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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2007-0002

REBUTTAL TESTIMONY

OF

PROFESSOR ROBERT C. DOWNS

ON

BEHALF OF

**UNION ELECTRIC COMPANY
d/b/a AmerenUE**

**St. Louis, Missouri
January, 2007**

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1 **REBUTTAL TESTIMONY**

2 **OF**

3 **PROFESSOR ROBERT C. DOWNS**

4 **CASE NO. ER-2007-0003**

5 **I. INTRODUCTION**

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

7 A. My name is Robert C. Downs. My business address is University of
8 Missouri-Kansas City School of Law, 5100 Rockhill Road, Kansas City, Missouri 64110.

9 **Q. Are you the same Robert C. Downs that filed Direct Testimony in this**
10 **proceeding?**

11 A. Yes, I am.

12 **II. RESPONSE TO DIRECT TESTIMONY OF GREG R. MEYER**

13 **Q. Professor Downs, have you read the Direct Testimony of Greg R. Meyer?**

14 A. Yes I have.

15 **Q. On page 6 of that testimony Mr. Meyer states that “In exchange for**
16 **purchasing the stock of EEInc., the sponsoring utility companies were entitled to**
17 **purchase any excess energy generated from the unit not required to meet AEC’s**
18 **demand.” Have you read the contract to which Mr. Meyer is referring, and do you**
19 **have a legal opinion regarding the accuracy of that testimony?**

20 A. Yes, I have read the contract dated September 2, 1987, which expired
21 December 31, 2005. The contract does not say that the right to purchase energy from
22 EEInc.’s Joppa plant is in exchange for purchasing stock in EEInc. Instead, the contract
23 includes various provisions that exchange rights and responsibilities of the parties, not unlike

1 other long-term supply contracts. While it is true that the shareholders of EEInc. did
2 establish their relative obligations to purchase excess power in proportion to their
3 shareholdings in EEInc., the shareholders had no obligation to do so and no legal right to
4 insist, as shareholders, upon a pro-rata amount of energy. It is also noteworthy that the
5 “entitlement” to which Mr. Meyer refers does not say that the shareholders are entitled to
6 purchase power indefinitely, and certainly not indefinitely valued on a “cost” basis.

7 **Q. On Page 7 of that testimony Mr. Meyer states that the “power from the**
8 **EEInc. unit is now being sold to the outside market through an affiliate and AmerenUE**
9 **ratepayers no longer receive any benefit from their many years of support of the plant**
10 **during its high cost stage.” Do you have a legal opinion as to whether EEInc. had any**
11 **obligation to sell power to AmerenUE after the supply contract ended on December 31,**
12 **2005?**

13 A. The contract ended on December 31, 2005. The power supply rights, to the
14 extent they existed at all, came from that contract. Once it ended, EEInc. was legally entitled
15 to sell power to anyone it chose at a price that reflected the fair value of the power. The fair
16 value of the power is determined by the market value of the power.

17 **Q. But Mr. Meyer suggests that the ratepayers should be entitled to have**
18 **that contract extended or a new contract implemented, because of “their many years of**
19 **support of the plant during its high cost stage.” Do you have a legal opinion regarding**
20 **any supposed rights that ratepayers have to insist upon purchasing power on a “cost”**
21 **basis from EEInc.’s Joppa plant?**

22 A. Yes, I do. First, it is not correct to say that the ratepayers supported the Joppa
23 plant during its high cost stage in the manner that Mr. Meyer implies. EEInc. for many years

1 sold most of the power from its Joppa plant to the federal government. Furthermore, to the
2 extent sales were made to shareholders of EEInc., they were made on a “cost” basis, which
3 was then intended to reflect a fair price for the power. Insofar as I understand it, there were
4 no “markets” for power of the type we normally understand to have existed for a long time
5 for other commodities like gasoline or oil. Thus, the ratepayers, to the extent they received
6 any power from EEInc., received it at fair value. In addition, the rates that ratepayers were
7 charged for power from EEInc.’s Joppa plant were regulated by the state agencies and surely
8 did not reflect any attempt by those regulators to convey any extraordinary financial benefit
9 upon EEInc. or its shareholders. There is simply no legal basis upon which to conclude that
10 any ratepayers have accrued a legal entitlement to purchase power from EEInc. and its Joppa
11 plant, or to purchase that power at less than fair market value.

12 **III. RESPONSE TO DIRECT TESTIMONY OF KEVIN HIGGINS**

13 **Q. Professor Downs, have you read the Direct Testimony of Kevin C.**
14 **Higgins, on behalf of the Commercial Group?**

15 A. Yes I have.

16 **Q. On page 3 of his Direct Testimony, Mr. Higgins asserts that AmerenUE,**
17 **and its affiliates, have chosen to forego the opportunity to purchase cost-based power**
18 **from its share of the EEInc. Joppa generating plant. Do you have a legal opinion**
19 **regarding whether it is legitimate to say that AmerenUE had a legal right to purchase**
20 **power from the EEInc. Joppa plant on a cost basis?**

21 A. Yes, I do. First, the power of the Joppa plant belongs to Electric Energy,
22 Incorporated, (EEInc.) an Illinois corporation formed more than 50 years ago. It is not the
23 property of the shareholders of EEInc. Even less is it the property of the customers of the

1 shareholders of EEInc. Customers who buy products (whether or not it is power) do not
2 thereby become owners of the corporation that sells the product. Further, Mr. Higgins asserts
3 that for AmerenUE to fail to force EEInc. to decide to sell its property (power) at less than
4 fair market value only focuses on the interests of the shareholders and not on the interests of
5 customers. The interests of the shareholders, which the company and its directors are legally
6 bound to protect through their duty of care and duty of loyalty, are only protected if the
7 company's products are sold in a manner that advances those shareholders interests. Sales at
8 fair market value do advance shareholder interests. Sales below fair market value would
9 violate the duty of care because it would not be a rational business decision of the board of
10 directors, and would violate the duty of loyalty, because the directors who sit on the board of
11 EEInc. who are also officers or directors of AmerenUE have a conflict of interest and would
12 be benefiting one entity at the cost of the other. Likewise, if the board of directors of
13 AmerenUE agrees to sell power that is obtained from EEInc., at cost rather than at fair
14 market value (given the existence of a well-defined market for the power), it would also be
15 violating its duty to its shareholders.

16 Mr. Higgins also asserted that the "equities" of ratepayers have been ignored.
17 This is simply incorrect. AmerenUE is purchasing its power for fair market value. The
18 ratepayers have always purchased their power at rates regulated by state agencies. Those
19 ratepayers, as I mentioned earlier, do not somehow grow into owners, or build up equity in
20 the power producing company. As Mr. Higgins says, AmerenUE is a regulated utility with
21 an obligation to provide safe, reliable service at just and reasonable rates. Presumably, Mr.
22 Higgins believes that the acquisition by AmerenUE of power at market rates is somehow
23 unjust or unreasonable. There is simply no legal authority to support such a conclusion.

1 Indeed, if the board of directors of either company should choose to donate its assets to
2 customers (without any other business justification, such as development of good will, etc.)
3 there would be a clear breach of fiduciary duty, subjecting those directors to legal action by
4 the shareholders of the respective corporate entities.

5 **Q. Mr. Higgins, on page 8 of his Direct Testimony, concludes that the rates**
6 **for retail customers should be established such that the effect of excluding the output**
7 **from the EEInc., Joppa plant should be absorbed by the Company, and not by its**
8 **customers. Do you have a legal opinion regarding the appropriateness of that**
9 **conclusion?**

10 A. Yes, I do. There is no legal basis for concluding that AmerenUE is entitled to
11 purchase power from EEInc.'s Joppa plant at any price other than fair market value.
12 Furthermore, the "balance" that Mr. Higgins suggests should be drawn between the interests
13 of shareholders and the interests of customers, has been drawn by him to exclude shareholder
14 interests entirely. This simply cannot legally be done.

15 **Q. Mr. Higgins also suggests that AmerenUE should have directed its**
16 **employees and directors, who sit on the board of directors of EEInc., to require those**
17 **people to vote to sell EEInc. Joppa plant power to AmerenUE on a cost-based price**
18 **rather than for fair market value. Do you have a legal opinion regarding the**
19 **appropriateness of such behavior?**

20 A. Yes, I do. It is not uncommon for corporations that have large shareholders to
21 have directors who are employees or directors of the large shareholders. It is also true that
22 sometimes people view those directors as "representatives" of the shareholders. It is also
23 true that such directors are in clear conflict of interest situations whenever there is a

1 transaction that involves both corporations. In this case, AmerenUE is a large shareholder of
2 EEInc. and there are over-lapping officers and directors. Nevertheless, it is absolutely clear
3 that the directors of EEInc. have powerful fiduciary duties to EEInc. when they are acting as
4 directors of EEInc. Those fiduciary duties are not reduced to account for their positions with
5 the major shareholder (AmerenUE, or Ameren Energy Resources, an AmerenUE affiliate).
6 The directors may be called upon to wear two hats, but they only wear one hat at a time. It
7 would be legally impermissible for AmerenUE to insist, through coercion or direction of its
8 employee/directors, that EEInc. sell its assets to AmerenUE for less than fair market value.
9 AmerenUE has a similar issue with its own shareholders. Even if it has improperly forced
10 EEInc. to sell its power to AmerenUE for less than fair value, AmerenUE could not properly
11 then transfer that value to customers for less than fair value, absent a commercially
12 reasonable business reason that would benefit the Company and its shareholders.

13 **Q. On page 9 of his Direct Testimony, Mr. Higgins suggests that the decision**
14 **and plan to sell the EEInc. Joppa plant power at fair market rates, was not actually the**
15 **decision of the Board of Directors of EEInc. but rather the decision of “representatives**
16 **of Sponsors’ companies.” Do you have a legal opinion regarding the decision making**
17 **process employed by EEInc. in reaching its decision?**

18 **A.** Yes, I do. Boards of Directors often delegate tasks to committees of the
19 Board, or to others who have experience and ability regarding the particular business activity.
20 In the case of this decision, the minutes of the meeting of the EEInc. Board of Directors
21 clearly show that it was the Board of Directors that decided to sell the output from its Joppa
22 plant at market-based rates.

1 **Q. Mr. Higgins asserts, on page 12 and thereafter, that because Union**
2 **Electric Company guaranteed certain EEInc. bonds (to fund pollution control**
3 **improvements) to facilitate the purchase thereof by Metropolitan Life Insurance**
4 **Company, the ratepayers are now and continue to be entitled to obtain “cost-based”**
5 **power from EEInc. Do you have a legal opinion regarding the asserted entitlement**
6 **based on the bond guarantee and related obligations Union Electric Company (and**
7 **others) to purchase power from EEInc.?**

8 A. Yes, I do. First, the bond issue was done in 1977, almost 30 years ago. The
9 benefits and burdens of that transaction have long since been received and incurred by the
10 parties to that agreement. AmerenUE never had to pay anything under that guarantee.
11 Second, that guarantee agreement had no provision that obligated EEInc to sell power to its
12 shareholders, forever, at a cost-based price. In addition, the EEInc customers received the
13 power at agreed rates, under the earlier power supply contracts as well as the most recent one
14 that expired in December 31, 2005. In my opinion, the rights and entitlements which Mr.
15 Higgins claims for customers are not founded on any legal right whatsoever. A “feeling” that
16 the customers “should” receive power for a below market rates does not create such a right. I
17 suspect that most customers would always want products at lower prices, but that desire does
18 not amount to an entitlement.

19 **IV. RESPONSE TO DIRECT TESTIMONY OF RYAN KIND**

20 **Q. Professor Downs, have you read the Direct Testimony of Ryan Kind?**

21 A. Yes, I have.

22 **Q. Mr. Kind asserts in his Direct Testimony, at pages 22-28, that the**
23 **ratepayers have a continuing entitlement to receive power from the EEInc. Joppa plant**

1 **at below market rates, and that such entitlement comes from the following sources: (a)**
2 **the duty of the utility companies to provide power at just and reasonable rates, (b) the**
3 **fact that the ratepayers supported the Joppa plant over the past 50 years by purchasing**
4 **power, and guaranteeing a bond issue, and (c) the by-laws of EEInc. entitle its**
5 **shareholders to receive a percentage of power from the Joppa plant. Do you have a**
6 **legal opinion regarding the accuracy of Mr. Kind's conclusions about such ratepayer**
7 **entitlements?**

8 A. Yes, I do. My responses regarding the duty to provide power at just and
9 reasonable rates and the participation of ratepayers in supporting the Joppa plant are
10 contained in my responses to the Direct Testimony of Mr. Higgins. The short answers are
11 that “just and reasonable rates” do not imply and certainly do not require the sale at below
12 market rates, and the participation of ratepayers in “supporting” the Joppa plant is greatly
13 exaggerated due to the fact that vast majority of the Joppa plant power output was purchased
14 by the federal government, and depended little if any upon the purchases of customers of
15 AmerenUE or other shareholders of EEInc. Moreover, buying the corporation's product at
16 cost-based rates that in effect “cover” the corporation's costs is not some kind of “support”
17 that then creates an entitlement in the customers to own the corporation or to obtain the
18 product at a particular price forever. Regarding the bylaws of EEInc., it is not accurate to say
19 that the bylaws provide that the shareholders will have a certain entitlement to the power
20 from the Joppa plant. Those bylaws, Article II, Section 6, merely describe what voting rights
21 shareholders have, and what voting percentages are required to take certain actions for the
22 corporation. It is clear from that provision that the shareholders of EEInc. could, with a 75%
23 vote, change the allocation of excess power from the Joppa plant that EEInc had previously

1 established. Of course, if EEInc can change the allocation, it would be inappropriate to
2 describe any particular allocation as a “right” of the shareholder. Moreover, those bylaws do
3 not provide for any shareholder right to buy power at cost from EEInc. in perpetuity. To the
4 extent that shareholders had rights and obligations regarding the purchase of Joppa plant
5 excess power, those rights were described in the Power Supply Contract, and terminated
6 when that Contract expired on December 31, 2005.

7 **V. RESPONSE TO DIRECT TESTIMONY OF MICHAEL BROSCH**

8 **Q. Professor Downs, have you read the Direct Testimony of Michael Brosch?**

9 **A. Yes, I have.**

10 **Q. Mr. Brosch discusses the EEInc. Joppa plant on pages 18-30 of his Direct**
11 **Testimony, is that correct?**

12 **A. Yes, it is.**

13 **Q. In his testimony, Mr. Brosch claims that the ratepayers of AmerenUE**
14 **should be entitled to receive the benefit of below market priced power from the EEInc.**
15 **Joppa plant due to the ratepayers’ support of the Joppa plant over the past 50 years,**
16 **and that it is of little consequence that EEInc.’s capital investment in the Joppa plant**
17 **was not made directly by AmerenUE’s shareholders. Do you have a legal opinion about**
18 **whether the purchase of power from EEInc.’s Joppa plant, at cost-based rates, created**
19 **some kind of indefinite legal right to purchase at below market rates into the future,**
20 **and whether it makes any difference as to who provided the investment capital for the**
21 **EEInc. to build the Joppa plant?**

22 **A. Yes, I do. Mr. Brosch makes the same claims as Mr. Meyer, Mr. Higgins and**
23 **Mr. Kind, and with no more support for his conclusions than they had for theirs. The Joppa**

1 plant was purchased with funds provided by the shareholders of EEInc., not with funds
2 provided by the customers who purchase power. The rates paid by customers of EEInc. were
3 cost-based, and were determined through the regulatory process. Nothing in that process is
4 intended to convert the ratepaying customers into owners of EEInc. or its Joppa power plant.
5 Thus, it is not correct to say that the Joppa plant was constructed, operated and maintained
6 largely at ratepayer risk and expense. Indeed, even the bond guarantee agreement, which
7 obligated the shareholders to support the Joppa plant output, was not done at ratepayer risk
8 and expense. First, there was no expense, since no power was purchased pursuant to that
9 commitment, and second, the risk that the witnesses assert existed assumes that the financial
10 risk would have been passed on to the ratepayers of the shareholders. I am unaware of any
11 indication that AmerenUE would have tried to pass this risk on to its ratepayers or that the
12 regulating agencies would have included such costs in the power rates charged to customers,
13 even if AmerenUE's shareholders would have had to make good on the guaranty.

14 **Q. Mr. Brosch claims that the price at which EEInc. is selling its power to**
15 **other buyers creates a “windfall” for the shareholders of EEInc., and that somehow**
16 **such profit is unfair to ratepayers. Do you have a legal opinion about whether EEInc.**
17 **and its shareholders are legally entitled to sell EEInc. Joppa plant power at fair market**
18 **value?**

19 **A.** As I have stated earlier in my testimony, I believe that EEInc is legally
20 *obligated* to sell its power at fair market value. EEInc. owns that power. The ratepayers do
21 not own that power. The shareholders of EEInc. and their shareholders are entitled to have
22 their corporations make a profit and are entitled to insist that the assets of the corporations
23 not be donated to third parties, without proper business justifications which benefit the

1 corporations and their shareholders. Indeed the use of the pejorative word “windfall” in
2 connection with the right of EEInc. to sell its power at fair market value, seems quite
3 improper in the extreme.

4 **Q. On page 25 of his testimony, Mr. Brosch suggests a way in which the**
5 **Commission could arrange to take the profits now accruing to the benefit of EEInc. and**
6 **its shareholders from the sale of Joppa plant power at fair market value, and pay those**
7 **profits to the customers of the EEInc. shareholders. Do you have a legal opinion**
8 **regarding the appropriateness of that recommendation?**

9 A. Yes, I do. I find it inconceivable that the recommendation could be
10 considered. Mr. Brosch apparently acknowledges that the Commission cannot force EEInc.
11 to extend the Power Supply Contract that expired on December 31, 2005, and force EEInc. to
12 sell power at below market rates to its shareholders or anyone else. Instead, he suggests that
13 the Commission should include unregulated assets that belong to the EEInc. and its
14 shareholders into the ratemaking process for the regulated rates of AmerenUE. The effect of
15 the suggestion is to acknowledge that a course of action cannot be legally undertaken, and
16 then to recommend that it be done in some nefarious fashion. Simply stated, Mr. Brosch is
17 suggesting that the Commission should take the funds owned by EEInc. and its shareholders
18 and *give* them to the customers of the shareholders, all under the guise of so-called “equity
19 and fairness,” in the view of Mr. Brosch. In my opinion, it is not unfair for customers to pay
20 fair market value for the power they consume. It is unfair for them to expect that power
21 companies will provide the power at less than the power is worth. Mr. Brosch makes much
22 of the “excess profits” to be earned by EEInc. in the sale of its power. Frankly, companies
23 and their shareholders, in capitalist countries, are entitled to the benefits of our system.

1 Customers do not own the store, even in regulated industries. They particularly don't own
2 the store when the store is owned by a separate company whose stock was purchased with
3 shareholder funds.

4 **Q. Does this conclude your Rebuttal Testimony?**

5 **A.** Yes it does.

