

Exhibit No. 406

Exhibit No.: 406
Issue(s): Rate of Return (ROR)/
Capital Structure/Return on Equity (ROE)
Witness/Type of Exhibit: Murray/Rebuttal
Sponsoring Party: Public Counsel
Case No.: ER-2021-0240

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. ER-2021-0240

October 15, 2021

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

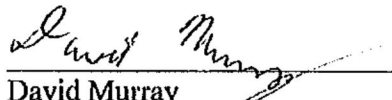
In the Matter of the Union Electric)
Company d/b/a Ameren Missouri's)
Tariffs to Increase its Revenues for) Case No. ER-2021-0240
Electric Service)
)

AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

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

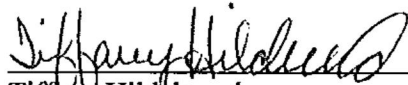
1. My name is David Murray. I am a Utility Regulatory Manager for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.


David Murray
Utility Regulatory Manager

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



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. ER-2021-0240

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

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

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

5 A. Yes.

6 **Q. What is the purpose of your testimony?**

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

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

11 A. I will address capital structure first. As it relates to capital structure, I will address Mr.
12 Sagel and Mr. Chari together since they recommend the same capital structure for purposes
13 of setting Ameren Missouri's authorized ROR for its vertically-integrated electric utility
14 system ("electric utility"). I will then address Ms. Bulkley's and Mr. Chari's recommended
15 ROE separately because they have different recommendations and different approaches to
16 how they arrive at their recommended ROEs.

17 **Q. Do you plan to address any other issues as it relates to Ameren Missouri's requested**
18 **revenue requirement?**

19 A. Yes. Although I will discuss some of these issues as it relates to Ameren Missouri's lower
20 business risk since it elected Plant In Service Accounting ("PISA") as allowed pursuant to
21 the passage of Senate Bill ("SB") 564 in 2018, it is important to highlight the fact that

1 Ameren Missouri has been capitalizing its PISA investments based on Ameren Missouri's
2 equity-rich capital structure, a 9.5% authorized ROE, and its embedded cost of debt as of
3 December 31, 2017 (5.07%), despite the fact that Ameren Corp and Ameren Missouri have
4 been able to issue capital at much lower costs since December 31, 2017. The most obvious
5 and objective measure of Ameren Missouri's use of an inflated cost to capitalize PISA
6 investments is its use of the 5.07% embedded cost of debt from 2017, despite the fact that
7 its current cost of debt is below 4%. Although Ameren Missouri's use of this high cost of
8 debt seems to be consistent with that which SB 564 allowed, this is an example of the of
9 utility companies' ability to tilt the scales in the favor of shareholders at the expense of
10 ratepayers. However, the Commission has the authority to strike a more equitable balance
11 by considering such issues when determining a reasonable ratemaking capital structure and
12 ROE. I urge the Commission to be mindful of this overarching concern as it sorts through
13 the technicalities of each ROR witnesses' arguments for the appropriate capital structure
14 and ROE in this case.

15 I will also address Ameren Missouri's request to recover \$7 million of Ameren Corp's
16 common equity issuance costs. It is my understanding that because Ameren Corp used all
17 of the proceeds from the equity issuance to fund its purchase of High Prairie Renewable
18 Energy Center and the Atchison Renewable Energy Center, it believes all of the issuance
19 costs should be recovered from Ameren Missouri ratepayers. A higher proportion of
20 common equity in Ameren Corp's capital structure provides more financial stability for all
21 companies within Ameren Corp's family. Therefore, Ameren Missouri should only pay a
22 portion of these costs consistent with allocation factors used for other common costs.

23 CAPITAL STRUCTURE

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

25 A. No. Both Mr. Sagel and Mr. Chari recommend the Commission determine Ameren
26 Missouri's authorized ROR for its electric utility using Ameren Missouri's capital structure
27 balances. At this point, the only cause for the difference in Mr. Chari's and Mr. Sagel's
28 capital structure ratios is due to Mr. Chari's use of Ameren Missouri's actual capital

1 structure balances as of June 30, 2021, where Mr. Sagel recommends Ameren Missouri's
2 projected capital structure ratios as of September 30, 2021. Assuming Mr. Chari updates
3 his Ameren Missouri capital structure recommendation through the true-up date, his
4 recommended capital structure ratios should be similar to Mr. Sagel's.

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

7 **A.** Yes. As I identified in my direct testimony, Ameren Missouri consistently manages its
8 capital flows to achieve a common equity ratio of approximately 52% for the capital
9 structure it desires for ratemaking. It is not difficult for Ameren Corp to achieve this target
10 for Ameren Missouri since Ameren Corp can simply allow Ameren Missouri to retain more
11 of its earnings in the intervening quarter to allow its equity ratio to reach its ratemaking
12 target of 52%. Ameren Corp has been able to consistently manage Ameren Missouri's
13 capital structures for ratemaking to achieve a common equity ratio range of 51.75% to
14 52.30% for the last ten years.

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

17 **A.** No. As I explained in my direct testimony, Ameren Corp's equity ratio has continued to
18 diverge from Ameren Missouri's equity ratio. In fact, in Ameren Missouri's last electric
19 rate case, Case No. ER-2019-0335, the difference between my recommended common
20 equity ratio (guided by Ameren Corp's consolidated capital structure) and Ameren
21 Missouri's common equity ratio was 4% (52% vs. 48%). This gap has widened to 7%
22 (52% for Ameren Missouri vs. 45% for Ameren Corp). This is due to the fact that Ameren
23 Corp has continued to increase the amount and proportion of holding company debt as
24 compared to total consolidated debt. On March 29, 2019, Moody's gave Ameren Corp the
25 flexibility to incur more leverage at the holding company level without jeopardizing its
26 credit rating by lowering its Funds from Operations ("FFO")/debt threshold to 17% from

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

3 **Q. What was Ameren Missouri’s authorized equity ratio and ROE before it was able to**
4 **elect PISA accounting?**

5 A. 51.76% equity and a 9.53% ROE.²

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

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

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

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

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

22 A. Because this would upset the ratemaking paradigm Ameren Corp believes it has established
23 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.

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

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

10 A. Yes. In Ameren Missouri's 2019 electric and gas rate cases, Staff recommended Ameren
11 Missouri's common equity ratio be set at 50% based on its comparison of Ameren Corp's
12 capital structures to Ameren Missouri's capital structures over the period 2011 through
13 2018.

14 **Q. Did Mr. Chari explain why he diverged from Staff's position in Ameren Missouri's**
15 **2019 rate cases?**

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

23 **Q. Did Staff discuss these factors in the 2019 rate case?**

24 A. No.

⁵ Staff COS Report, p. 26, lines 18-19.

1 **Q. What information did Staff provide in the 2019 rate case to support its recommended**
2 **50% common equity ratio?**

3 A. The fact that the difference between Ameren Corp's common equity ratio and Ameren
4 Missouri's common equity ratio had been widening since at least 2014.⁶ At the time, Staff
5 showed that the difference between Ameren Corp's and Ameren Missouri's common
6 equity ratios had widened to approximately 4% in 2018. Staff also supported its
7 recommended 50% equity ratio by citing the fact that a 50% ratemaking common equity
8 ratio had been used for setting rates for Ameren Illinois' electric utility operations. After
9 many years of litigation, the Staff of the Illinois Commerce Commission ("ICC") and
10 Ameren Illinois agreed a common equity ratio no higher than 50% should be deemed
11 prudent for ratemaking unless Ameren Illinois provided evidence that specific
12 circumstances justified the need for a higher common equity ratio. This agreement later
13 became law with Illinois' 2016 passage of the Future Energy Jobs Act ("FEJA").

14 **Q. What is your understanding of the basis for the three criteria discussed by Mr. Chari?**

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

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

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

1 8. Spire Missouri's stand-alone capital structure supports its own bond
2 rating.

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

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

13 **Q. What is Mr. Chari's first factor?**

14 **A.** Mr. Chari indicates that Ameren Missouri operates as an independent entity when
15 considering Ameren Missouri's procurement of financing and the cost of that financing.
16 He indicates that because Ameren Corp is not the primary source of Ameren Missouri's
17 long-term and short-term debt, this supports the use of Ameren Missouri's capital structure.
18 Mr. Chari's first factor seems to follow the first factor cited in the CRRA curriculum.

19 **Q. What is Mr. Chari's second factor?**

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

24 **Q. What is Mr. Chari's third factor?**

25 **A.** Mr. Chari indicates that because Ameren Missouri's debt is not secured by Ameren Corp.'s
26 assets and Ameren Corp's debt is not secured by Ameren Missouri's assets that this
27 supports using Ameren Missouri's stand-alone capital structure. Mr. Chari's third factor

⁷ David Parcell, "The Cost of Capital – A Practitioner's Guide," 2010 Edition, p. 46.

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

3 **Q. Did Staff cite these same factors in the concurrent Ameren Missouri gas rate case,
4 Case No. GR-2021-0241?**

5 A. Yes, but Staff added another factor in the Ameren Missouri gas rate case. Dr. Seoung Joun
6 Won, Staff's ROR witness in that case, cited an additional factor for supporting his use of
7 Ameren Missouri's capital structure, which is that Ameren Corp. is "primarily a regulated
8 utility," which in his opinion supports the use of Ameren Missouri's stand-alone capital
9 structure because Ameren Corp's business risk is similar to that of Ameren Missouri's
10 business risk.⁸

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

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

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

18 A. No. First, as I argued in the recent Spire Missouri gas rate case, Case No. GR-2021-0108,
19 these factors should not be analyzed in isolation without consideration of the
20 interrelationship of the other factors. For example, the existence of double leverage and
21 the fact that Ameren Corp is a pure-play regulated holding company should be considered
22 together (and given the most weight) because Ameren Corp is able to issue holding
23 company debt due to its regulated utilities' low business risk. In the last rate case, Ameren
24 Corp argued it could carry more leverage for its investments in its other regulated utility
25 subsidiaries because they have lower business risk than Ameren Missouri.⁹ However,

⁸ Case No. GR-2021-0241, Staff Direct COS Report, p. 27, lines 14-17.

⁹ Case No. ER-2019-0335, Darryl T. Sagel Rebuttal, p. 14, lines 3-8.

1 Ameren Corp is no longer making this argument for Ameren Illinois. In fact, Ameren Corp
2 is currently arguing for an approximate 53% common equity ratio for its Ameren Illinois
3 electric utility operations because its authorized ROE for the upcoming calendar year will
4 be 7.36%. Ameren Corp has also increased ATXI's common equity ratio to 60.1%.
5 Considering the increase in the equity ratios at Ameren Missouri's affiliates and Ameren
6 Missouri's constant equity ratio of ~52%, it would be logical to conclude that Ameren
7 Corp's consolidated common equity ratio would be higher rather than lower since these
8 changes, but this is not the case due to Ameren Corp's more aggressive use of holding
9 company debt, which has almost doubled in proportion to total debt since the updated test
10 year in Ameren Missouri's last rate case (8.39% to 16.59%).

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

14 **A.** Yes. First, Mr. Chari is correct that Ameren Missouri issues long-term debt and short-term
15 debt directly to third-party investors. However, Mr. Chari does not specify that Ameren
16 Corp shares credit facilities with Ameren Missouri and Ameren Illinois. Under Ameren
17 Corp's shared credit facility with Ameren Missouri, it has the ability to directly borrow up
18 to \$900 million of the shared \$1.4 billion credit facility or issue this amount in commercial
19 paper. Commercial paper is typically used to support immediate cash needs, such as for
20 working capital, construction work in progress ("CWIP"), or paying expected dividends to
21 third-party shareholders. The ability of Ameren Corp to issue this commercial paper is
22 dependent on the low business-risk profile of its Ameren Missouri assets, which was
23 enhanced by its ability to elect PISA.

24 It is also important to note that while Ameren Corp does not execute inter-company notes
25 to provide debt proceeds to Ameren Missouri, the debt it issues is used to invest in the
26 equity of its other subsidiaries. The only reason Ameren Corp has not done so for its
27 Ameren Missouri subsidiary is because it wants to preserve the appearance that Ameren
28 Missouri's assets are not supported/responsible for more leverage than that which is
29 represented on its books. This is a superficial argument. As Ameren Corp demonstrates

1 through its financial policy of injecting capital through infusions and disbursements into
2 Ameren Missouri related to its tax equity agreement, many of Ameren Corp's financial
3 transactions are not a function of capital needs, but rather for purposes of facilitating
4 affiliate financial transactions and agreements. This is an example of why S&P assigns the
5 same group credit rating to Ameren Corp and all of its subsidiaries.

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

8 A. Yes.

9 **Q. Is it appropriate to make this blanket statement?**

10 A. No.

11 **Q. Why?**

12 A. Because Moody's and S&P have differing approaches relating to assigning Ameren
13 Missouri its credit rating. Moody's gives weight to Ameren Missouri's stand-alone capital
14 structure for purposes of assigning its long-term issuer rating of 'Baa1'. However, S&P
15 assigns Ameren Missouri a credit rating based on Ameren Corp's group credit profile.
16 Because Staff cited S&P Global Market Intelligence as support for its position, I requested
17 Staff to provide the specific information from S&P Global Market Intelligence it relied on
18 for its conclusion. In response to my data request, Staff provided a copy of S&P Global
19 Ratings, RatingsDirect, April 30, 2021, report describing the ratings assigned to Ameren
20 Missouri. S&P states the following in this report:

21 Under our group rating methodology, we consider AM a core subsidiary of parent
22 Ameren with a group credit profile of 'bbb+'. This core status reflects our view that
23 AM is highly unlikely to be sold, integral to the group's overall strategy, possesses
24 a strong long-term commitment from senior management, and closely linked to the
25 parent's name and reputation. Given its core subsidiary status and Ameren's group
26 credit profile of 'bbb+', the issuer credit rating on AM is 'BBB+'.¹⁰

¹⁰ William Hernandez, et. al., Union Electric Co. d/b/a Ameren Missouri, S&P Global Ratings – RatingsDirect, April 30, 2021, pgs. 10-11.

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

4 The rating actions reflect the application of our revised Group Rating Methodology
5 criteria as well as our assessment of Ameren Illinois and Union Electric as core
6 subsidiaries of Ameren Corp. Our view is that the current insulation measures are
7 not sufficient to warrant a notch of separation between parent Ameren Corp. and
8 either subsidiary. Therefore, we align our issuer credit rating on both subsidiaries
9 with our 'bbb+' group credit profile on Ameren Corp.¹¹

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

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

13 A. 'A-'. But S&P ultimately assigns Ameren Illinois a credit rating based on Ameren Corp's
14 group credit profile of 'BBB+'.¹²

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

18 A. No.

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

21 A. Yes.¹³ The yield-to-maturities ("YTM") for bonds of similar tenors were actually slightly
22 lower for Ameren Missouri's bonds than for Ameren Illinois's bonds. This market-based
23 evidence indicates that if anything, bond investors perceive Ameren Missouri's bonds as

¹¹ 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.

¹² Ameren Illinois Company, S&P Global Ratings – RatingsDirect, April 30, 2021.

¹³ Murray Direct, p. 45, Ins. 1-18.

1 being slightly safer than Ameren Illinois' bonds, despite the fact that Moody's rates
2 Ameren Illinois' bonds higher.

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

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

10 **Q. Is Mr. Chari correct that Ameren Missouri's assets are not pledged as security for**
11 **Ameren Corp's debt or any of its affiliates' debt?**

12 A. Yes.

13 **Q. Is Mr. Chari correct that none of Ameren Missouri's affiliates' assets are pledged as**
14 **security for Ameren Missouri's debt?**

15 A. Yes.

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

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

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

22 A. Yes. Ameren Corp did so in 2010 when it was attempting to limit the impact Ameren
23 Corp's non-regulated subsidiary, Ameren Energy Generating Company had on its credit

1 quality.¹⁴ Ameren Corp also did so in 2006 when it no longer allowed Ameren Illinois
2 (then operating as five different companies: Central Illinois Public Service Company,
3 CILCORP Inc., Central Illinois Light Company, Illinois Power Company and Ameren
4 Energy Resources Generating Company) access to the shared credit facility Ameren Corp
5 had with Ameren Missouri and Ameren Energy Generating Company.¹⁵

6 **Q. Does Ameren Corp currently provide current financial support for non-regulated**
7 **subsidiaries?**

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

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

12 A. Yes. As I explained in my direct testimony, Ameren Corp used holding company debt to
13 support investments in ATXI since 2010. ATXI did not issue its own debt until June 22,
14 2017, when it made an inaugural debt offering of \$450 million, of which \$425 million was
15 used to refund \$500 million of debt Ameren Corp had issued on its behalf.

16 **Q. What is the final factor Staff cited in the gas rate case as support for its decision to**
17 **recommend Ameren Missouri's ROR be set based on Ameren Missouri's capital**
18 **structure?**

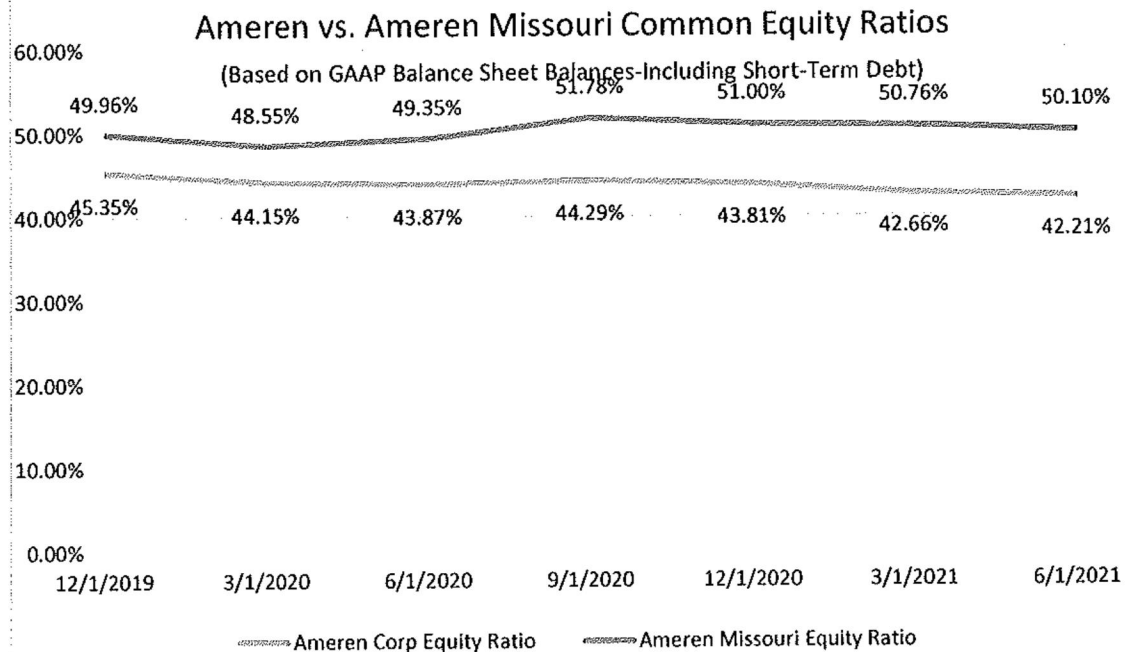
19 A. In the gas rate case, Dr. Won indicates that because both Ameren Corp and Ameren
20 Missouri are primarily regulated utilities, this supports the use of Ameren Missouri's
21 capital structure. He reasons that because business risks of the parent company (Ameren
22 Corp) and its subsidiary (Ameren Missouri) are similar, they should be able to incur similar
23 amounts of financial risk.¹⁶ I agree. However, Dr. Won goes on to state that Ameren Corp
24 and Ameren Missouri have similar proportions of leverage in their capital structures as of

¹⁴ Ameren Corp 2010 SEC 10-K Filing, pgs. 114-118.

¹⁵ Ameren Corp 2006 SEC 10-K Filing, pgs. 124-128.

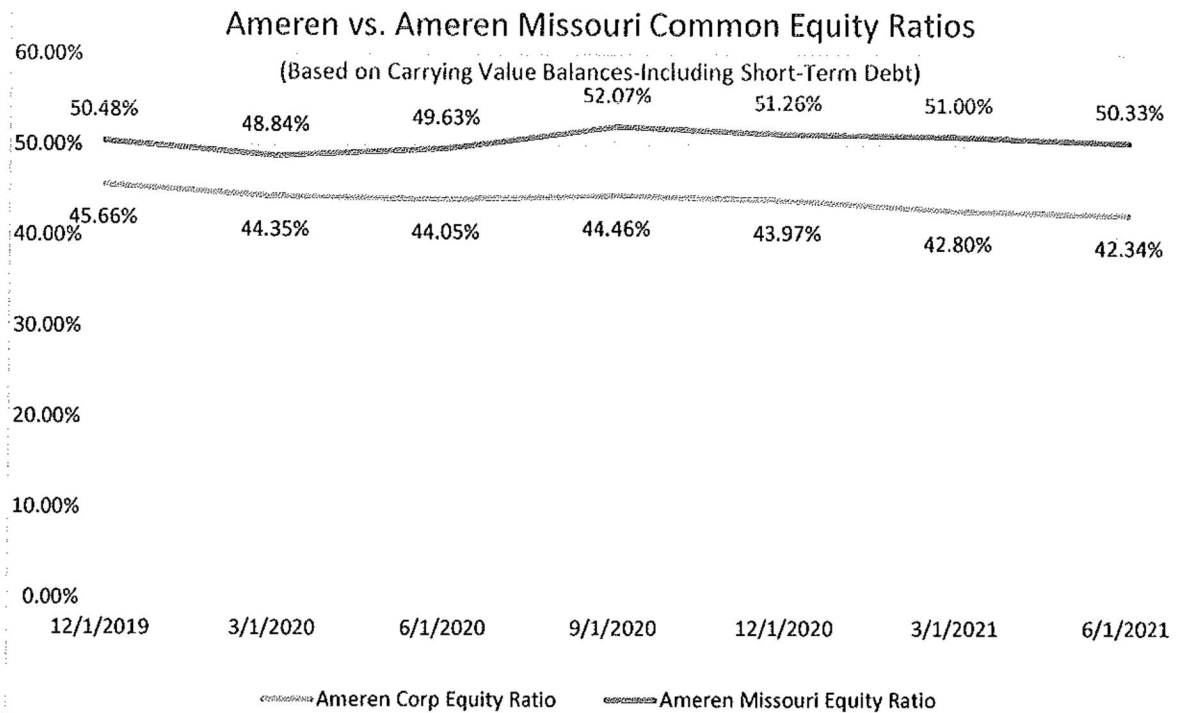
¹⁶ Case No. GR-2021-0241, Won Direct Testimony, p. 27, Ins. 14-21.

1 December 31, 2020 (52% long-term debt, which would imply approximately 48% common
 2 equity, but Staff did not provide supporting calculations so I am not sure how Staff
 3 determined the specific capital structure ratios). I disagree. Schedule DM-D-6-2 attached
 4 my direct testimony provided a comparison of Ameren Corp's and Ameren Missouri's
 5 capital structures over the five-quarter period covering the test year in this case. Due to
 6 the importance of ensuring Ameren Missouri's ratepayers receive credit for the lower
 7 business risk they support through PISA, it is very important to closely consider the
 8 widening gap between Ameren Corp's use of a higher proportion of debt in comparison to
 9 Ameren Missouri's constant proportion of debt at 48%. Therefore, I expanded the period
 10 I showed in the schedule attached to my direct testimony to show a comparison of Ameren
 11 Corp's and Ameren Missouri's capital structures through the most recent quarter in which
 12 data is available (12/31/2019 through 6/30/2021). As detailed in in Schedule DM-R-1 and
 13 summarized in the below graph, using balance sheet balances filed with the Securities and
 14 Exchange Commission ("SEC"), Ameren Corp's consolidated common equity ratio has
 15 been declining whereas Ameren Missouri's has remained approximately constant.



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

5



6

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

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

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

19 Staff's testimony is correct as it related to no cross-collateralization of its subsidiaries'
20 assets. In fact, Ameren Missouri is required by law to request Commission authority to
21 pledge its assets for any financial obligations, whether this is for its own debt obligations
22 or any other entities' financial obligations.¹⁷ Staff is also correct that Ameren Missouri
23 issues long-term debt directly to third-party debt investors as well as commercial paper to
24 third-party investors. However, Staff did not discuss the fact that Ameren Corp shares a
25 credit facility with Ameren Missouri that Ameren Corp uses for purposes of accessing
26 commercial paper.

¹⁷ Section 393.190, RSMo.

1 While there are differing degrees of merit in deciding when to consider the holding
2 company's consolidated capital structure compared to a subsidiary's capital structure, the
3 overarching consideration that should be given the most weight is whether the use of
4 leverage is consistent with a company's business risk. As I discussed in my direct
5 testimony, Ameren Corp and Moody's recognized the lower business risk afforded by the
6 ability to elect PISA in 2018. This was cited as a primary reason to allow Ameren Corp to
7 carry more leverage. Unfortunately, it appears the Commission is the only entity that has
8 the authority and potential willingness to ensure Ameren Missouri's ratepayers receive fair
9 consideration for the lower business risk profile their rate payments support.

10 **RETURN ON COMMON EQUITY**

11 *ANN E. BULKLEY'S RECOMMENDED ROE*

12 **Q. What is Ms. Bulkley's recommended allowed ROE for Ameren Missouri's electric**
13 **utility?**

14 **A.** Ms. Bulkley recommends the Commission allow Ameren Missouri an ROE anywhere in
15 the range of 9.75% to 10.50% for its electric utility. Based on her range, she concludes
16 that the Company's request of a 9.90% allowed ROE is reasonable.¹⁸

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

18 **A.** Ms. Bulkley estimates the cost of equity ("COE") for Ameren Missouri's electric utility to
19 be in the range of 9.75% to 10.50% based on her application of a three primary COE
20 methodologies: (1) the constant-growth discounted cash flow ("DCF") method, (2) the
21 Capital Asset Pricing Model ("CAPM") – a standard CAPM and an empirical CAPM, and
22 (3) a Bond Yield Plus Risk Premium analysis.

¹⁸ Bulkley Direct, p. 8, lns. 1-8.

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

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

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

10 A. I accept the signals the market is providing to us, which is that utilities' cost of capital is at
11 historically low levels justifying lower allowed ROEs. Ms. Bulkley dismisses low long-
12 term interest rates as temporary and unsustainable. Therefore, she concludes, high utility
13 stock valuation levels are not sustainable. Consequently, she gives less weight to her
14 constant-growth DCF results, which directly incorporate utility stock prices into a COE
15 estimate. Instead, she gives more weight to her CAPM and Bond Yield Plus Risk Premium
16 ("BYPRP") methods.¹⁹ These methods are more easily manipulated by using irrational
17 inputs, such as unreasonable expected market returns, to justify a higher COE estimate.

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

19 A. Yes, to the extent she doesn't recognize or discuss the fact that some of her companies have
20 significant exposure to non-regulated operations. As Ms. Bulkley acknowledges when
21 discussing the characteristics of cyclical compared to defensive industries, cyclical
22 industries are impacted to a much greater extent by variations in economic/market
23 conditions. This explains why companies in cyclical industries typically have stock betas
24 closer to 1, which indicates that the equity risk associated with these industries are higher
25 than for regulated utilities. For example, the consumption of commodities, such as energy,
26 are highly correlated with the expansion and contraction of the economy. This explains

¹⁹ Bulkley Direct, pp. 21-24.

1 why utility companies with exposure to unregulated commodity prices typically have
2 higher betas than pure-play regulated utilities. The following companies included in Ms.
3 Bulkley's proxy group have significant non-regulated business exposure at least as recently
4 as 2020: Entergy Corporation, NextEra Energy Inc., OGE Energy Corporation and Otter
5 Tail Corporation. Unfortunately, Ms. Bulkley focuses on her perception that the regulatory
6 ratemaking shortcomings in Missouri as compared to her proxy group cause Ameren
7 Missouri to have a higher cost of capital than the cost of capital of her proxy companies
8 that have considerable non-regulated business risks.²⁰

9 **Q. Ms. Bulkley indicates that the fact that Ameren Missouri is owned by Ameren Corp**
10 **does not affect her analysis of Ameren Missouri's cost of capital.²¹ Was this prudent**
11 **on her part?**

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

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

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

²⁰ Bulkley Direct, p. 67, l. 19 – p. 68, l. 9.

²¹ Bulkley Direct, p. 11, lns. 14-21.

1 **Q. Ms. Bulkley maintains that it is important to authorize Ameren Missouri a ROR**
2 **based on an ROE and capital structure that will allow it to attract capital on a stand-**
3 **alone basis and within the Ameren Corp system.²² Did Ms. Bulkley compare her**
4 **recommended ROR for Ameren Missouri to Ameren Corp's other systems?**

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

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

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

12 *INTERPRETATION OF MARKET CONDITIONS*

13 **Q. What is Ms. Bulkley's solution for her view that utility stocks are trading at levels**
14 **above historical averages and may not be sustainable?²³**

15 A. Her solution is to give less weight to DCF methods, which directly incorporate utility stock
16 prices, and give more weight to her methods that rely on market risk premium estimates,
17 such as the CAPM.²⁴

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

20 A. It is lower.

²² *Id.*

²³ *Id.*, p 21, l. 7 – p. 23, l. 11 and p. 41, l. 20 – p. 42, l. 4.

²⁴ *Id.*, p. 24, ll. 5-20 and p. 36, ll. 7-20.

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

4 | **A.** We completely disagree about the signals provided by capital market data. While Ms.
5 | Bulkley admits that utility securities have been highly-valued over the last several years,
6 | and even after the onset of the pandemic, she explains that these higher valuation levels are
7 | abnormal and should not cause the Commission to authorize lower returns. She reasons
8 | that because Ameren Missouri's rates will be in effect in the future, it is important to adjust
9 | current COE estimates to reflect future market conditions.²⁵ Apparently, Ms. Bulkley
10 | believes that utility equity investors do not factor in expected changes in market conditions
11 | in determining a fair price to pay for utility stocks today. This violates a fundamental tenet
12 | of the efficient market hypothesis, which dictates that security prices reflect all known
13 | information at the time, whether that information is certain or not, such as changes in
14 | earnings, dividends, interest rates, economic growth, etc. Ms. Bulkley goes as far to
15 | suggest that investors have mispriced utility stocks to the point that she believes they may
16 | deflate causing dividend yields to increase.

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

²⁵ Bulkley Direct, p. 24, ll. 5-20.

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

4 A. No.

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

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

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

13 A. Yes. The constant-growth model can be extended to include expected changes in the P/E
14 ratio. This version of the constant-growth DCF is referred to as the “Grinold- Kroner”
15 model.²⁶ It is expressed algebraically as:

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

17 Where:

18 k = the cost of equity;

19 D_1 = the expected next 12 months dividend;

20 P_0 = the current price of the stock;

21 g = the dividend growth rate; and

22 ΔPE = the per period change in the P/E multiple

23 **Q. If Ms. Bulkley had used this derivative of the constant-growth DCF method to**
24 **estimate the cost of common equity, how would this impact her cost of equity**
25 **estimates?**

26 A. They would be lower.

²⁶ 2010 CFA® Program Curriculum, Level III, Volume 3, p. 35.

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

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



14

1 The average P/E ratios for the electric utility groups for the entire period since 2012 is
2 approximately 18x. If this is what Ms. Bulkley considered normal, then P/E ratios would
3 need to contract by approximately 2x to trade consistent with this average. However,
4 because these P/E ratios are based on a prolonged period of low long-term interest rates,
5 Ms. Bulkley may believe P/E ratios will contract even further to a long-term average of
6 around 15x to 16x, which captures higher interest rate periods since 1995,²⁷ which Ms.
7 Bulkley considers to be more normal.

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

10 A. Again, it depends on how quickly one assumes the repricing will occur. Assuming Ms.
11 Bulkley's proxy groups' P/E ratios contract by 2.0x in the next five years, then Ms.
12 Bulkley's constant-growth DCF estimates would need to be reduced 2.09%/year, which if
13 applied to her mean DCF COE estimate of 9.2%,²⁸ results in an implied required return of
14 7.11%. If the proxy groups' P/E ratios contract by 5.0x over the next five years, then Ms.
15 Bulkley's constant-growth estimates would need to be reduced 4.97%/year, which results
16 in a required return of 4.23%.

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

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

²⁷ Durgesh Chopra, et. al., "Steady Growth – A Look at Q3 Electric Demand," Evercore ISI, October 3, 2021, p. 8.

²⁸ Bulkley Direct, p. 41, Figure 6.

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

3 | A. Over the last several years, to the extent utility equity analysts have factored in forward
4 | yields, most have consistently factored in projected increases in bond yields when
5 | estimating a justified P/E ratio. This explains why when there has been an unexpected drop
6 | in long-term interest rates, this has typically resulted in an increase in utility stock prices.
7 | Therefore, utility stock prices, and consequently their P/E ratios, already reflect a potential
8 | increases in interest rates, if this is in fact the consensus. This perhaps explains why electric
9 | and gas utility P/E ratios have not expanded with the recent decline in interest rates. For
10 | example, Wells Fargo and Evercore ISI indicate that utility P/E ratios imply an expected
11 | forward 10-year United States Treasury (“UST”) yield in the range of 2% to 2.3%.²⁹

12 | TAX CUT AND JOBS ACT

13 | **Q. Do you think the Commission needs to consider the Tax Cut and Jobs Act (“TCJA”)**
14 | **of 2017 when setting Ameren Missouri’s allowed ROE?**

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

²⁹ 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.