Exhibit No. 414

Office of the Public Counsel – Exhibit 414
David Murray
Rebuttal Testimony (Gas)
File Nos. ER-2021-0240 & GR-2021-0241

Exhibit No.:	414
Issue(s):	Rate of Return (ROR)/ Capital Structure/Return on Equity (ROE)
Witness/Type of Exhibit:	Murray/Rebuttal
Sponsoring Party:	Public Counsel
Case No.:	GR-2021-0241

REBUTTAL TESTIMONY

OF

DAVID MURRAY

Submitted on Behalf of the Office of the Public Counsel

UNION ELECTRIC COMPANY D/B/A AMEREN MISSOURI

FILE NO. GR-2021-0241

October 15, 2021

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Union Electric Company d/b/a Ameren Missouri's Tariffs to Increase its Revenues for Gas Service	)))))	Case No. GR-2021-0241

AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI)
) **ss**
COUNTY OF COLE)

David Murray, of lawful age and being first duly sworn, deposes and states:

1. My name is David Murray. I am a Utility Regulatory Manager for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

David Murray
Utility Regulatory Manager

Subscribed and sworn to me this 15th day of October 2021.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI
TIFFANY HILDEBRAND
My Commission Expires
August 8, 2023
Cole County
Commission #15637121

Tiffany Hildebrand
Notary Public

My Commission expires August 8, 2023.

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REBUTTAL TESTIMONY

OF

DAVID MURRAY

UNION ELECTRIC COMPANY d/b/a AMEREN MISSOURI

FILE NO. GR-2021-0241

Q. Please state your name and business address.

A. My name is David Murray and my business address is P.O. Box 2230, Jefferson City, Missouri 65102.

Q. Are you the same David Murray who previously filed Direct Testimony in this case?

A. Yes.

Q. What it the purpose of your testimony?

A. To respond to the direct testimony of Ameren Missouri's witnesses, Ann E. Bulkley and Darryl T. Sagel, as it relates to rate of return ("ROR") and capital structure. I will also address Staff witness Seoung Joun Won's (Dr. Won) direct testimony.

Q. How will you approach the presentation of your rebuttal testimony?

A. I will address capital structure first. As it relates to capital structure, I will address Mr. Sagel and Dr. Won together since they recommend the same capital structure for purposes of setting Ameren Missouri's authorized ROR for its local natural gas distribution system ("gas utility"). I will then address Ms. Bulkley's and Dr. Won's recommended ROE separately because they have different recommendations and different approaches to how they arrive at their recommended ROEs.

CAPITAL STRUCTURE

Q. Do you agree with the other parties' positions on capital structure in this case?

A. No. Both Mr. Sagel and Dr. Won recommend the Commission determine Ameren Missouri's authorized ROR for its gas utility using Ameren Missouri's capital structure balances. At this point, the only cause for the difference in Dr. Won's and Mr. Sagel's capital structure ratios is due to Dr. Won's use of Ameren Missouri's actual capital structure balances as of June 30, 2021, where Mr. Sagel recommends Ameren Missouri's projected capital structure ratios as of September 30, 2021. Assuming Dr. Won updates his Ameren Missouri capital structure recommendation through the true-up date, his recommended capital structure ratios should be similar to Mr. Sagel's.

Q. Are you confident Ameren Missouri will be able to achieve its projected common equity ratio of 51.93% as of the September 30, 2021, true-up date in this case?

A. Yes. As I identified in my direct testimony, Ameren Missouri consistently manages its capital flows to achieve a common equity ratio of approximately 52% for the capital structure it desires for ratemaking. It is not difficult for Ameren Corp to achieve this target for Ameren Missouri since Ameren Corp can simply allow Ameren Missouri to retain more of its earnings in the intervening quarter to allow its equity ratio to reach it ratemaking target of 52%. Ameren Corp has been able to consistently manage Ameren Missouri's capital structures for ratemaking to achieve a common equity ratio range of 51.75% to 52.30% for the last ten years.

Q. Has Ameren Corp consistently targeted this same high common equity ratio on a consolidated basis?

A. No. As I explained in my direct testimony, Ameren Corp's equity ratio has continued to diverge from Ameren Missouri's equity ratio. In fact, in Ameren Missouri's last electric rate case, Case No. ER-2019-0335, the difference between my recommended common equity ratio (guided by Ameren Corp's consolidated capital structure) and Ameren Missouri's common equity ratio was 4% (52% vs. 48%). This gap has widened to 7% (52% for Ameren Missouri vs. 45% for Ameren Corp). This is due to the fact that Ameren Corp has continued to increase the amount and proportion of holding company debt as compared to total consolidated debt. On March 29, 2019, Moody's gave Ameren Corp the flexibility to incur more leverage at the holding company level without jeopardizing its credit rating by lowering its Funds from Operations ("FFO")/debt threshold to 17% from

19%. One of the primary reasons for doing so was the "improved regulatory construct in Missouri facilitating meaningful rate base growth and reducing regulatory lag [PISA]."[1]

Q. What was Ameren Missouri's authorized equity ratio and ROE for its electric utility before it was able to elect PISA accounting?

A. 51.76% equity and a 9.53% ROE.[2]

Q. Has Ameren Corp adjusted its common equity ratio for its subsidiary, Ameren Illinois, and its ATXI subsidiary since Ameren Missouri's 2019 electric utility and gas utility rate cases?

A. Yes. It increased its common equity ratio for its subsidiary, Ameren Illinois, to approximately 53% from 50%.[3] It increased its common equity ratio for ATXI to 60.1% from 56%.[4]

Q. If Ameren Corp has increased the equity thickness at its other subsidiaries and is still maintaining a 52% equity ratio at Ameren Missouri, why is Ameren Corp's consolidated capital structure more leveraged now than at the time of Ameren Missouri's 2019 rate cases?

A. Because it is issuing holding company debt to invest in the equity of its subsidiaries. Ameren Corp's only assets are its equity interests in its subsidiaries. Ameren Corp's debt capacity arises from its ownership of low-risk regulated utility assets. Ameren Corp's debt capacity increased after Ameren Missouri was able to elect PISA.

Q. Why hasn't Ameren Corp allowed this debt capacity to be directly used by its Ameren Missouri subsidiary?

A. Because this would upset the ratemaking paradigm Ameren Corp believes it has established for its Ameren Missouri subsidiary. The Commission can correct this misappropriation of

[1] "Updated to Credit Analysis," Moody's Investor Service, March 29, 2019, p. 2.
[2] Case No. ER-2014-0258, Report and Order, April 29, 2015, pgs. 61 and 68.
[3] Docket 21-0365, Illinois Commerce Commission, Ameren Illinois Company.
[4] Ameren Corporation SEC Form 10-K Filing, December 31, 2020, p. 8.

Ameren Missouri's debt capacity to Ameren Corp by authorizing Ameren Missouri a lower common equity ratio. I recommend the Commission authorize Ameren Missouri a 45% common equity ratio, which is consistent with the leverage Ameren Corp has deemed appropriate and optimal considering the low business risk of its regulated assets. If Ameren Corp wants the Commission to authorize Ameren Missouri a higher common equity ratio, it can reduce the amount of holding company debt it issues and maintain the current debt ratios at its subsidiaries.

Q. Has Staff changed its opinion as to the appropriate ratemaking capital structure for Ameren Missouri since the 2019 electric and gas rate cases?

A. Yes. In Ameren Missouri's 2019 electric and gas rate cases, Staff recommended Ameren Missouri's common equity ratio be set at 50% based on its comparison of Ameren Corp's capital structures to Ameren Missouri's capital structures over the period 2011 through 2018.

Q. Did Dr. Won explain why he diverged from Staff's position in Ameren Missouri's 2019 rate cases?

A. Not specifically. In fact, it appears that Staff believes it recommended Ameren Missouri's stand-alone capital structure in the 2019 rate cases. Dr. Won indicates that there has not been a "discernable change to Ameren Missouri's or Ameren Corp's capital structure policies since the last rate case to cause Staff to recommend that Ameren Missouri's stand-alone capital structure should not be used for ratemaking purposes in this proceeding."[5] Dr. Won then goes on to cite four criteria he believes supports the use of Ameren Missouri's capital structure to set Ameren Missouri's ROR.

Q. Did Staff discuss these factors in the 2019 rate cases?

A. No.

[5] Staff COS Report, p. 26, lines 17-19.

Q. What information did Staff provide in the 2019 rate cases to support its recommended 50% common equity ratio?

A. The fact that the difference between Ameren Corp's common equity ratio and Ameren Missouri's common equity ratio had been widening since at least 2014.[6] At the time, Staff showed that the difference between Ameren Corp's and Ameren Missouri's common equity ratios had widened to approximately 4% in 2018. Staff also supported its recommended 50% equity ratio by citing the fact that a 50% ratemaking common equity ratio had been used for setting rates for Ameren Illinois' electric utility operations. After many years of litigation, the Staff of the Illinois Commerce Commission ("ICC") and Ameren Illinois agreed a common equity ratio no higher than 50% should be deemed prudent for ratemaking unless Ameren Illinois provided evidence that specific circumstances justified the need for a higher common equity ratio.

Q. What is your understanding of the basis for the four criteria discussed by Dr. Won?

A. These criteria appear to be a blend of factors the Commission considered in Spire Missouri's 2017 rate case, Case No. GR-2017-0215 and four factors cited in the curriculum used for the Certified Rate of Return Analyst ("CRRA") test administered by the Society of Utility and Regulatory Financial Analysts ("SURFA"). The Commission cited the following reasons for using Spire Missouri's capital structure in its Report and Order ("R&O") in the 2017 rate case:

> 7. Spire Missouri has an independently determined capital structure in that its debt is secured by its own assets and not the assets of Spire Inc. or any of Spire Inc.'s other subsidiaries.117 [footnote omitted] Additionally, Spire Missouri's assets do not guarantee the long-term debt of its parent or of any of Spire Inc.'s other public utilities or of Spire Marketing or Spire STL Pipeline.118 [footnote omitted] Further, the Commission must approve any long-term debt issuances made by Spire Missouri; and
>
> 8. Spire Missouri's stand-alone capital structure supports its own bond rating.

[6] Case No. ER-2019-0335, Staff COS Report, December 4, 2019, p. 21.

The four factors cited in the CRRA curriculum are as follows:

1. Whether the subsidiary utility obtains all of its capital from its parent, or issues its own debt and preferred stock;
2. Whether the parent guarantees any of the securities issued by the subsidiary;
3. Whether the subsidiary's capital structure is independent of its parent (i.e. existence of double leverage, absence of proper relationship between risk and leverage of utility and non-utility subsidiaries);
4. Whether the parent (or consolidated enterprise) is diversified into non-utility operations.[7]

Q. What is Dr. Won's first factor?

A. Dr. Won indicates that Ameren Missouri operates as an independent entity when considering Ameren Missouri's procurement of financing and the cost of that financing. He indicates that Ameren Missouri has not received long-term financing from Ameren Corp. or any of its subsidiaries.[8] Dr. Won cites Ameren Missouri's response to Staff Data Request No. 0328 to support his position. Dr. Won's first factor seems to follow the first factor cited in the CRRA curriculum.

Q. What is Dr. Won's second factor?

A. Dr. Won states that because in his opinion, Ameren Missouri's stand-alone capital structure supports its own credit rating, this supports using Ameren Missouri's capital structure for ratemaking. Dr. Won's second factor takes guidance from the Commission's Findings of Fact No. 8 cited in the R&O in Spire Missouri's 2017 rate case.

Q. What is Dr. Won's third factor?

A. Dr. Won indicates that because Ameren Missouri's debt is not secured by Ameren Corp.'s assets and Ameren Corp's debt is not secured by Ameren Missouri's assets that this supports using Ameren Missouri's stand-alone capital structure. Dr. Won's third factor is

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[7] David Parcell, "The Cost of Capital – A Practitioner's Guide," 2010 Edition, p. 46.
[8] Staff Direct COS Report, p. 26, l. 22 – p. 27, l. 2.

a combination of the Commission's Findings of Fact No. 7 from the R&O in the 2017 Spire Missouri rate case and the second factor cited in the CRRA curriculum.

Q. Did Staff cite these same three factors in Ameren Missouri's concurrent electric rate case?

A. Yes.

Q. What is Dr. Won's fourth factor?

A. Dr. Won indicates that because both Ameren Corp and Ameren Missouri are primarily regulated utilities, this supports the use of Ameren Missouri's capital structure. He reasons that because business risks of the parent company (Ameren Corp) and its subsidiary (Ameren Missouri) are similar, they should be able to incur similar amounts of financial risk.[9] Dr. Won then indicates that Ameren Corp and Ameren Missouri have similar proportions of leverage in their capital structures as of December 31, 2020 (52% long-term debt, which would imply approximately 48% common equity). However, Dr. Won did not provide supporting calculations for his conclusion regarding financial risk similarities.

Q. Did Staff cite these same factors in the concurrent Ameren Missouri electric rate case, Case No. ER-2021-0240?

A. No. Staff's witness in the electric rate case, Peter Chari, cited the first three factors, but he did not cite the final factor.

Q. Did Staff omit one of the factors cited in the CRRA curriculum?

A. Yes. Staff did not discuss factor number three in the CRRA curriculum, which is whether a subsidiary's capital structure can be considered independent as it relates to the existence of double leverage and the absence of a proper relationship between risk and leverage of utility and non-utility subsidiaries.

[9] Case No. GR-2021-0241, Won Direct Testimony, p. 27, lns. 14-21.

Q. Do you agree with Staff that the factors it cited supports the use of Ameren Missouri's stand-alone capital structure?

A. No. First, as I argued in the recent Spire Missouri gas rate case, Case No. GR-2021-0108, these factors should not be analyzed in isolation without consideration of the interrelationship of the other factors. For example, the existence of double leverage and the fact that Ameren Corp's subsidiaries are pure-play regulated utilities should be considered together (and given the most weight) because Ameren Corp is able to issue holding company debt due to its regulated utilities' low business risk. In the last rate case, Ameren Corp argued it could carry more leverage for its investments in its other regulated utility subsidiaries because they have lower business risk than Ameren Missouri.[10] However, Ameren Corp is no longer making this argument for Ameren Illinois. In fact, Ameren Corp is currently arguing for an approximate 53% common equity ratio for its Ameren Illinois electric utility operations because its authorized ROE for the upcoming calendar year will be 7.36%. Ameren Corp has also increased ATXI's common equity ratio to 60.1%. Considering the increase in the equity ratios at Ameren Missouri's affiliates and Ameren Missouri's constant equity ratio of ~52%, it would be reasonable to conclude that Ameren Corp's consolidated common equity ratio would be higher rather than lower since these changes, but this is not the case due to Ameren Corp's more aggressive use of holding company debt, which has almost doubled in proportion to total debt since the updated test year in Ameren Missouri's last rate case (8.39% to 16.59%).

Q. Can you address each factor independently first, and then discuss how the factors combined support your recommendation to use Ameren Corp's consolidated capital structure as a guide a fair and reasonable common equity ratio in this case?

A. Yes. First, Dr. Won is correct that Ameren Missouri issues debt directly to third-party investors. However, Dr. Won does not specify that Ameren Corp shares credit facilities with Ameren Missouri and Ameren Illinois. Under Ameren Corp's shared credit facility with Ameren Missouri, it has the ability to directly borrow up to $900 million of the shared

[10] Case No. ER-2019-0335, Darryl T. Sagel Rebuttal, p. 14, lines 3-8.

$1.4 billion credit facility or issue this amount in commercial paper. Commercial paper is typically used to support immediate cash needs, such as for working capital, construction work in progress ("CWIP"), or paying expected dividends to third-party shareholders. Commercial paper is can be used for a variety of purposes, which may include for purposes of paying dividends to third-party shareholders. The ability of Ameren Corp to issue this commercial paper is dependent on the low business-risk profile of its Ameren Missouri assets, which was enhanced by its ability to elect PISA.

It is also important to note that while Ameren Corp does not execute inter-company notes to provide debt proceeds to Ameren Missouri, the debt it issues is used to invest in the equity of its other subsidiaries. The only reason Ameren Corp has not done so for its Ameren Missouri subsidiary is because it wants to preserve the appearance that Ameren Missouri's assets are not supported/responsible for more leverage than that which is represented on its books. This is a superficial argument. As Ameren Corp demonstrates through its financial policy of injecting capital through infusions and disbursements into Ameren Missouri related to its tax equity agreement, many of Ameren Corp's financial transactions are not a function of capital needs, but rather for purposes of facilitating affiliate financial transactions and agreements. This is an example of why S&P assigns the same group credit rating to Ameren Corp and all of its subsidiaries.

Q. Does Staff maintain that Ameren Missouri's capital structure supports its credit rating?

A. Yes.

Q. Is it appropriate to make this blanket statement?

A. No.

Q. Why?

A. Because Moody's and S&P have differing approaches relating to assigning Ameren Missouri its credit rating. Moody's gives weight to Ameren Missouri's stand-alone capital structure for purposes of assigning its long-term issuer rating of 'Baa1'. However, S&P

assigns Ameren Missouri a credit rating based on Ameren Corp's group credit profile. Because Staff cited S&P Global Market Intelligence as support for its position, I requested Staff to provide the specific information from S&P Global Market Intelligence it relied on for its conclusion. In response to my data request, Staff provided a copy of S&P Global Ratings, RatingsDirect, April 30, 2021, report describing the ratings assigned to Ameren Missouri. S&P states the following in this report:

> Under our group rating methodology, we consider AM a core subsidiary of parent Ameren with a group credit profile of 'bbb+'. This core status reflects our view that AM is highly unlikely to be sold, integral to the group's overall strategy, possesses a strong long-term commitment from senior management, and closely linked to the parent's name and reputation. Given its core subsidiary status and Ameren's group credit profile of 'bbb+', the issuer credit rating on AM is 'BBB+'.[11]

In a report S&P published after it revised its group ratings methodology as of July 1, 2019, S&P stated the following about its decision to assign Ameren Missouri a credit rating based on Ameren Corp's group credit profile:

> The rating actions reflect the application of our revised Group Rating Methodology criteria as well as our assessment of Ameren Illinois and Union Electric as core subsidiaries of Ameren Corp. Our view is that the current insulation measures are not sufficient to warrant a notch of separation between parent Ameren Corp. and either subsidiary. Therefore, we align our issuer credit rating on both subsidiaries with our 'bbb+' group credit profile on Ameren Corp.[12]

Therefore, Staff's testimony is incorrect in stating that S&P assigns Ameren Missouri a credit rating based on its own capital structure.

Q. What SACP does S&P assign to Ameren Illinois?

A. 'A-'. But S&P ultimately assigns Ameren Illinois a credit rating based on Ameren Corp's group credit profile of 'BBB+'.

[11] William Hernandez, et. al., Union Electric Co. d/b/a Ameren Missouri, S&P Global Ratings – RatingsDirect, April 30, 2021, pgs. 10-11.
[12] William Hernandez, et. al., "Research Update: Ameren Illinois Co. And Union Electric 'BBB+' Ratings Affirmed and Removed from UCO," S&P Global Ratings – RatingsDirect, September 18, 2019, pg. 1.

Q. Staff also indicates that the cost of Ameren Missouri's financing supports the use of Ameren Missouri's capital structure. Did Staff provide evidence to support this position?

A. No.

Q. Did you provide evidence in your direct testimony that shows Ameren Missouri's cost of debt is very similar to Ameren Illinois' cost of debt?

A. Yes.[13] The yield-to-maturities ("YTM") for bonds of similar tenors were actually slightly lower for Ameren Missouri's bonds than for Ameren Illinois's bonds. This market-based evidence indicates that if anything, bond investors perceive Ameren Missouri's bonds as being slightly safer than Ameren Illinois' bonds, despite the fact that Moody's rates Ameren Illinois' bonds higher.

Q. Does the fact that the current YTM on outstanding bonds are fairly similar across Ameren Corp's companies support S&P's group ratings approach or Moody's entity-specific approach?

A. It supports S&P's group ratings approach. S&P assigns Ameren Illinois' and Ameren Missouri's mortgage bonds the same rating based on Ameren Corp's group credit rating profile of 'BBB+'. S&P's methodology applies the same two-notch upgrade to the parents' credit rating for mortgage bonds issued by its subsidiaries.

Q. Is Dr. Won correct that Ameren Missouri's assets are not pledged as security for Ameren Corp's debt or any of its affiliates' debt?

A. Yes.

[13] Murray Direct, p. 45, lns. 1-18.

Q. Is Dr. Won correct that none of Ameren Missouri's affiliates' assets are pledged as security for Ameren Missouri's debt?

A. Yes.

Q. Does Ameren Missouri need support from Ameren Corp to issue stand-alone debt?

A. No. In fact, Ameren Missouri could have its own stand-alone credit facility without sharing it with Ameren Corp, but this would not be beneficial to Ameren Corp as it relates to its access to commercial paper to fund other investments.

Q. Has Ameren Corp disaggregated shared credit facilities in the past when an entity was causing a strain on Ameren Corp's credit quality?

A. Yes. Ameren Corp did so in 2010 when it was attempting to limit the impact Ameren Corp's non-regulated subsidiary, Ameren Energy Generating Company had on its credit quality.[14] Ameren Corp also did so in 2006 when it no longer allowed Ameren Illinois (then operating as five different companies: Central Illinois Public Service Company, CILCORP Inc., Central Illinois Light Company, Illinois Power Company and Ameren Energy Resources Generating Company) access to the shared credit facility Ameren Corp had with Ameren Missouri and Ameren Energy Generating Company.[15] .

Q. Does Ameren Corp provide current financial support for non-regulated subsidiaries?

A. Not that I am aware. The financial obligations Ameren Corp is required to fund is its holding company debt.

Q. Has Ameren Corp's holding company debt issuances directly supported its other subsidiaries' in the past?

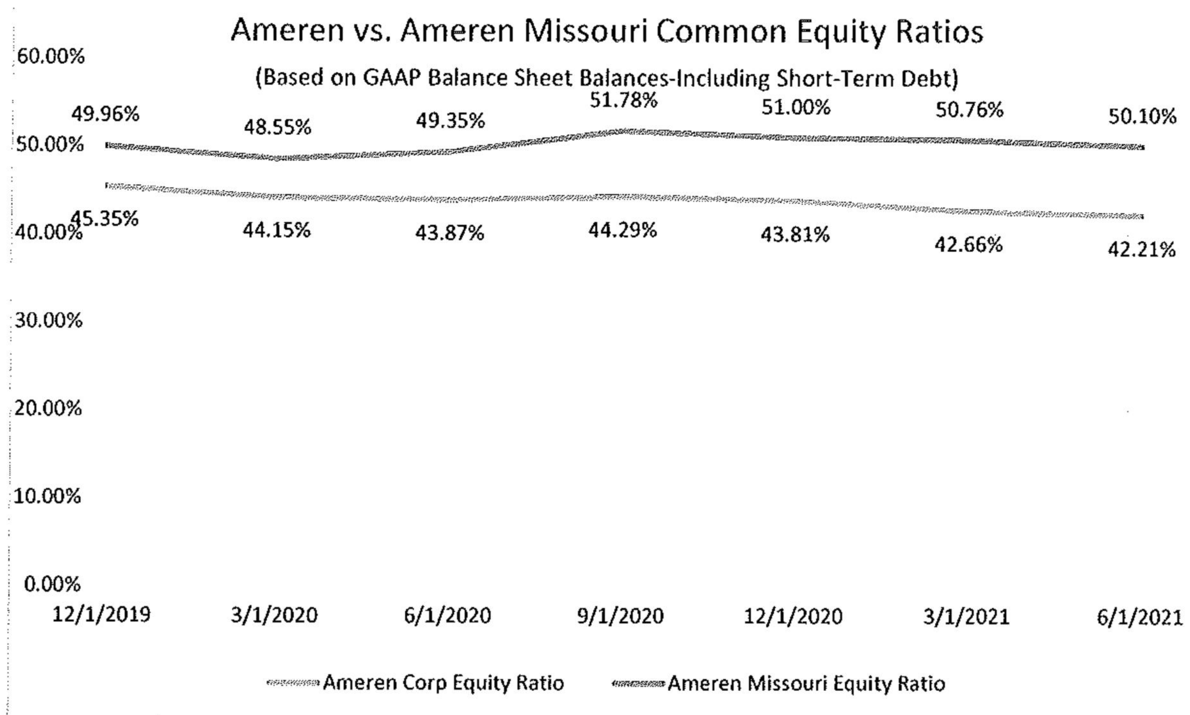
A. Yes. As I explained in my direct testimony, Ameren Corp used holding company debt to support investments in ATXI since 2010. ATXI did not issue its own debt until June 22,

[14] Ameren Corp 2010 SEC 10-K Filing, pgs. 114-118.
[15] Ameren Corp 2006 SEC 10-K Filing, pgs. 124-128.

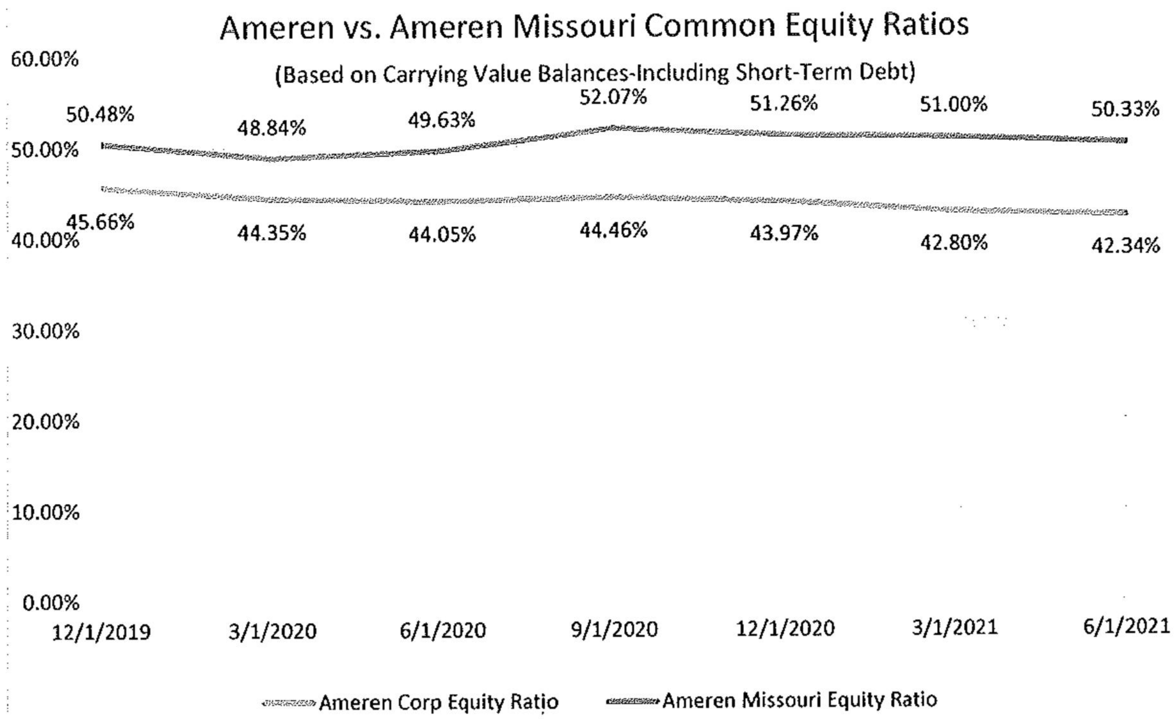
2017, when it made an inaugural debt offering of $450 million, of which $425 million was used to refund $500 million of debt Ameren Corp had issued on its behalf.

Q. What is your response to the final factor Staff cited as support for its decision to recommend Ameren Missouri's ROR be set based on Ameren Missouri's capital structure?

A. I agree with Dr. Won that because Ameren Corp and Ameren Missouri are primarily regulated utilities with low business risk profiles, they should be able to use similar proportions of debt in their capital structures. However, I disagree with Dr. Won's conclusion that they have similar proportions of debt in their capital structures. Schedule DM-D-6-2 attached my direct testimony provided a comparison of Ameren Corp's and Ameren Missouri's capital structures over the five-quarter period covering the test year in this case. Due to the importance of ensuring Ameren Missouri's ratepayers receive credit for the lower business risk they support through PISA, it is very important to closely consider the widening gap between Ameren Corp's use of a higher proportion of debt in comparison to Ameren Missouri's constant proportion of debt at 48%. Therefore, I expanded the period I showed in the schedule attached to my direct testimony to show a comparison of Ameren Corp's and Ameren Missouri's capital structures through the most recent quarter in which data is available (12/31/2019 through 6/30/2021). As detailed in in Schedule DM-R-1 and summarized in the below graph, using balance sheet balances filed with the Securities and Exchange Commission ("SEC"), Ameren Corp's consolidated common equity ratio has been declining whereas Ameren Missouri's has remained relatively constant.



Recognizing the fact that for ratemaking purposes, capital balances may be adjusted to reflect the carrying values or net proceeds received for various capital issuances, I also show Ameren Corp's and Ameren Missouri's common equity ratios using these balances in the below chart:



As clearly demonstrated in the above charts, Ameren Corp has been utilizing more leverage at the consolidated level by issuing a larger proportion of holding company debt as it relates to total consolidated debt. Although I agree with Staff that Ameren Corp and Ameren Missouri should have similar debt capacities considering the low business-risk associated with their regulated utility investments, the financial data clearly shows Ameren Corp is using this debt capacity for its own gain by supporting high-cost ratemaking capital structures with cheap debt financing at the holding company level.

Q. **Can you summarize your disagreement with Staff regarding whether the factors it cited supports the use of Ameren Missouri's stand-alone capital structure for ratemaking in this case?**

A. Yes. Staff is incorrect in stating that Ameren Missouri's capital structure supports its own credit rating. While I agree that Moody's gives consideration to Ameren Missouri's capital structure, and consequently its financial risk, when assessing Ameren Missouri's financial risk profile, S&P clearly states that it assigns Ameren Missouri a credit rating based on Ameren Corp's group credit profile. The fact that the cost of Ameren Missouri's and Ameren Illinois' debt is fairly similar provides evidence that debt investors consider Ameren Corp's family of companies to have similar risk profiles. Staff is also incorrect in stating that Ameren Corp and Ameren Missouri have similar amounts of financial risk in their capital structures, but Staff is correct that there is no reason Ameren Missouri's capital structure should be less levered than Ameren Corp's capital structure. Instead of passing the benefit of lower capital costs through to Ameren Missouri ratepayers who provide the certainty of recovery of costs associated with PISA investments, Ameren Corp is attempting to retain the financial benefit of lower capital costs for its shareholders. The Commission can correct the misappropriation of Ameren Missouri's debt capacity to Ameren Corp by authoring a lower common equity ratio for ratemaking.

Staff's testimony is correct as it related to no cross-collateralization of its subsidiaries' assets. In fact, Ameren Missouri is required by law to request Commission authority to pledge its assets for any financial obligations, whether this is for its own debt obligations or any other entities' financial obligations.[16] Staff is also correct that Ameren Missouri issues long-term debt directly to third-party debt investors as well as commercial paper to third-party investors. However, Staff did not discuss the fact that Ameren Corp shares a credit facility with Ameren Missouri that Ameren Corp uses for purposes of accessing commercial paper.

While there are differing degrees of merit in deciding when to consider the holding company's consolidated capital structure compared to a subsidiary's capital structure, the overarching consideration that should be given the most weight is whether the use of leverage is consistent with a company's business risk. As I discussed in my direct testimony, Ameren Corp and Moody's recognized the lower business risk afforded by the ability to elect PISA in 2018. This was cited as a primary reason to allow Ameren Corp to carry more leverage. Unfortunately, it appears the Commission is the only entity that has

[16] Section 393.190, RSMo.

the authority and potential willingness to ensure Ameren Missouri's ratepayers receive fair consideration for the lower business risk profile their rate payments support.

RETURN ON COMMON EQUITY

ANN E. BULKLEY'S RECOMMENDED ROE

Q. What is Ms. Bulkley's recommended allowed ROE for Ameren Missouri's gas utility?

A. Ms. Bulkley recommends the Commission allow Ameren Missouri an ROE anywhere in the range of 9.65% to 10.40% for its gas utility. Based on her range, she concludes that the Company's request of a 9.80% allowed ROE is reasonable.[17]

Q. What is the premise underlying Ms. Bulkley's recommended allowed ROE?

A. Ms. Bulkley estimates the cost of equity ("COE") for Ameren Missouri's gas utility to be in the range of 9.65% to 10.40% based on her application of a three primary COE methodologies: (1) the constant-growth discounted cash flow ("DCF") method, (2) the Capital Asset Pricing Model ("CAPM") – a standard CAPM and an empirical CAPM, and (3) a Bond Yield Plus Risk Premium analysis.

Q. Do you and Ms. Bulkley agree on some fundamental issues in this case?

A. Yes. We both agree that utility stocks have been trading at historically high valuation levels over the last several years, reaching all-time highs right before the onset of the COVID pandemic. We also agree that these high valuation levels have been primarily driven by a continued low long-term interest rate environment.

[17] Bulkley Direct, p. 8, lns. 1-8.

Q. If you both agree that utility stock valuation levels are higher due to lower long-term interest rates, why do you arrive at distinctly different conclusions about the implications such market conditions should have on utilities' cost of capital and therefore, your recommended allowed ROEs?

A. I accept the signals the market is providing to us, which is that utilities' cost of capital is at historically low levels justifying lower allowed ROEs. Ms. Bulkley dismisses low long-term interest rates as temporary and unsustainable. Therefore, she concludes, high utility stock valuation levels are not sustainable. Consequently, she gives less weight to her constant-growth DCF results, which directly incorporate utility stock prices into a COE estimate. Instead, she gives more weight to her CAPM and Bond Yield Plus Risk Premium ("BYPRP") methods.[18] These methods are more easily manipulated by using irrational inputs, such as unreasonable expected market returns, to justify a higher COE estimate.

Q. Do you have concerns about Ms. Bulkley's chosen proxy group?

A. Yes, but only to the extent she doesn't recognize or discuss the fact that the most publicly-traded holding companies that own regulated local natural gas distribution systems also own non-regulated subsidiaries. As is evident from the fact that I used the same proxy group as Ms. Bulkley for purposes of my direct testimony, there are simply too few pure-play local natural gas distribution companies ("LDCs") to form a reasonably sized proxy group. Currently, ONE Gas is the only 100% pure-play LDC. However, Atmos Energy Corporation is a 100% pure-play regulated gas utility if one considers its FERC regulated gas pipelines as similar to its LDCs. Some of the other companies, such as Spire Inc. and Northwest Natural Gas Company are predominately regulated LDCs, but they also have exposure to non-regulated business risks, which causes a higher cost of capital. Recognizing such is important to the extent Ms. Bulkley argues that Ameren Missouri's 100% regulated gas utility system is riskier than her chosen proxy group, which she does.

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[18] Bulkley Direct, pp. 21-24.

Q. Ms. Bulkley indicates that the fact that Ameren Missouri is owned by Ameren Corp does not affect her analysis of Ameren Missouri's cost of capital.[19] Was this prudent on her part?

A. No. Ameren Missouri is inextricably linked to its parent company, Ameren Corp. Ameren Corp.'s financial strategies, such as capital structure management, directly impact Ameren Missouri. Additionally, Ameren Corp.'s corporate governance structure does not allow for Ameren Missouri's financial health to be managed independent of Ameren Corp, which has been directly acknowledged by S&P in its rating assessment.

Ameren Corp's cost of equity is based on the collective business risks of its various subsidiaries, approximately 50% of which is related to Ameren Missouri, as well as the financial risk it incurs at the consolidated level. Because Ameren Corp's business operations are predominately regulated electric utilities (both vertically integrated and transmission and distribution) and local natural gas distribution utilities, its capital structure and cost of equity are appropriate proxies for estimating Ameren Missouri's cost of capital.

Therefore, because Ms. Bulkley did not consider Ameren Corp in her assessment of Ameren Missouri's cost of capital, I consider her cost of capital analysis in her direct testimony to be incomplete.

Q. Ms. Bulkley maintains that it is important to authorize Ameren Missouri a ROR based on an ROE and capital structure that will allow it to attract capital on a stand-alone basis and within the Ameren Corp system.[20] Did Ms. Bulkley compare her recommended ROR for Ameren Missouri to Ameren Corp's other systems?

A. If she did, she did not provide such analysis in her direct testimony.

[19] *Id.*, p. 10, lns. 15-22.
[20] *Id.*

Q. Based on the factual circumstances associated with Ameren Corp.'s family of companies, is it reasonable and appropriate to use information related to Ameren Corp.'s cost of capital (both debt and equity) in determining a fair and reasonable allowed ROR for Ameren Missouri?

A. Yes. Therefore, this includes estimating Ameren Corp's cost of equity and analyzing the interrelationship of its capital structure management.

INTERPRETATION OF MARKET CONDITIONS

Q. What is Ms. Bulkley's solution for her view that utility stocks are trading at levels above historical averages and may not be sustainable?[21]

A. Her solution is to give less weight to DCF methods, which directly incorporate utility stock prices, and give more weight to methods that rely on market risk premium estimates, such as the CAPM.[22]

Q. If utility stock prices are at unusually high valuation levels, what does this imply about utility investors' required returns and therefore, the utility industry's cost of equity?

A. It is lower.

Q. On pages 12 through 24 of her direct testimony, Ms. Bulkley provides her view on how the Commission should consider the impact of market conditions when setting Ameren Missouri's allowed ROR. What is your reaction to her testimony?

A. We completely disagree about the signals provided by capital market data. While Ms. Bulkley admits that utility securities have been highly-valued over the last several years, and even after the onset of the pandemic, she explains that these higher valuation levels are abnormal and should not cause the Commission to authorize lower returns. She reasons that because Ameren Missouri's rates will be in effect in the future, it is important to adjust

[21] Bulkley Direct, p 21, l. 7 – p. 23, l. 11 and p. 41, l. 20 – p. 42, l. 4.
[22] *Id.*, p. 24, ll. 5-20 and p. 36, ll. 7-20.

current COE estimates to reflect future market conditions.[23] Apparently, Ms. Bulkley believes that utility equity investors do not factor in expected changes in market conditions in determining a fair price to pay for utility stocks today. This violates a fundamental tenet of the efficient market hypothesis, which dictates that security prices reflect all known information at the time, whether that information is certain or not, such as changes in earnings, dividends, interest rates, economic growth, etc. Ms. Bulkley goes as far to suggest that investors have mispriced utility stocks to the point that she believes they may deflate causing dividend yields to increase.

Ms. Bulkley and I reviewed the same capital market information and arrived at starkly different conclusions. I embrace the capital market information that the utility industry's cost of capital has been declining steadily for the past several years and represents a fundamental shift in market valuations. Ms. Bulkley uses these facts to argue that the DCF method, which directly incorporates higher utility stock prices, is not reliable for determining a fair and reasonable allowed ROE. She is wrong. The fact that the DCF provides lower cost of equity estimates reflects the reality of current capital market conditions.

Q. If Ms. Bulkley were correct that utility stocks are overvalued and will revert to historical valuation levels, is she correct in her conclusion that a properly applied constant-growth DCF analysis results in an underestimated cost of equity?

A. No.

Q. Would it actually cause an overestimation of the cost of equity in a properly applied constant-growth DCF analysis?

A. Yes. Ms. Bulkley claims that utility stocks are currently overvalued and do not reflect "normal" capital market conditions. If Ms. Bulkley is correct, then investors buying utility stocks are factoring in a contraction in P/E ratios. Ms. Bulkley's constant-growth DCF does not consider this expected contraction.

[23] *Id.*, p. 24, ll. 5-20.

Q. Is there a means to adjust the constant-growth DCF method to account for Ms. Bulkley's anticipated changes to utilities' P/E ratios?

A. Yes. The constant-growth model can be extended to include expected changes in the P/E ratio. This version of the constant-growth DCF is referred to as the "Grinold- Kroner" model.[24] It is expressed algebraically as:

$$k = D_1/P_0 + g + \Delta PE$$

Where:
k = the cost of equity;
D_1 = the expected next 12 months dividend;
P_0 = the current price of the stock;
g = the dividend growth rate; and
ΔPE = the per period change in the P/E multiple

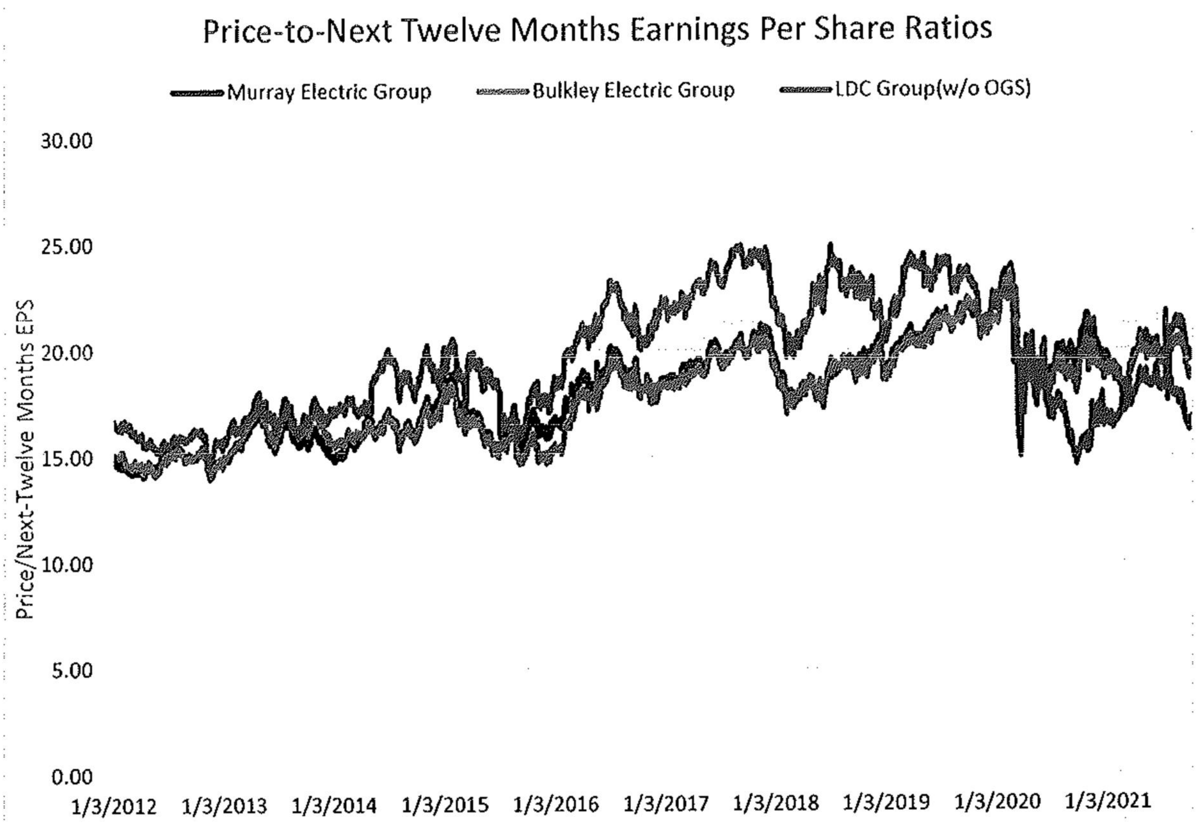
Q. If Ms. Bulkley had used this derivative of the constant-growth DCF method to estimate the cost of common equity, how would this impact her cost of equity estimates if she believes LDC P/E ratios will contract?

A. They would be lower.

Q. How much lower would Ms. Bulkley's DCF estimates be if she had factored in her expectation of a contraction in the P/E ratios?

A. It depends on how quickly she expects this contraction to occur and what she considers to be a "normal" valuation level. Because Ms. Bulkley apparently believes Ameren Missouri's cost of capital is going to rapidly increase during the period Ameren Missouri's rates will be in effect, she may believe this will occur within no more than the next five years. Unfortunately, Ms. Bulkley does not indicate what she considers to be a "normal" valuation level for utility stocks, but she does imply that the utility industry's valuation levels are unsustainable due to low long-term interest rates, which have become the "norm" for the last decade. The P/E ratios for LDCs since 2012 are shown in the below graph (I also included the P/E ratios for the electric utility groups for comparison):

[24] 2010 CFA® Program Curriculum, Level III, Volume 3, p. 35.



The average P/E ratios for the LDC group for the entire period since 2012 is approximately 19.5x. If this is what Ms. Bulkley considered normal, then P/E ratios would actually need to expand by approximately 2.5x to 3.0x from their current levels of around 16.5x to 17.0x to trade consistent with this average. However, because the average P/E ratios for the LDC group include a period (2015 to 2019) in which they traded at a significant premium to the electric utility group, Ms. Bulkley may believe LDC P/E ratios will not expand back to these levels. Based on Ms. Bulkley's testimony in the recent Missouri American Water Company rate case, Case No. WR-2020-0344, she maintained that she believed that utility P/E ratios in March to April 2020 (the onset of the pandemic) were more consistent with historical averages.[25] If this is still Ms. Bulkley's view regarding "normal" valuation levels, then she may consider a P/E ratio of around 15x to be reasonable for LDCs, which

[25] Case No. WR-2020-0344, Bulkley Direct, p. 26.

is consistent with long-term averages for the electric utility industry of around 15x to 16x, which captures higher interest rates prior to the financial crisis in 2008 to 2009. If this is the case, then she would factor in a contraction in LDC P/E ratios of around 1.5x to 2.0x.

Q. How would factoring in a contraction in P/E ratios impact Ms. Bulkley's DCF cost of equity estimates?

A. Again, it depends on how quickly she believes this repricing will occur. Assuming Ms. Bulkley's LDC proxy group's P/E ratios contract by 2.0x in the next five years, then Ms. Bulkley's constant-growth DCF estimates would need to be reduced 2.47%/year, which if applied to her mean DCF COE estimate of approximately 9.7%,[26] results in an implied required return of 7.23%.

Q. Following Ms. Bulkley's logic that the DCF underestimates the COE when valuation levels are abnormally high, what does this imply when valuation levels are below historical averages?

A. Based on Ms. Bulkley's logic, if she believes LDCs should trade more consistent with the average since 2012 of 19.5x, then her DCF COE estimates of 9.7% are too high.

Q. If investors did expect a return to historical average P/E ratios, wouldn't this already be factored into the price they are willing to pay for the stock today?

A. Yes. The Grinold-Kroner extension of predicting changes in market P/E ratios are primarily used by active portfolio managers who are trying to achieve alpha (excess return over expected market returns). The objective of utility rate of return witnesses, including Ms. Bulkley and me, should be to provide insight on current market required returns, which is an underlying assumption for cost of capital models, including the CAPM.

[26] Bulkley Direct, p. 43, Figure 6.

Q. Do you have an opinion as to whether investors are factoring in a change in the P/E ratio due to macroeconomic expectations, such as projected changes in interest rates?

A. Over the last several years, to the extent utility equity analysts have factored in forward yields, most have consistently factored in projected increases in bond yields when estimating a justified P/E ratio. This explains why when there has been an unexpected drop in long-term interest rates, this has typically resulted in an increase in utility stock prices. Therefore, utility stock prices, and consequently their P/E ratios, already reflect a potential increases in interest rates, if this is in fact the consensus. This perhaps explains why electric and gas utility P/E ratios have not expanded with the recent decline in interest rates. For example, Wells Fargo and Evercore ISI indicate that utility P/E ratios imply an expected forward 10-year United States Treasury ("UST") yield in the range of 2% to 2.3%.[27]

TAX CUT AND JOBS ACT

Q. Do you think the Commission needs to consider the Tax Cut and Jobs Act ("TCJA") of 2017 when setting Ameren Missouri's allowed ROE?

A. No. Regulators and utility companies have already addressed issues related to the TCJA. Besides, Ameren Corp has been more aggressive with its use of debt since the passage of the TCJA, while targeting a DPS growth rate close to its long-term CAGR in EPS guidance of 6% to 8%. If Ameren Corp is sincerely concerned about the impacts of the TCJA on its cash flows, it should initiate more conservative financial policies.

[27] Neil Kalton, et. al., "Between the Lines: Wells Fargo Utility Monthly," Wells Fargo, October 1, 2021 and Durgesh Chopra, et. al., "Q3 2021 Weather Summary," Evercore ISI, October 10, 2021.

DISCOUNTED CASH FLOW ASSUMPTIONS

Q. Although Ms. Bulkley urges caution regarding her DCF COE estimates for purposes of informing her recommended ROE, do you agree with the assumptions Ms. Bulkley used in her DCF analysis?

A. No. Ms. Bulkley argues that her constant-growth DCF results under-estimate the electric utility industry's COE because she doesn't believe current higher stock prices are sustainable. As I indicated previously, this is incorrect. However, even without an adjustment for changes in P/E ratios, her DCF analysis overestimates the COE. Ms. Bulkley's DCF analysis assumes her proxy groups' DPS can grow in perpetuity at the same rate as equity analysts' projected 5-year CAGR in EPS. This is not how equity analysts determine fair prices to pay for utility stocks.

CAPM ASSUMPTIONS

Q. Why are Ms. Bulkley's CAPM cost of equity estimates so high?

A. Because she uses irrational expected market returns. Ms. Bulkley estimates a total compound annual market return for the S&P 500 of 14.13% for the foreseeable future (perpetually based on her use of a constant-growth DCF to estimate S&P 500 returns).[28] Subtracting long-term risk-free rates from Ms. Bulkley's estimated market return results in her market risk premium estimates of 11.33% to 12.36%.[29] Therefore, Ms. Bulkley's expected market risk premiums are approximately double the market risk premiums typically used by equity analysts to determine a fair price to pay for utility stocks.

Q. How is Ms. Bulkley able to achieve such high market risk premium estimates?

A. Because she assumes that the S&P 500 can grow its earnings at a compound annual rate of 12.45% in perpetuity.[30]

[28] Bulkley Direct, p. 45, lns. 1-12.
[29] *Id.*
[30] *Id.*