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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2019-0335

SURREBUTTAL TESTIMONY

OF

JOHN J. REED

ON BEHALF OF

**UNION ELECTRIC COMPANY
D/B/A AMEREN MISSOURI**

**St. Louis, Missouri
February, 2020**

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SURREBUTTAL TESTIMONY

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JOHN J. REED

FILE NO. ER-2019-0335

I. INTRODUCTION

1

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

3 A. My name is John J. Reed. I am President and Chief Executive Officer of Concentric
4 Energy Advisors, Inc. (“Concentric”) and CE Capital Advisors, Inc. (“CE
5 Capital”), which has its headquarters at 293 Boston Post Road West, Suite 500,
6 Marlborough, Massachusetts 01752.

7 **Q. Did you previously file direct and rebuttal testimony in this proceeding?**

8 A. Yes.

II. PURPOSE OF TESTIMONY

9

10 **Q. What is the purpose of your surrebuttal testimony?**

11 A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of
12 the Office of the Public Counsel (“OPC”) witness Robert Schallenberg.

**III. OVERVIEW OF AND RESPONSE TO OPC WITNESS
SCHALLENBERG’S REBUTTAL POSITIONS**

13

14

15 **Q. Please summarize Mr. Schallenberg’s positions as set forth in his rebuttal
16 testimony.**

17 A. Mr. Schallenberg alleges that

- 18 • Ameren Missouri has not fully complied with the Affiliate Transaction Rule
19 (“ATR”);¹

¹ Rebuttal Testimony of Robert E. Schallenberg, p. 15, lines 20-22.

- 1 • Non-compliance with this rule equates to Ameren Missouri subsidizing its
2 affiliates;²
- 3 • Ameren Missouri has not shown that its administrative and general (“A&G”)
4 costs associated with affiliate transactions (in this context, with Ameren
5 Services Company (“AMS”)), are reasonable;
- 6 • Without such a showing, Ameren Missouri’s A&G costs from AMS should
7 be fully excluded from recovery through rates;
- 8 • There is no presumption of prudence for these AMS costs;³
- 9 • Ameren Missouri has not shown that these A&G costs were prudently
10 incurred or that such services were even necessary; for example, shareholder-
11 related costs are not needed by Ameren Missouri;
- 12 • I did not “prove” in my direct testimony that AMS’s charges for its services
13 are market-based, and he asserts that productivity of unaffiliated providers
14 could be higher than that achieved by AMS;
- 15 • I did not “prove” in my direct testimony that AMS has achieved any
16 economies of scale or scope, as compared to cost levels for Ameren Missouri
17 on a stand-alone basis;
- 18 • Ameren Missouri “must provide some justification” for its A&G costs from
19 AMS and that it has not done so; and

² Rebuttal Testimony of Robert E. Schallenberg, p.16, lines 2-3.

³ Id., p. 2, lines 7-8.

- 1 • The issue here is the reasonableness of Ameren Missouri’s test year A&G
2 costs and ensuring that the customers are not paying higher than reasonable
3 rates.

4 **Q. How do you respond to Mr. Schallenberg’s allegation that Ameren Missouri**
5 **has not fully complied with the ATR?**

6 A. On the most fundamental point, I agree that the issue here is determining just and
7 reasonable rates for Ameren Missouri. The issue is *not* compliance with, or waivers
8 of, the ATR. Those issues are being addressed in Missouri Public Service
9 Commission ("Commission") Docket No. EO-2017-0176.⁴ However, whether full
10 compliance was or was not achieved does not change the need to set just and
11 reasonable rates in this proceeding that reflect a normal level of the costs Ameren
12 Missouri will need to incur once rates are set in this case in order to provide service
13 to its customers. The AMS costs at issue are just such costs.

14 Nonetheless, I have explained that Ameren Missouri has met at least the
15 intent of the rule (to not have customers pay rates that are too high), if not the letter
16 of the rule. As I discussed in my direct testimony, I have explained how, in the case
17 of Ameren Missouri and AMS, the mandate of the ATR has been met because
18 AMS’s costs, which are the basis on which it provides services to Ameren Missouri,
19 also meet or beat market-based pricing. Therefore, the “lower of cost or market”
20 transfer pricing principle of the ATR has been met.

⁴ And as Mr. Byrne discusses in his rebuttal testimony, the remedy for claimed violations of Commission rules is not to set rates in a rate case that ignore the reality that these services need to be obtained and paid for, but rather, is for the party claiming a rule has been violated to avail themselves of the Commission’s complaint procedures.

1 In my direct testimony I submitted a benchmarking analysis for Ameren
2 Missouri's costs for the years 1990 through 2018 which shows that the A&G cost
3 levels⁵ for the merged Ameren companies are consistently lower than the sum of
4 the individual stand-alone operating companies' escalated A&G expense levels.
5 This indicates that the merged companies have A&G costs, including AMS's
6 allocated costs, which are significantly lower than they would likely have been
7 absent the mergers. That alone is strongly indicative of the prudence and
8 reasonableness of the AMS costs Ameren Missouri incurs.

9 In my direct testimony, I also presented an analysis comparing Ameren
10 Missouri's total non-fuel operations and maintenance ("O&M") expense and A&G
11 expense against three peer groups:

- 12 1. National Electric Utilities with regulated generation;
- 13 2. Midwest Electric Utilities with regulated generation; and
- 14 3. National Electric Utilities with regulated generation and 500,000 to
15 2,000,000 customers.

16 The analysis examined the five most recent years for which data was available (i.e.,
17 2014-2018) to perform the analyses. This analysis showed that Ameren Missouri
18 has had non-fuel O&M costs that are below its peer-group averages in every year
19 of the analysis. Over the five-year period, Ameren Missouri's costs have also
20 increased at about one half of the rate that national average costs grew. Out of the
21 52 companies in the peer group, Ameren Missouri's A&G expense per customer
22 has shown a dramatic improvement on both an absolute and relative basis over the

⁵ The AMS costs at issue consist largely of A&G costs, which is why I focused on those costs in my analysis.

1 past five years. In 2014, Ameren Missouri's A&G cost per customer was 4.5%
2 above the national average, but by 2018 they were 18.5% below the national
3 average.

4 This too strongly supports the conclusion that the AMS costs Ameren
5 Missouri incurs are prudent and reasonable.

6 **Q. Does Mr. Schallenberg take issue with these analyses?**

7 A. No. While Mr. Schallenberg complains that there is no support in the record for
8 the reasonableness of Ameren Missouri's A&G costs, which is only because he
9 completely ignores the record that has been presented on this issue, including all of
10 the analyses I have provided in my direct testimony. He did not offer one word of
11 commentary on or criticism of these analyses. This evidence demonstrates that
12 Ameren Missouri's A&G costs (which are largely derived from affiliate
13 transactions) are not only reasonable, but also are clearly at or below market-based
14 levels. It also demonstrates that the creation and use of AMS as a service provider
15 has benefitted customers.

16 **Q. What is the basis for Mr. Schallenberg's claim that ATR non-compliance**
17 **equates to subsidization of affiliates?**

18 A. He offers no support whatsoever for this remarkable assertion. Instead, he focuses
19 on his view that there should be "no presumption of prudence" and transforms that
20 position into a presumption of *imprudence*. While I understand the view that at
21 least for some affiliate transactions there should be no presumption of prudence,
22 there is no regulatory principle or precedent for presuming that all costs incurred
23 through affiliate transactions are imprudent, certainly not for services taken from a

1 service company that charges for its services at cost with no profit, and I have never
2 seen this proposition even suggested in my 43 plus years of regulatory work.

3 **Q. Has Ameren Missouri requested or assumed that the A&G costs paid to its**
4 **affiliated company qualify for a presumption of prudence?**

5 A. No. The Company has provided substantial evidence that its costs are reasonable
6 and necessary, including my analyses presented in my direct testimony as discussed
7 above. Mr. Schallenberg, however, suggests that these costs are not prudently
8 incurred and that at least some (such as costs related to shareholder activities) are
9 not necessary for Ameren Missouri.

10 With regard to prudence, there is no defensible position which could lead
11 the Commission to conclude that these costs were not prudently incurred. Not only
12 is there substantial affirmative evidence of the prudence and reasonableness of
13 these costs, but the entire concept of prudence supports reflecting them in the
14 Company's revenue requirement. This is because prudence is a concept that applies
15 to actions, not costs *per se*; the question addressed in considering the prudence of a
16 decision (here, whether to take services from AMS) is whether management's
17 actions were within a range of reasonable conduct; prudence does not require
18 optimality or perfect foresight; it does require that management reasonably consider
19 the facts that were known or knowable at the time the decision was made; this

1 standard of prudence is consistent with the national perspective⁶ and Missouri's
2 precedent.⁷

3 The question here is whether a reasonable manager, in possession of and
4 with regard for the relevant facts, would select AMS to provide these A&G
5 services. In addressing that question, the facts that would influence the decision
6 maker are:

- 7 • AMS has provided these services every year for more than 20 years and is
8 uniquely qualified to provide continuity of accounting, human resources,
9 legal, payroll, information technology and other services that if Ameren
10 Missouri were a standalone company, Ameren Missouri would have to
11 provide for/or obtain for itself;
- 12 • AMS has achieved significant reductions (in real terms) in the cost of
13 providing these services;
- 14 • AMS provides these services on a zero-profit basis which no other provider
15 could do on a sustainable basis;
- 16 • AMS provides these services to all of Ameren Missouri's regulated affiliates
17 and no regulator has, to date, found these costs to be unreasonable or
18 imprudently incurred;

⁶ National Regulatory Research Institute, The Prudent Investment Test In The 1980s, April 1985.

⁷ See for example, In the Matter of the Third Prudence Review of Costs Subject to the Commission-Approved Fuel Adjustment Clause of KCP&L Greater Missouri Operations Company, EO-2011-0390, September 4, 2012.

- 1 • AMS uses extensive benchmarking to ensure that its costs are market-based
2 and uses competitive bidding in accordance with corporate policies for
3 procurement; and
- 4 • Ameren Missouri could, if it chose to do so, reduce the services it takes from
5 AMS in given areas and either self-provide a service or obtain it elsewhere.

6 Simply put, with these facts known, it is inconceivable for any unbiased analyst to
7 conclude that selection of AMS as the service provider is outside the range of
8 reasonable outcomes for a decision maker. This decision by Ameren Missouri is
9 unquestionably prudent.

10 **Q. Mr. Schallenberg singles out shareholder services and concludes that Ameren**
11 **Corporation is the only entity with shareholders and that AMS has incorrectly**
12 **charged Ameren Missouri for shareholder services.⁸ How do you respond?**

13 A. This is completely wrong. Shareholder services are essential to maintaining access
14 to equity markets, which are ultimately the source of equity capital for Ameren
15 Missouri and all of Ameren Corporation's other subsidiaries. Put another way,
16 Ameren Missouri needs equity in its capital structure and as a practical matter it
17 gets it from Ameren Corporation shareholders. Shareholder services include costs
18 of investor recordkeeping, communications and other administrative
19 responsibilities associated with being a publicly-traded company. Without these
20 services, Ameren Corporation and Ameren Missouri would not be able to secure
21 the equity needed to run the business. These services are needed and are properly
22 allocated to each of the companies within the Ameren family of businesses.

⁸ Rebuttal Testimony of Robert E. Schallenberg, p. 19-20.

1 **Q. Mr. Schallenberg states on multiple occasions that you did not “prove” that**
2 **AMS’s charges are market-based, or that AMS has achieved any economies of**
3 **scale or scope. He also states that AMS/Ameren Missouri “must provide some**
4 **justification” for its A&G costs but that it has not done so. Mr. Schallenberg**
5 **also cites to your statements which include phrases such as “more likely” and**
6 **“reasonable to conclude” which he claims indicates that your opinions are**
7 **unsupported.⁹ Please respond.**

8 A. Those phrases are the kind of statements that any careful analyst would use when
9 answering the questions as to how AMS’s costs compare to what would have
10 existed in the counter factual scenario in which AMS had not been formed and
11 Ameren Missouri self-provided its A&G service. The comparisons I made are
12 between a known outcome (the current cost levels) and an outcome that did not
13 occur (the cost levels that would have prevailed in a stand-alone context for Ameren
14 Missouri). Because it is of course not possible to prove beyond all doubt what
15 would have happened in a scenario that did not happen, I chose words that
16 acknowledge the inferential nature of any such comparison. However, the fact that
17 a conclusion is not totally free from all uncertainty does not indicate any absence
18 of compelling support for a finding that Ameren Missouri’s A&G costs are
19 reasonable. The support I have relied on in arriving at my opinions in this case
20 includes:

- 21 • All the testimony submitted in this docket (File No. ER-2019-0335) on
22 affiliate transactions, including filed testimony of Ameren Missouri witnesses

⁹ Rebuttal Testimony of Robert E. Schallenberg, p 22.

1 Tom Byrne, Laura Moore, Ben Hasse, and Kelly Hasenfratz, testimony of
2 Missouri Public Service Commission Staff ("Staff") witness Mark
3 Oligschlaeger, and the testimony of Mr. Schallenberg;

4 • All of the data requests responses provided on the topic of affiliate transaction
5 costs and compliance in this docket, which includes a very large volume of
6 material on the following topics:

- 7 ○ Details of numerous affiliate transactions
- 8 ○ Ameren Missouri's corporate policies and procedures for
9 purchasing such services
- 10 ○ Ameren Missouri's and AMS's bidding procedures
- 11 ○ Organization charts for Ameren Missouri and its affiliates
- 12 ○ Information on shared employees
- 13 ○ Ameren Missouri's Joint Planning and Procurement procedure
- 14 ○ Vendor lists and information for Ameren Missouri and AMS
- 15 ○ Details of corporate contracts for AMS
- 16 ○ Details of real estate transactions and costs for Ameren Missouri
- 17 ○ Cost allocation methodologies
- 18 ○ Compensation studies
- 19 ○ Tax allocation agreements
- 20 ○ Employee training processes
- 21 ○ Audits of affiliate transactions
- 22 ○ Determinations of the fair market price
- 23 ○ AMS's and Ameren Missouri's budgeting processes;

- 1 • All of the testimony submitted in the Cost Allocation Manual ("CAM")
2 docket (File No. EO-2017-0176) including the testimony of Mr. Hasse, Ms.
3 Moore and Mr. Byrne;
- 4 • All of the data request responses provided in the CAM docket, which
5 represent another very large volume of information on affiliate transactions,
6 compliance procedures, cost benchmarking and many other topics;
- 7 • All of the similar material filed in Ameren Missouri's recent gas rate case
8 (File No. GR-2019-0077);
- 9 • All of the filings in the Commission's recent affiliate transactions rule
10 workshop (File No. AW-2018-0394);
- 11 • Numerous benchmarking studies provided to me by Ameren Missouri,
12 including studies prepared by PA Consulting, the IFMA Utilities Council, the
13 American Productivity and Quality Center, Aon Hewitt, and Mercer;
- 14 • Multiple versions of Ameren Missouri's Cost Allocation Manual;
- 15 • My own analysis of utility holding companies, service companies, Ameren
16 Missouri's A&G costs over time, and my benchmarking of Ameren
17 Missouri's non-fuel O&M and A&G costs versus national averages and
18 Midwest utilities presented in my direct testimony;
- 19 • Regulatory actions for past Ameren Missouri rate cases and in past rate cases
20 for its utility affiliates, all of which provided for cost recovery for affiliate-
21 provided A&G services (e.g., File No. ER-2016-0179 and Illinois Commerce
22 Commission Docket No. 16-0262);

- 1 • The Commission’s decisions in similar cases for other Missouri utilities,
2 including cases for KCP&L (File Nos. EM-2007-0374 and EE-2017-0113),
3 Laclede Gas (File No. GR-2017-0215), and Empire District Electric (File No.
4 AO-2012-0062); and
- 5 • Missouri and federal statutes relating to the treatment of costs of affiliate
6 transactions.

7 In aggregate, my testimony reflects my review of thousands of pages of material in
8 preparing the opinions expressed in my testimony, and my 43 years of experience
9 in utility regulation. It is disturbing that Mr. Schallenberg offers his conclusion that
10 my positions are unsupported when he ignored all of the analyses filed in my direct
11 testimony and never even bothered to inquire about the basis for my opinions or the
12 process I used to reach those opinions.

13 **Q. What is Mr. Schallenberg’s ultimate recommendation to the Commission?**

14 A. He recommends that all of Ameren Missouri’s A&G costs that are the product of
15 affiliate transactions should be completely ignored in setting rates in this case. The
16 test year sum of these expenditures is approximately \$200 million (Ms. Moore
17 indicates in her surrebuttal testimony that he overstates this figure by more than
18 \$80 million). In essence, Mr. Schallenberg takes the position that rates should be
19 set in this proceeding on the assumption that the reasonable cost level for all or
20 most of the human resources, accounting, treasury, investor services, purchasing,
21 legal, and other administrative functions of Ameren Missouri is zero.

22 **Q. What is your response to this recommendation?**

1 A. Mr. Schallenberg's position is indefensible and should be fully rejected. In
2 reaching this conclusion, I am also mindful of the testimony of Mr. Oligschlaeger
3 which supports full recovery through rates for Ameren Missouri's A&G costs.
4 Staff performed its usual thorough audit of these costs and found no basis for any
5 disallowance. From what I have seen in the filed evidence, Staff bases its opinion
6 on the same standard for recovery of affiliate costs that it has used for many years,
7 including the years during which Mr. Schallenberg was on the Commission Staff.
8 Conversely, Mr. Schallenberg now seeks to impose a radically different standard
9 for cost recovery, and asks the Commission to pivot from full cost recovery to no
10 cost recovery, even though he admits that the Company's conduct of its affiliate
11 transactions is no different from what it has been for decades. There is no sound
12 ratemaking basis for Mr. Schallenberg's new cost recovery standard, and there is
13 certainly no conceivable support for his position that the reasonable cost level to be
14 included in rates for Ameren Missouri's A&G services procured from affiliates is
15 zero. Mr. Schallenberg appears to have lost sight of what he agrees is the purpose
16 of this proceeding, which is to set just and reasonable rates for Ameren Missouri.
17 His recommendation certainly does not achieve that result.

18 IV. CONCLUSIONS

19 **Q. Please provide the conclusions of your surrebuttal testimony to the**
20 **Commission.**

21 A. There is no disagreement between me and Mr. Schallenberg that the issue before
22 the Commission is the determination of just and reasonable rates for Ameren
23 Missouri. Within that process, the Commission will need to determine whether the

1 A&G costs submitted by Ameren Missouri for the test year are reasonable. The
2 Commission Staff and I have concluded that these costs are reasonable and that
3 they should be fully included in the revenue requirement. Staff has reached this
4 conclusion through its audit of these expenses and through the application of the
5 standard for cost recovery that has been applied since the ATR was implemented.
6 I have reached that conclusion through my review of thousands of pages of material
7 on the issue of affiliate cost recovery and the specific nature of the affiliate
8 transaction costs incurred by Ameren Missouri. My conclusions from that effort
9 are:

- 10 • AMS's services to Ameren Missouri are provided at cost (reflecting no-profit)
11 and reflect significant economies of scale and scope; no other service provider
12 could provide that cost and quality of service;
- 13 • AMS's costs are frequently benchmarked against the market and have
14 achieved their market-median target;
- 15 • While Ameren Missouri could operate without reliance on the service
16 company model and create its own administrative departments (or in some
17 cases outsource functions), it has chosen to use AMS for nearly all of its A&G
18 services; that decision is unquestionably prudent since it is within a range of
19 reasonable behavior;
- 20 • Ameren Missouri's non-fuel O&M and A&G costs have been demonstrated
21 to be reasonable as compared to peer group averages, and demonstrate a
22 strong performance improvement trend;

- 1 • Ameren Missouri's procurement practices for A&G services have not
2 materially changed in the past 20 years, and have never been found to produce
3 an unreasonable level of costs; the same is true for AMS's other regulated
4 utility affiliates; and
- 5 • The ATR was implemented to prevent any subsidization of unregulated
6 affiliates and to ensure that the costs charged to customers of regulated
7 businesses are reasonable; there is no doubt that Ameren Missouri's
8 procurement of A&G services has met both of these goals.

9 On the basis of these findings, I recommend to the Commission that it include all
10 of Ameren Missouri's A&G costs in its test year revenue requirement.

11 **Q. Does this conclude your surrebuttal testimony?**

12 A. Yes, it does.

