the alleged violation occurred, or not less than twenty-five consumers or purchasers, or prospective consumers or purchasers, of such gas, electricity, water, sewer or telephone service.[16]
>
> Upon the complaint in writing of the mayor or the president or chairman of the board of aldermen, or a majority of the council, commission or other legislative body of any city, town, village or county within which the alleged violation occurred, or by not less than twenty-five consumers or purchasers, or prospective consumers or purchasers of such gas, electricity, water or sewer, as to the illuminating power, purity, pressure or price of gas, the efficiency of the electric incandescent lamp supply, the voltage of the current supplied for light, heat or power, or price of electricity sold and delivered in such municipality, or the purity, pressure or price of water or the adequacy, sanitation or price of sewer service, the commission shall investigate as to the cause of such complaint.[17]

Only certain persons or combinations of persons are authorized to bring an overearnings complaint.[18] The complaint must be written and must "[set] forth any act or thing done or omitted to be done by any person, corporation, or public utility, including any rule or charge established or fixed by or for any person, corporation, or public utility, in violation or claimed to be in violation of any provision of law or of any rule or order or decision of the commission."[19] "[A] complaint under the *Public Service Commission Law* is not to be tested by the technical rules of pleading; if it fairly presents for determination some matter which falls within the jurisdiction of the Commission, it is sufficient."[20] Additionally, any such complaint must include both an allegation that the utility has

[16] Section 386.390.1, RSMo.

[17] Section 393.260.1, RSMo.

[18] Sections 386.390.1, 393.260.1, RSMo.; Rule 4 CSR 240-2.070(5).

[19] Commission Rule 4 CSR 240-2.070(4); additional technical requirements are set out in this rule as authorized by § 393.260.3, RSMo.

[20] ***State ex rel. Kansas City Terminal Railway Co. v. PSC,*** 308 Mo. 359, 372, 272 S.W. 957, 960 (banc 1925).

violated a statute or Commission rule or order[21] and an allegation that conditions have changed since the utility's current rates were approved by the Commission.[22]

Once an adequate overearnings complaint has been filed by appropriate complainants, the Commission is authorized to conduct an investigation:

> When such complaint is made, the commission **may**, by its agents, examiners and inspectors, inspect the works, system, plant, devices, appliances and methods used by such person or corporation in manufacturing, transmitting and supplying such gas, electricity or water or furnishing said sewer service, and may examine or cause to be examined the books and papers of such person or corporation pertaining to the manufacture, sale, transmitting and supplying of such gas, electricity or water or furnishing of such sewer service.[23]

How does the Commission conduct an investigation? By directing its Staff – its "agents, examiners and inspectors" -- to conduct the desired investigation and to submit a report by a designated date. One question that arose at the hearing in this case was, how could any party but Staff conduct an audit and bring forward "all relevant factors" for the Commission's consideration? The answer is that the statute does not expect any party other than Staff to conduct the necessary audit. For that reason, the statute authorizes the Commission, upon the filing of an overearnings complaint, to conduct an investigation via its "agents, examiners and inspectors."[24]

In the present case, having adopted the very aggressive procedural schedule upon which the Complainants insisted, the Commission directed Staff to perform only a truncated investigation and analysis:

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[21] ***State ex rel. Ozark Border Electric Cooperative v. PSC,*** 924 S.W.2d 597 (Mo. App., W.D. 1996).

[22] Section 386.550, RSMo.; ***State ex rel. Licata v. PSC,*** 829 S.W.2d 515 (Mo. App., W.D. 1992).

[23] Section 393.260.2, RSMo.; emphasis added.

[24] That is to say, its Staff.

> After considering the arguments of the parties, the Commission concludes that the Complainants should be allowed to present their complaint in the time of their choosing. They have the burden of proof and if they believe they can prove their complaint in a short amount of time, the Commission will allow them to proceed. Ameren Missouri is concerned that it be allowed enough time to prepare a defense to the complaint but the schedule proposed by the Complainants is not so short as to deny the company a full opportunity to respond. Staff indicates it will not have enough time to undertake any audit, cost of service study, class cost of service study or other extended or exhaustive analysis to support or refute the complaint. The Commission directs Staff to perform an analysis and investigation, the parameters of which will be more fully defined by the Commission as the case progresses. In particular, Staff shall analyze and investigate the allegations in paragraph 12 of the complaint. The Commission expects Staff to comply with the procedural schedule.[25]

By persuading the Commission to adopt a very short procedural schedule, despite Staff's warning that it could not perform an audit or other necessary general rate case activities in that time frame, the Complainants themselves have ensured that a very real question will necessarily exist as to whether the Commission has indeed considered "all relevant factors" in reaching its decision in this case.

Of course, it is up to the Commission to determine which factors are relevant.[26] "All relevant factors" does not mean "all possible factors." A factor is legally relevant if it tends to prove or disprove a matter in issue.[27] "Each case must be determined upon its own facts and, oftentimes, varying factors that may be peculiarly relevant to a reasoned determination of the issue of 'just and reasonable' rates under conditions then

[25] *Order Establishing Procedural Schedule,* issued April 16, 2014, pp. 2-3. The Commission specifically ordered Staff to analyze the allegations in ¶ 12 of the *Complaint,* and that is precisely what Staff did. Despite the language of the *Order,* no additional guidance as to the scope and nature of the desired analysis and investigation was forthcoming. On April 18, 2014, Staff filed an outline of its proposed testimony in this case in order to ensure that the scope of its proposed investigation and analysis was satisfactory to the Commission.

[26] *See* ***Marbury v. Madison,*** 5 U.S. 137, 177, 1803 WL 893, 26 (U.S., 1803): "It is emphatically the province and duty of the judicial department to say what the law is. Those who apply the rule to particular cases, must of necessity expound and interpret that rule. If two laws conflict with each other, the courts must decide on the operation of each."

[27] ***Black's Law Dictionary*** 1293 (7th ed., West: Minneapolis, MN, 1999).

existing."[28] The evil that the prohibition against single-issue ratemaking is intended to prevent is the fixing of rates to meet an increase in one cost without realizing that an offsetting decrease has occurred in another.[29]

Section 393.270.2, RSMo., prescribes the actions the Commission is to take following the hearing in an overearnings complaint case:

> After a hearing and after such investigation as shall have been made by the commission or its officers, agents, examiners or inspectors, the commission within lawful limits **may**, by order, fix the maximum price of gas, electricity, water or sewer service not exceeding that fixed by statute to be charged by such corporation or person, for the service to be furnished; and may order such improvement in the manufacture, distribution or supply of gas, in the manufacture, transmission or supply of electricity, in the distribution or supply of water, in the collection, carriage, treatment and disposal of sewage, or in the methods employed by such persons or corporation as will in its judgment be adequate, just and reasonable.[30]

What sort of decision can the Commission make in this case? Section 393.270.2, RSMo., set out above, authorizes, but does not require, the Commission to issue an order setting rates. Whether or not the Commission will do so must depend in part upon its determination as to whether or not the parties have placed "all relevant factors" before it for its consideration and, if they have not, whose fault that is.

Argument

1. **Can and should the Commission order a reduction in Ameren Missouri's rates as proposed by Complainants, to apply to service rendered after the conclusion of this case?**

Although the parties formulated only a single issue in this case, Complainants actually brought and tried a two-count *Complaint.* Staff has previously summarized

[28] ***Missouri Water Co.,*** *supra,* 308 S.W.2d at 718.

[29] *See* note 13, *supra.*

[30] Emphasis added.

those counts as follows: first, whether Ameren Missouri is earning returns in excess of its authorized ROE; second, whether Ameren Missouri's authorized ROE is now unreasonably high in the light of changed circumstances. Staff will discuss each count separately.

A.

Is Ameren Missouri earning returns in excess of its authorized ROE?

In his direct testimony, Noranda's expert witness Greg Meyer testified that Ameren Missouri reported a 10.32% ROE for the 12 months ended September 30, 2013, which ROE "represents an approximate over-earnings level of $29.2 million above the Commission authorized ROE of 9.8%."[31] With certain adjustments, Mr. Meyer testified that the overearnings actually amounted to $44.639 million.[32] About five months later, in his surrebuttal testimony, Mr. Meyer testified that Ameren Missouri reported a 10.34% ROE for the 12 months ended December 31, 2013, which "represents an approximate over-earnings level of $31 million above the Commission-authorized ROE of 9.8%."[33] After applying a somewhat different set of adjustments, Mr. Meyer concluded that the December 31, 2013, overearnings level was actually $26.354 million.[34]

In his rebuttal testimony, Staff's expert witness John Cassidy criticized Mr. Meyer's adjustments, noting that "since Mr. Meyer does not have actual information

[31] Meyer Direct (Declassified), p. 4. Dated February 7, 2014.

[32] *Id.,* p. 5. Meyer's adjusted figure is $67.130 million, which includes $22.491 million for the reduced ROE which will be discussed in the next section. Without the ROE adjustment, the adjusted figure is $44.639 million.

[33] Meyer Surrebuttal (corrected and declassified), p. 2. Dated July 3, 2014.

[34] *Id.,* p. 4. Meyer's adjusted figure is $49.464 million, which includes $23.110 million for the reduced ROE which will be discussed in the next section. Tr. 3:160. Without the ROE adjustment, the adjusted figure is $26.354 million.

for many of the items in the period he is examining, he is forced to rely on disallowance adjustments, annualization and normalization adjustments developed by Staff in Ameren Missouri's prior rate case, relevant to a different time period than the one that he is examining in this proceeding."[35] For this reason, Mr. Cassidy stated, "some of his adjustments relate to time periods that extend back almost three years."[36]

Staff conducted its own analysis of Ameren Missouri's earnings for the 12 months ended December 31, 2013. Mr. Cassidy testified that Ameren Missouri's adjusted earnings for that period were $39.135 million in excess of the amount authorized by the Commission.[37] Mr. Cassidy testified, "this calculation is still a very high-level approximation and does not take into consideration any other changes that may have occurred since new rates last went into effect for Ameren Missouri in relation to all of the other relevant factors normally considered by Staff in its analysis during a general rate case."[38] Mr. Cassidy went on to say that Staff does not recommend that the Commission set new rates for Ameren Missouri based upon its "limited analysis."[39] Should the Commission nonetheless choose to adjust Ameren Missouri's rates based upon the evidence presented by Staff, Mr. Cassidy noted that the overearnings of $39.135 million would have to be offset by an amortization of solar rebates amounting to perhaps as much as $33.7 million.[40] The Commission must also necessarily be mindful of the tariffs filed by Ameren Missouri on July 3, 2014, proposing a rate *increase* of

[35] Cassidy Rebuttal (declassified), p. 25.

[36] *Id.*

[37] Cassidy Surrebuttal (declassified), p. 7. Note: it is therefore Staff's position that Ameren Missouri is indeed overearning in a technical sense.

[38] *Id.*

[39] *Id.*

[40] *Id.,* at pp. 7-8.

some $264 million, reflecting "continued investment in the Company's generation and energy delivery systems, including large investments in environmental controls at the Company's Labadie Energy Center and a new reactor vessel head at the Company's Callaway Energy Center"; as well as "escalating net energy costs, the recovery of solar rebates as approved in File No. ET-2014-0085 and recovery of the revenue requirement associated with the Company's new O'Fallon Solar Energy Center, as well as other revenue requirement increases."[41]

In summary, it is Staff's opinion that any overearnings reflected by Ameren Missouri's surveillance report for the 12 months ended December 31, 2013, are largely illusory, and are certainly neither material nor likely to be ongoing. For this reason, Staff recommends that the first count of the *Complaint* be denied.

B.

Is Ameren Missouri's authorized ROE now unreasonably high in the light of changed circumstances?

Complainants presented a cost-of-capital study performed by expert financial analyst Michael Gorman. Mr. Gorman recommended that Ameren Missouri's ROE be reduced from the 9.8% authorized in Case No. ER-2012-0166 to 9.4%,[42] reflecting a significant improvement in Ameren Missouri's investment risk.[43] Ameren Missouri offered its own cost-of-capital study performed by expert financial analyst Robert Hevert, who recommended that Ameren Missouri's ROE be set in a range of 10.20% to

[41] ***In the Matter of Union Electric Company d/b/a Ameren Missouri,*** Case No. ER-2014-0258 (***Filing Cover Letter,*** filed July 3, 2014) p. 1.

[42] Gorman Direct, p. 2. Although Mr. Gorman's analyses reflected a range from 8.90% to 9.85%, he made it clear that his recommendation was 9.40%. Tr. 3:311-12.

[43] *Id.,* pp. 2-3.

10.60%, midpoint 10.40%.[44] Mr. Hevert testified that Ameren Missouri's ROE should be *increased* from the 9.8% authorized in Case No. ER-2014-0166 because of Missouri's adverse regulatory environment:

> Because of the regulatory lag created by the inability to include CWIP in the rate base, the use of historical test periods, and the inability to implement interim rates, Ameren Missouri is at a disadvantage in terms of its ability to earn its authorized return. Mr. Gorman"s 9.40 percent ROE recommendation would only diminish the Company"s ability to earn a reasonable return. In light of those risks, I believe that an ROE of 10.40 percent is reasonable and appropriate.[45]

Mr. Hevert also suggested that the increased business risk inherent in Ameren Missouri's high reliance on coal-fired generation and its ownership of only a single nuclear generating plant merited a higher ROE.[46]

Staff's case focused on Complainants' first count and thus Staff did not perform a cost-of-capital study. Instead, Staff used the ROE set by the Commission in Case No. ER-2012-0166 as a "benchmark" in its analysis of Ameren Missouri's earnings.[47] Mr. Oligschlaeger testified, "The current rates were established to provide a reasonable opportunity to earn a 9.8% ROE, and Ameren Missouri's current earnings should be judged accordingly."[48] However, Mr. Oligschlaeger indicated that Staff would undertake a cost-of-capital study in the context of an overearnings case under certain circumstances:

> If the factors affecting a utility's required ROE at the point in time its earnings are being examined are believed to be substantially different from when its current authorized ROE was set, then Staff might consider

[44] Hevert Rebuttal, p. 61.

[45] *Id.,* p. 59.

[46] *Id.,* pp. 59-60.

[47] Oligschlaeger Rebuttal, p. 11; *accord,* Cassidy Rebuttal (declassified), p. 17.

[48] *Id.*

> using a more current required ROE value for purposes of assessing whether overearnings exists. This circumstance is more likely if a substantial amount of time had elapsed between the point the earnings review occurs compared to when the utility's authorized ROE was set.[49]

In Staff's view, those circumstances did not exist here and so Staff did not perform a cost-of-capital study.

The first count of the *Complaint* required that the authorized ROE of 9.8% be used as a "benchmark" in the analysis and that is what Staff did. The second count, however, asks whether Ameren Missouri's authorized ROE should be reduced. That is a very different question. Although Staff did not perform a cost-of-capital analysis in this case, Staff has provided expert analysis and testimony on ROE in each of Ameren Missouri's file-and-suspend general rate cases:

Case	Staff	Company	Gorman	Decision
ER-2012-0166[50]	9.00	10.50	9.30	9.80
ER-2011-0028[51]	8.75	10.70	9.90	10.20
ER-2010-0036[52]	9.35	10.80	10.00	10.10
ER-2008-0318[53]	9.375	10.90	9.95-10.00	10.76
ER-2007-0002[54]	9.25	12.20 12.00	9.80	10.20

Table 1.

[49] *Id.*

[50] ***In the Matter of Union Electric Co. d/b/a Ameren Missouri,*** Case No. ER-2012-0166 (***Report and Order,*** iss'd Dec. 12, 2012) pp. 63-73. Staff's witness was David Murray.

[51] ***In the Matter of Union Electric Co. d/b/a Ameren Missouri,*** Case No. ER-2011-0028 (***Report and Order,*** iss'd July 13, 2011) pp. 63-74. Staff's witness was David Murray.

[52] ***In the Matter of Union Electric Co. d/b/a AmerenUE,*** Case No. ER-2010-0036 (***Report and Order,*** iss'd May 28, 2010) pp. 14-24. Staff's witness was David Murray.

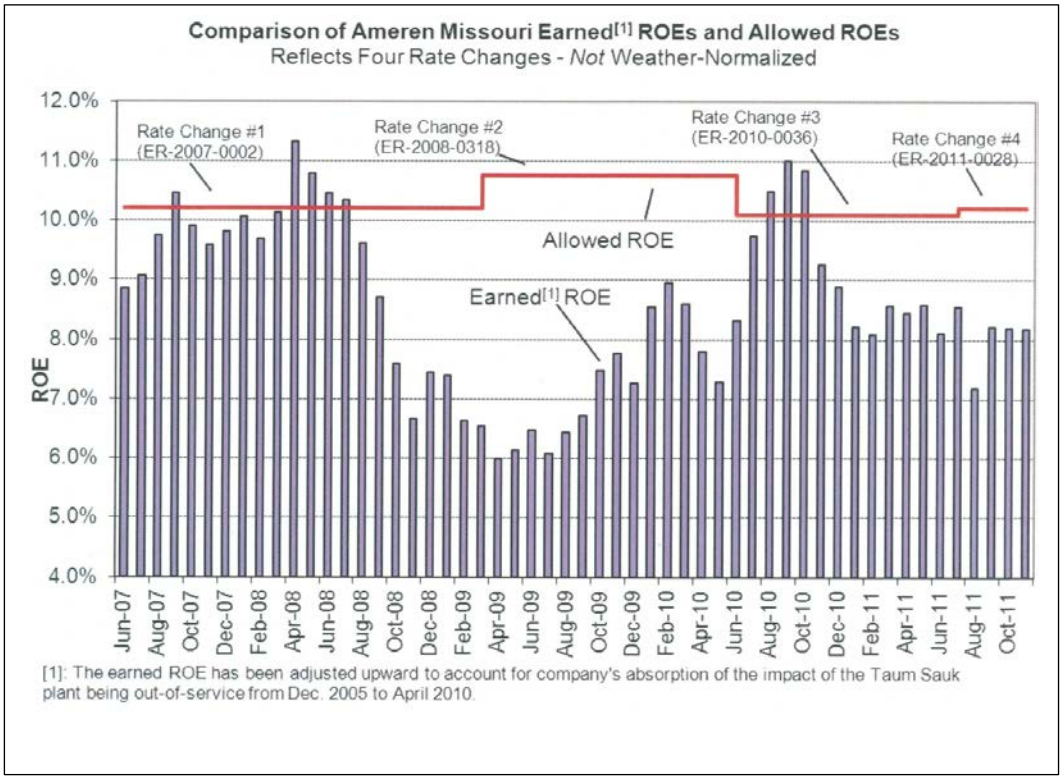
[53] ***In the Matter of Union Electric Co. d/b/a AmerenUE,*** Case No. ER-2008-0318 (***Report and Order,*** iss'd Jan. 27, 2009) pp. 15-32. Staff's witness was Stephen Hill.

[54] ***In the Matter of Union Electric Co. d/b/a AmerenUE,*** Case No. ER-2007-0002 (***Report and Order,*** iss'd May 22, 2007) pp. 36-44. Staff's witness was Stephen Hill.

Just as was pointed out at the hearing of this matter, Staff's ROE recommendation has always been lower than that of Mr. Gorman.[55]

In most of Ameren Missouri's past file-and-suspend general rate cases, the Company has presented testimony to the effect that it has been unable to earn its authorized return. For example, in Case No. ER-2012-0166, Ameren Missouri's CEO Warner Baxter testified as follows:

> As the chart below shows, since 2006, on a twelve-month rolling basis, Ameren Missouri has earned below the return that this Commission itself indicated was a fair return to earn in 46 out of 54 months—or nearly 85% of the time. In many months it has earned far below its authorized return.[56]



The Company has presented this testimony in an effort to obtain a higher authorized ROE. Surveillance reports filed by Ameren Missouri and made public in this case,

[55] Tr. 3:89.

[56] [56] ***In the Matter of Union Electric Company d/b/a Ameren Missouri,*** Case No. ER-2012-0166 (***Direct Testimony of Warner Baxter,*** filed Feb. 3, 2012) pp. 12-13.

however, reveal that the Company now consistently earns *more* than its authorized ROE:

Period	Earned ROE per Surveil-lance Report	Authorized ROE
12 months ended 03-31-14	10.45	9.80
12 months ended 12-31-13[57]	10.34	9.80
12 months ended 09-30-13[57]	10.32	9.80
12 months ended 06-30-13[57]	10.57	9.80
12 months ended 03-31-13[57]	12.28	9.80
12 months ended 12-31-12	11.66	10.20
12 months ended 09-30-12	10.50	10.20
12 months ended 06-30-12	10.53	10.20

Table 2.[58]

What is ROE and what is its significance? How should the Commission interpret these figures?

ROE, as noted above, stands for "return on equity." Equity is one variety of capital, the other being debt. One of the Commission's most significant tasks in a rate case is to provide for the utility's capital costs. The Due Process Clause requires that the shareholders be allowed an opportunity to earn a reasonable return on the value of their investment.[59] This return – ROE – is the *profit* realized by the utility's owners. Profits are paid only after all operating and maintenance costs are paid and debt has been serviced. Since the equity owners are last in line to be paid, their position is risky.

[57] The authorized ROE was 10.20% for the portion of this reporting period prior to January 2, 2013, and was 9.8% for the portion thereafter.

[58] Tr. 3:36-7, granting Consumer Council of Missouri's *Motion to Declassify Historical Surveillance Monitoring Reports.* The Commission should also be aware that there can be material differences between a utility's unadjusted reported earnings and its earnings level when appropriately adjusted for ratemaking purposes. *See* Oligschlaeger Rebuttal, pp. 13-15; Tr. 4:441-443. For this reason, Staff cautions that proposals for ratemaking actions based solely or primarily upon unadjusted earnings results should be treated with some skepticism. However, the unadjusted figures presented in Table 2 are directly comparable to the unadjusted figures in Mr. Baxter's chart.

[59] ***UCCM,*** *supra,* 585 S.W.2d at 49.

While the cost of debt capital is determined by the terms of the securities, the cost of equity capital is set by the Commission based upon the expert analysis and testimony presented at the rate case hearing. The Commission's decision is guided by constitutionally-required parameters stated by the United States Supreme Court. In the earlier of the two most important cases, ***Bluefield Water Works***, the Court stated that:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[60]

The Court restated these principles 20 years later in ***Hope Natural Gas Company***:

> '[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[61]

From these two decisions, three guiding principles can be discerned:

(1) An adequate return is commensurate to the returns realized from other

[60] ***Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia***, 262 U.S. 679, 692-93, 43 S.Ct. 675, 679, 67 L.Ed. 1176, 1182-83 (1923).

[61] ***Federal Power Commission v. Hope Natural Gas Company***, 320 U.S. 591, 603, 64 S.Ct. 281, 288, 88 L.Ed. 333, 345 (1943) (citations omitted).

businesses with similar risks. This is the principle of the commensurate return.

(2) An adequate return is sufficient to assure confidence in the financial integrity of the utility and to maintain its credit rating. This is the principle of financial integrity.

(3) An adequate return is sufficient to enable the utility to obtain necessary capital. This is the principle of capital attraction.

The first of these principles is based on risk and requires a comparative process. The return on common equity set by the Commission must be about as much as investors would realize from other investments with similar risks. What entities are those? Other public utilities. Financial analysts and investors recognize that every line of business is, by its very nature, subject to a set of unique risks. Consequently, the business entities that face corresponding risks and uncertainties to the utility under consideration are necessarily other utilities engaged in delivering the same service under similar conditions. Therefore, the Commission must look to the returns realized by a proxy group of comparable companies in setting the utility's return on common equity.[62]

The second principle, simply stated, refers to the effect of the PSC's decision on the utility's credit rating. If the Commission's decision will not cause it to drop, then the utility's credit is maintained and confidence is unimpaired that the utility will continue in business in the future, meeting its obligations as they come due, providing safe and adequate service to its customers, and yielding a fair return to its shareholders.

[62] Both Mr. Gorman and Mr. Hevert analyzed a group of comparable companies in their cost-of-capital studies.

The third principle refers to the utility's ability to compete in the market place for necessary capital. Ameren Missouri competes on a national basis for capital with other utilities and utilities likewise compete with unregulated businesses.

With these principles in mind, how is the Commission to interpret the earned-ROE figures set out above? Mr. Baxter's chart shows that, up to and including October 2011, Ameren Missouri chronically earned *less* than its Commission-authorized ROE. However, by June 30, 2012, less than a year later, as revealed by the surveillance reports, Ameren Missouri began to consistently earn *more* than its Commission-authorized ROE (*see* Table 2). What changed?

Staff suggests that one important change concerns the risk environment in which Ameren Missouri functions. The Commission has significantly reduced the business risk faced by Ameren Missouri by providing risk-reducing mechanisms to the Company. The principal of these is the Fuel Adjustment Clause ("FAC"), but there are others in the form of various trackers and regulatory assets created by Accounting Authority Orders ("AAOs"). The cumulative effect of these deviations from the traditional cost-of-service regulatory model has been a very real shift of business risk away from the Company and onto the ratepayers as revealed by the significant change in earned ROE between Mr. Baxter's chart and Table 2. The Commission should carefully consider this change in Ameren Missouri's risk environment when authorizing its ROE in the present and subsequent file-and-suspend general rate cases.

With respect to the second count of the *Complaint,* Staff will present a full cost-of-service study in Ameren Missouri's now-pending file-and-suspend general rate case, including a cost-of-capital study, Case No. ER-2014-0258. Based upon its recent

ROE recommendations for Ameren Missouri, it is likely that Staff will recommend an ROE below the current authorized level of 9.8% at that time. However, Staff recommends that the Commission *not* adjust Ameren Missouri's ROE in this case, either downward as recommended by Mr. Gorman or upward as recommended by Mr. Hevert.

Conclusion

Staff recommends that the *Complaint* be denied in that Complainants have failed to show that, based upon a consideration of all relevant factors, Ameren Missouri is likely to continue to earn a return materially greater than that authorized by the Commission.

WHEREFORE, Staff prays that the Commission will resolve each contested issue as recommended herein by Staff; and grant such other and further relief as may be just in the circumstances.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this **15th day of August, 2014,** on the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

/s/ Kevin A. Thompson