

Exhibit No.:
Issue(s):
Witness: Kelly Hasenfratz
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Union Electric Company
File No.: ER-2022-0337
Date Testimony Prepared: February 15, 2023.

MISSOURI PUBLIC SERVICE COMMISSION

FILE NO. ER-2022-0337

REBUTTAL TESTIMONY

OF

KELLY HASENFRATZ

ON

BEHALF OF

UNION ELECTRIC COMPANY

D/B/A AMEREN MISSOURI

**St. Louis, Missouri
February 15, 2023**

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I. INTRODUCTION

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Q. Please state your name and business address.

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A. Kelly Hasenfratz, Union Electric Company d/b/a Ameren Missouri ("Ameren Missouri" or "Company"), One Ameren Plaza, 1901 Chouteau Avenue, St. Louis, Missouri 63103.

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Q. By whom are you employed and in what capacity?

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A. I am employed by Ameren Services Company ("AMS") as Director, Compensation & Performance.

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Q. Please describe your educational background and employment experience.

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A. I was awarded a Bachelor of Science in Business Administration in 1985 from the University of Missouri – Columbia. I have over 30 years of experience with Ameren in increasingly responsible roles – more than 25 of which were focused on total rewards and human resources-related activities. I have been in my current role since December 2015. In my current role, I am responsible for overseeing the strategy, design and delivery of broad-based compensation and executive compensation programs and processes for Ameren and its subsidiary companies. This includes base pay infrastructure, merit, short- and long-term incentive programs, paid time off and recognition programs.

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II. PURPOSE OF TESTIMONY

Q. What is the purpose of your rebuttal testimony in this proceeding?

A. I am responding to the Missouri Public Service Commission Staff witness Matthew Young, regarding Staff's positions on employee compensation matters. Specifically, I will address how Restricted Stock Units ("RSUs") differ from other forms of stock-based compensation agreements in the Company's Long-Term Incentive Plan ("LTIP"). RSUs reflect competitive and reasonable compensation for employees that provide tangible benefits to our customers and should therefore be reflected in the revenue requirement used to set rates in this case. I will also address the cost associated with the Exceptional Performance Bonus Program and Severance Plan.

III. RESTRICTED SHARE UNITS

Q. Please explain Staff's recommendation related to the cost of RSU awards?

A. Staff recommends that the entire cost of the Company's LTIP, comprised of both RSUs and Performance Share Units ("PSUs"), be assigned to shareholders, rather than reflecting the cost of the RSUs in the revenue requirement used to set Ameren Missouri's electric rates. Staff makes no distinction between PSUs, for which the Company is not seeking recovery, and RSUs. In general, Staff's rationale for disallowing recovery of RSUs is the same as the Company's rationale for not seeking recovery of its PSUs, despite RSUs having meaningful differences from the Company's PSUs. Staff claims that "Historically, the Commission has consistently assigned the portion of incentive compensation expense that is tied to shareholder benefit to the utility's shareholders." Additionally, Staff references the Company's response to Data Request No. 22, where the Company provided the intent of the entire LTIP plan.

1 **Q. Are RSUs awarded based on goals that relate to shareholder benefits?**

2 A. No.

3 **Q. What are RSUs and how do they differ from other forms of stock-based**
4 **compensation such as the Company's PSUs?**

5 A. RSUs represent the right to receive stock depending solely on an employee's
6 continued employment with Ameren through a defined vesting period. As a starting point,
7 RSUs and PSUs have fundamental differences; otherwise there would be no logical
8 rationale to grant awards with different characteristics (i.e., all could be either PSUs or
9 RSUs). Unlike PSUs tied to a financial performance measure (like Relative Total
10 Shareholder Return) which primarily benefit shareholders; RSUs represent the right to
11 receive stock depending solely on an employee's continued employment with Ameren
12 Missouri through a defined vesting period, and thus are not based on the Company's
13 financial performance. RSUs are awarded to encourage retention and longevity with
14 Ameren and have no value to the employees unless the employee remained employed for
15 the defined vesting period. A stable workforce benefits Ameren Missouri's customers with
16 retained talent and the avoided costs of employee turnover, which are considerable.
17 Consequently, RSUs provide meaningful benefits to customers. Moreover, with continued
18 employment being the only requirement to receive the RSUs, this award contains a service
19 condition per United States Generally Accepted Accounting Principles ("US GAAP").
20 RSUs will always pay out at 100% of the targeted share level, so long as the employee
21 meets the service criteria. Again, this distinguishes RSUs from PSUs that pay out based
22 solely on financial performance, or other pre-established operational performance

1 measures. PSUs and RSUs complement each other as they align employees with the
2 interest of different stakeholders – for PSUs shareholders, and for RSUs, customers.

3 By contrast, PSUs represent the right to receive stock if, at the end of a defined
4 performance period Ameren has met certain performance targets regarding relative total
5 shareholder return ("TSR") as compared to a pre-determined group of peer utilities (or
6 other operational or financial metrics). Since PSUs are based on the operations or activities
7 of the Company, this award contains a performance condition. PSUs could pay out at 0%
8 or 200% of target (or somewhere in between) based on the performance of the Company
9 compared to the defined performance parameters. The Company's PSU awards in this case
10 contain a performance condition based on relative TSR compared to peer utilities. This
11 comparison to a peer group normalizes for the impact of overall market forces on the stock
12 price (as best as it can) and evaluates the Company's performance relative to other peers in
13 the industry. The performance condition of the PSUs applicable to this case is tied solely
14 to relative total shareholder return and clearly aligns with shareholders' interests. I offer
15 this distinction to show that other respected regulatory bodies (i.e., The Financial
16 Accounting Standards Board) meaningfully differentiate between the Company's PSUs and
17 RSUs.

18 **Q. How do RSUs differ from any non-stock-based compensation?**

19 A. RSUs are a component of the total compensation package offered to the
20 Ameren Leadership Team ("ALT"), which is defined as management employees from the
21 Director level up to the Officer level, as part of the LTIP. Base pay and short-term incentive
22 compensation, while necessary components of Ameren's total compensation package, do
23 not require the employee to remain employed for 36 months before receiving payment. So,

1 while all compensation incentivizes employment itself, RSUs specifically incentivize
2 continued employment for an established duration.

3 **Q. Why were PSUs reduced and RSUs added to the LTIP, and how does**
4 **this change benefit customers?**

5 A. PSUs were reduced and RSUs were added to the LTIP in 2018 after
6 completing a comprehensive study of peer company LTI compensation market practices.
7 Regular studies of market practices are performed to ensure aspects of the Company's total
8 rewards remain attractive to current and future employees. This study found that Ameren's
9 plan differed from market practice in that our plan was 100% performance based and was
10 trying to achieve both performance and retention goals in one plan. Peer companies' plans
11 were 70% – 75% performance based, with two-thirds of the peer companies including a
12 time-based restricted stock to aid in retention. On that basis, we took the same step that
13 had already been taken by two-thirds of our peers and added RSUs to create a greater
14 incentive for our employees to continue their employment with us. The most recent study
15 completed in 2022 showed that 85% of peer companies grant time-based restricted stock
16 units as part of the annual LTI grant, and consistent with Ameren's LTIP, time-based
17 awards make up approximately 30% of the award (median of companies in study).

18 RSUs are a common component of total compensation for Director and Officer-
19 level roles at peer utilities. They encourage and reward longevity, which benefits customers
20 not only by providing an experienced leadership team, which will provide more effective
21 and efficient management, leading to lower overall costs and better service, but also by
22 avoiding the productivity loss and replacement costs associated with turnover. RSUs

1 motivate employees to stay and remain dedicated to serving our customers, rather than look
2 for new employment.

3 Having RSUs as part of the Company's total compensation plan also serves to
4 attract and retain a sufficient, qualified, and motivated work force. There are a number of
5 benefits that inure to customers from a tenured and experienced workforce. Encouraging
6 the retention of tenured employees' benefits customers by having leaders who are
7 experienced in overseeing utility services generally, but who are also familiar with the
8 uniqueness of Ameren Missouri's service area. The process of having to recruit and replace
9 tenured employees with newer and/or less experienced employees, of course, requires
10 training and a learning curve to ensure optimal processes for the benefit of our customers.
11 There are also costs associated with recruiting and hiring replacements, and those costs
12 tend to be higher at the ALT level. Given the extremely tight labor markets we are seeing
13 in the U.S. generally, and which Ameren also sees, attracting and retaining employees is
14 more important than ever.

15 **Q. How does a stable workforce benefit customers?**

16 A. Significant personnel turnover should be avoided from a pure operations
17 standpoint, for obvious reasons. A stable workforce avoids the costs of employee turnover.
18 This in turn keeps the labor costs that are ultimately reflected in the revenue requirement
19 down. Clearly, the Company's RSU expense is prudent, reasonable and operates in a way
20 to benefit the Company's customers. Specifically, Josh Bersin, a respected global industry
21 analyst with Bersin by Deloitte, suggests it can cost 2 – 3x first year salary to replace an
22 employee, and he points out that in a tight labor market, the cost gets much higher.¹ For

¹ See, Josh Bersin, "*What To Expect In A Red Hot Job Market? Five Things To Consider.*" Published March 9, 2021, Updated March 11, 2021

1 example, replacement costs include recruiting costs, onboarding, cost/time for training, lost
2 productivity and ramp-up time. Employees get more productive the longer they are at a
3 company, having learned the systems, the products and how to work together with their
4 teams – all of which benefit customers.

5 **Q. Have you quantified any avoided cost of employee turnover?**

6 A. Yes. While the Company does not track all tangible and intangible costs of
7 ALT employee turnover, the most tangible data we have is related to the cost to recruit and
8 onboard an experienced leader at the Officer level. In most cases, these individuals will
9 have similar compensation packages to what Ameren offers, with vesting periods designed
10 to promote retention. It is frequently necessary for companies to offer sign-on bonuses as
11 part of the offer of employment to attract experienced leaders. At the Officer level, this
12 cost alone has averaged approximately 1.8x base pay, based on three senior-level officer
13 hires at Ameren since 2016. This value does not include other costs, such as relocation,
14 recruitment costs when using an external search firm, lost productivity and training.
15 Ameren's history with hiring senior level Officers is in line with Josh Bersin's estimate of
16 2 – 3x first year salary to replace someone, as previously referenced. By avoiding ALT
17 turnover costs, the Company can keep the labor costs that are ultimately reflected in the
18 revenue requirement down. Clearly, the Company's RSU expense is prudent, reasonable
19 and operates in a way to benefit the Company's customers.

20 **Q. Is voluntary turnover at the ALT level low in Ameren Missouri?**

21 A. Since 2018, Ameren Missouri has only had two voluntary terminations at
22 the ALT level, for reasons other than retirement – one in 2021 and one in 2022. This
23 equates to a voluntary attrition rate of 1.4% for both years, compared to 2.1% voluntary

1 attrition in 2021 and 3.9% voluntary attrition in 2022 for all other Ameren Missouri
2 employees.

3 **Q. Staff applied the same Commission guidance from Case Nos. EC-87-**
4 **114 and ER-2006-0314 to the LTIP in this case and Staff argues that the primary**
5 **incentive for an employee receiving the RSUs portion of the LTIP is to increase the**
6 **Ameren share price.² How do you respond?**

7 A. I completely disagree. The primary purpose of the RSU is to incent an
8 employee to continue their employment through the payment date. The basis that underlies
9 US GAAP and the determination of the Company's RSUs containing only a service
10 condition, further supports the Company's conclusion that the primary incentive is
11 continued employment. Acceptance of Staff's view would be an outright indication that the
12 decisions called for under US GAAP are flawed and incorrect. The amount of RSUs
13 awarded to an employee is solely based on retaining employment for the defined period,
14 regardless of whether the stock appreciates or depreciates in value. Unlike the Company's
15 PSUs that are based on TSR, which I described earlier; it is not feasible to believe an
16 employee can overpower overall market forces to increase their RSU awards. Any
17 fluctuation in valuation of the Company's stock price during the vesting period is a risk
18 borne by the employee and, secondary or indirect, as compared to the primary incentive of
19 continued employment.

² File No. ER-2022-0337, Direct Testimony of Matthew R. Young, at 11, ll. 11-20, January 10, 2023.

1 **Q. Is there an alternative to Staff's recommended disallowance if the**
2 **Commission desires to allocate these costs between shareholders and customers?**

3 A. Yes. If the Commission is truly concerned with the mere presence of stock
4 in the plan or share price fluctuations during the term of the award, an alternative that at
5 least partially recognizes the benefits customers receive from RSUs would be to allow
6 recovery of the cost of its RSUs at the grant date of the award. This is the value of the
7 award as if it were cash on the date the award is granted. If the Commission were to order
8 it so, in this case, the Company would include \$2,753,821 (as compared to the Company's
9 position of \$3,620,163) of long-term incentive compensation in its revenue requirement
10 used to set rates in this case.

11 **Q. Staff cites the Company's policy, presumably as evidence RSUs**
12 **primarily benefit shareholders. How do you respond?**

13 A. Staff's reference to the Company's policy is a description of the goals of the
14 LTIP plan, as a whole. For the sake of clarity, the primary incentive of the Company's

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17 _____ ****** As noted above,
18 these are separate objectives where one element is based on financial performance (PSUs)
19 and the other is based on tenure (RSUs). The Commission should not be confused by
20 arguments made about the plan as a whole and should instead focus on the single RSU
21 component of the plan, for which the Company is seeking recovery.

1 **Q. Has the recovery of PSUs and RSUs been addressed in other**
2 **jurisdictions?**

3 **A.** Yes. I am most familiar with the regulatory treatment of Incentive
4 Compensation at the Company's operating affiliate Ameren Illinois, regulated by the
5 Illinois Commerce Commission ("ICC"). Similar to the Commission, the ICC has a long
6 history of disallowing costs from the revenue requirement in rate cases for incentive
7 compensation under certain circumstances. Specifically, the ICC ordered disallowances for
8 incentive compensation costs like the Company's current PSUs that contain performance
9 conditions tied to shareholder return or earnings per share.³ The ICC, however, has allowed
10 recovery of prudent and reasonable incentive compensation cost, including RSUs, as a part
11 of the utility's total compensation cost, in utility rates.⁴ Therefore, as noted above, RSUs
12 are completely disconnected from any Ameren financial goals and the ICC allowed
13 recovery of those costs.⁵

14 The Company and Ameren Illinois both utilize the same LTIP, including RSU
15 compensation. Ameren Illinois has recovered its RSU costs in rates since its 2018 natural
16 gas rate review and its 2019 electric formula rate review, shortly after RSUs were included
17 in the LTIP. Clearly this outcome is due to the reasonableness of the incentive costs and
18 the RSUs not being tied to a financial goal or financial metric, and the ICC's recognition
19 that RSUs and PSUs are, in fact, different. In Ameren Illinois' most recent natural gas
20 case,⁶ the ICC recognized that:

³ See, ICC Docket No. 07-0507 (*"The Commission has consistently disallowed recovery of payouts that are tied to overall financial goals."*)

⁴ See, e.g., ICC Docket No. 15-0142, Order at 44 and ICC Docket No. 18-1775, Order at 82.

⁵ See, ICC Docket Nos. 18-1775; 19-0436; 18-0463; and 20-0308.

⁶ ICC Docket 20-0308.

1 RSUs are stock units that vest over a defined period of time
2 based solely on continued employment and are not subject
3 to or based on financial metrics for the benefit of
4 shareholders. The Commission holds that employee
5 longevity provides a tangible benefit to ratepayers through
6 reduced expenses and the creation of greater efficiencies in
7 operations due to a more seasoned workforce.

8 ICC Docket 20-0308, Order at 55-56 *citing* ICC Docket No. 18-1775, Order
9 at 82.

10 Staff has not distinguished the RSUs from the PSUs in the long-term incentive plan.
11 Staff disregards the fact that employee longevity provides a tangible benefit to customers
12 through reduced expenses and the creation of greater efficiencies in operations due to a
13 more seasoned workforce.

14 **Q. Is there any element of Staff's position that would suggest it would**
15 **recommend disallowance of RSU costs if those payments were made in cash rather**
16 **than stock?**

17 A. No. The Company would almost certainly be allowed to recover its RSU
18 costs under an arrangement where it made those payments in cash rather than stock. It is
19 unreasonable to believe that an experienced workforce does not add value to management
20 and operational processes that benefit our customers, or that this benefit is somehow
21 outweighed by the mere presence of stock in the plan. It is unreasonable to think that such
22 an insignificant difference could result in the disallowance of more than \$3 million of
23 prudently incurred compensation costs.

24 **Q. Why are the Company's RSU payments made in stock rather than**
25 **cash?**

26 A. Stock awards promote greater retention than cash awards, and retention is
27 the purpose of the RSUs. In addition, as I mentioned previously, the Company regularly

1 benchmarks its compensation arrangements against its peers. This is because we are
2 competing against those peers to attract and retain our skilled employees. Differences from
3 the benchmark (market data) could negatively impact our ability to hire or retain key
4 employees and, as a result, undermine our attraction and retention strategy as well as lead
5 to increased costs. Industry practice is to make such payments in stock, rather than in cash.

6 **IV. EXCEPTIONAL PERFORMANCE BONUS**

7 **Q. Staff proposed a normalization of Exceptional Performance Bonus**
8 **("EPB") costs using a three-year average. Does the Company agree with this**
9 **adjustment?**

10 A. No. Staff does not provide any justification as to why normalization of the
11 Company's EPB expense is appropriate. EPBs are a form of cash compensation for
12 employees, similar to traditional payroll. Staff did not propose a normalization of payroll
13 costs. Much like there is no logical justification for normalizing payroll, there is no logical
14 rational for normalizing the Company's EPB expense, which is based on a percentage of
15 annual payroll costs.

16 The EPB Budget is established annually based on a percentage of eligible employee
17 base salaries. The EPB program allows leaders to reward employees when they provide
18 outstanding results and/or do work that is above and beyond what is expected or required.
19 Spot bonus programs, like the EPB program, are intended to be cost-effective programs
20 that motivate employees, increase engagement, impact productivity, and provide retention
21 for high performers, all of which benefit customers. Because the EPB budget is established
22 annually based on base pay at the beginning of each year, normalizing the cost of a three-
23 year period does not allow for appropriate recovery of the cost of this program.

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V. SEVERANCE PAYMENTS

Q. Staff has proposed to disallow severance expenses. Does the Company agree with this adjustment?

A. No. Staff asserts that the Company will have cost savings by means of regulatory lag because the employees who are no longer employed are still included in current customer rates. It is not appropriate to apply ratemaking considerations to a single issue like severance. No savings exist after considering overall wages increased, as well as employment levels when compared to the Company's last rate review. Staff's recommendation of a wage rate increase in this case further demonstrates that on an overall basis net savings as compared to current rates do not exist.

Staff also asserts that severance payments are not a reoccurring cost; however, some level of ongoing severance costs is necessary and normal for the Company to incur in the normal course of business. As shown below, the Company has had direct severance costs or indirect severance cost from Ameren Services Company each of the last five years.

	2018	2019	2020	2021	2022
Ameren Services Company	\$40,658	\$496,900	\$38,051	\$59,578	\$208,886
Ameren Missouri	\$114,300	\$159,500	\$0	\$170,600	\$0

Additionally, severance is intended to be a safety net for employees who are displaced from their position due to a reduction in force, elimination of position, or change in strategic direction. This safety net encourages retention, which benefits customers as noted above with respect to other tenure-based programs.

1 If Staff's proposal is accepted, the allowed level of expense would fail to reflect a
2 normal, ongoing level of severance expense and would thus understate the Company's
3 revenue requirement.

4 **Q. Does this conclude your rebuttal testimony?**

5 A. Yes, it does.

