

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

Noranda Aluminum, Inc., et al.,)	
)	
Complainants,)	
)	
vs.)	<u>Case No. EC-2014-0223</u>
)	
Union Electric Company doing business)	
As Ameren Missouri,)	
)	
Respondent.)	

STAFF’S REPLY BRIEF

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Reply Brief*, states as follows:

Introduction

In its initial post-hearing brief, Staff explained that Noranda’s overearnings complaint contained two counts: first, whether Ameren Missouri is earning returns in excess of its authorized Return on Equity (“ROE”); second, whether Ameren Missouri’s authorized ROE is now unreasonably high in the light of changed circumstances. It is Staff’s position that Noranda has not shown that it is entitled to relief on either count.

Argument

A.

The Initial Briefs of the Parties

Initial post-hearing briefs were filed by the Complainants (“Noranda”), Ameren Missouri (“Ameren”), the Office of the Public Counsel (“OPC”), AARP and the Missouri Consumers’ Council (“AARP”), the Missouri Retailers’ Association (“MRA”),

and amicus United For Missouri (“UFM”), as well as by the Staff. Staff will reply to certain points raised in each of the other parties’ initial briefs.

Noranda:

Noranda is the complainant and bears the burden of proving that it is entitled under the law to the general rate reduction it seeks.

In its initial post-hearing brief, Noranda repeatedly asserts that the record shows that Ameren has been consistently overearning.¹ Staff responds emphatically that the testimony and evidence upon which Noranda relies relate to Ameren’s reported surveillance results or “book earnings.” For the reasons explained at length in testimony² and on the stand³ “book” overearnings do not necessarily translate into “rate” overearnings. For example, the 12 months ending June 2012 formed, in large part, the relevant test year, update and true-up audit periods for Case No. ER-2012-0166, from which the Commission nonetheless ordered a rate increase for Ameren of approximately \$260 million.

The only relevant analyses of potential rate overearnings for Ameren since June 2012 in the record are (1) that contained in Greg Meyer’s direct testimony for the 12 months ended September 2013 (which was heavily flawed and superseded by his surrebuttal analysis) and (2) two for the 12 months ending December 2013 (Cassidy rebuttal, modified in surrebuttal; Meyer surrebuttal). It is Staff’s judgment that the December 2013 analyses both show an immaterial level of rate overearnings by Ameren, ignoring the fact that both analyses fall far short of the type of detailed audit

¹ E.g., *Noranda Initial Brief*, pp. 1, 2, 6, 7, 8, 9, 11, 13, etc.

² Oligschlaeger Rebuttal, pp. 13–19.

³ Tr. 426-427, 441-443.

analysis that should be conducted before changing a utility's rates. For these reasons, Staff suggests that Noranda's assertions that Ameren has overearned in a meaningful and material ratemaking sense since its last general rate case are not supported in the record.

Noranda also asserts that no financial items embedded within Ameren's Uniform System of Accounts ("USOA") accounting records were excluded from Mr. Meyer's analysis.⁴ Staff agrees in the limited sense that Noranda's rate analysis reflects the test year totals for every USOA revenue and expense account, whether adjustments to those accounts were considered or not. However, Staff emphasizes that the adjustment process is crucial in ensuring that appropriate and matched values for all relevant factors (revenues, expenses, rate base and rate of return) are reflected in customer rates. Otherwise, a party could argue that all relevant factors have been taken into account when presenting a recommendation for a rate change based solely on unadjusted test year results.

Noranda also asserts that ratemaking adjustments to every USOA account are not necessary in order to set rates.⁵ Staff does not disagree with this assertion; however, Staff points out that it is misleading in this context. The purpose of a detailed audit of a rate request is, among other things, to assess the need to make an adjustment to each USOA account. That adjustments will not be necessary for every (or even for many) accounts does not change the fact that this analysis is required to determine whether all relevant factors are appropriately measured and matched in the ratemaking equation. Among the many common adjustments that Noranda failed to

⁴ *Noranda Initial Brief*, p. 8.

⁵ *Noranda Initial Brief*, p. 14.

take into account in its rate analysis are such major cost of service elements as a customer growth adjustment for revenues, fuel and purchased power expense annualization and normalization; an adjustment for property taxes; an adjustment for the impact of employee level changes on payroll expense; and consideration of trends in service company allocations.⁶

Noranda also asserts that Staff will not bring an overearnings complaint if it perceives an overearnings situation is likely to end within two years.⁷ This assertion is false and the reference to “two years” is not supported anywhere in the record.

It is true that Staff will only seek a rate reduction if it determines that utility overearnings are both material and likely to persist in the future.⁸ In this particular situation, Staff was aware of Ameren’s plans to file for a general rate increase several months before the Noranda complaint was filed.⁹ By the time of Staff’s analysis of Ameren’s earnings in response to the earnings complaint, the general rate increase filing by the utility was imminent and was known to be premised upon material additions to its rate base projected to be in-service by year-end 2014. In these circumstances, it is reasonable to assume that any current over-earnings by Ameren will not persist into the future and therefore an action to reduce its rates in the short-term would not be advisable. The wiser course of action would be to examine the need to adjust Ameren’s rates in its current rate increase application.

⁶ Tr. 368-375.

⁷ *Noranda Initial Brief*, p. 16.

⁸ Oligschlaeger Rebuttal, p. 4.

⁹ *Id.*, p. 5.

Ameren:

Among other things, Ameren emphasizes “the significant costs that Ameren Missouri has already incurred in 2014 and investment in additional plant already under construction, which will be placed in service by year's end.”¹⁰ Ameren goes on to say:

More specifically, in addition to the approximately \$700 million of new plant placed in service from August 2012 (the true-up cut-off date from the last rate case) to May 2014, Ameren Missouri has placed, or will place in service, an additional over \$1 billion in capital expenditures just this year. Also, as of June, Ameren Missouri had already paid over \$63 million in mandatory solar rebates incurred increases in wages for employees and is experiencing increases in property taxes and in other costs.¹¹

Ameren also points out, as does Staff, that the level of overearnings identified in this proceeding is immaterial.¹² Finally, Ameren states, “In fact, Ameren Missouri has done a full cost of service study for its pending rate case (File No. ER-2014-0258), and this study shows that Ameren Missouri's rates should be increased by \$264 million, not decreased by \$49.5 million as Complainants propose.”¹³

While Staff agrees that the immaterial and un-audited overearnings revealed in this case do not justify a rate reduction, Staff does **not** agree that Ameren's rates should be increased. Staff will comment on Ameren's pending rate increase request, after a full audit is completed, in its direct filing in Case No. ER-2014-0258.

¹⁰ *Ameren Initial Brief*, p. 3.

¹¹ *Id.*

¹² *Id.*, p. 4.

¹³ *Id.*

OPC:

OPC asserts that, if the Commission finds that overearnings exist, it should reduce rates.¹⁴ Staff responds that an overearning situation cannot be “found” absent a full audit addressing all relevant factors. No such audit was conducted or presented within the context of the present case.

OPC points out that Staff, which opposes any rate reduction, has calculated and testified that Ameren is currently overearning by \$25 million on an annual basis.¹⁵ Staff also testified that this figure is the result of an analysis that was much less thorough and comprehensive than a normal rate case audit.¹⁶ Therefore, Staff would not characterize this amount as “overearnings” in the first place.¹⁷ Staff has also characterized this amount as immaterial as it is less than 1% of Ameren’s current level of annual revenues, assuming that this figure accurately represents Ameren’s current revenue requirement.

OPC also asserts that the Staff has more expansive discovery rights and access to confidential information than other parties that may be interested in reducing a utility’s rates.¹⁸ As explained in Staff’s initial post-hearing brief, the statute contemplates an audit by Staff upon the filing of an overearnings complaint, and this observation by Public Counsel highlights the wisdom of the statutory scheme. It is *not* an argument for reducing the burden of proof of a non-Staff party in seeking a rate reduction.

¹⁴ *OPC Initial Brief*, p. 2.

¹⁵ *Id.*, p. 6.

¹⁶ Cassidy Rebuttal, pp. 40-41.

¹⁷ Tr. 327, 336-337.

¹⁸ *OPC Initial Brief*, p. 9.

OPC finishes by insisting that Staff’s calculation of an approximate \$25 million of Ameren overearnings at the present time is clearly material.¹⁹ Staff’s general guideline that a rate reduction should not be sought unless the ongoing overearnings amounts greater than 1% of annual revenues is intended to apply to utilities of all sizes, across the board. Because Ameren is by far the largest Missouri utility, 1% of its annual revenues will be a far larger number than the equivalent amount for other utilities. Nonetheless, when appropriately examined from the perspective of “average customer impact,” Staff believes that a reduction in Ameren’s rates of \$25 million would be immaterial on a customer impact basis. OPC’s attempted sole reliance on the gross dollar value of a potential Ameren rate reduction to demonstrate its materiality is therefore misleading.

AARP:

AARP explains, in the opening section of its brief, that Ameren’s Fuel Adjustment Clause (“FAC”) has been a “game changer”: “significantly increasing the likelihood that the utility may over-earn—that is, collect an actual return on equity (“ROE”) in excess of its authorized ROE.”²⁰ Staff agrees that the FAC and other risk-shifting mechanisms such as trackers and regulatory assets – once memorably described by then-Public Counsel Lewis R. Mills, Jr., as “regulatory ratchets” – have indeed significantly reduced the operating risk faced by Ameren and correspondingly increased the risk borne by ratepayers. What is that risk? The risk that the revenue produced by Ameren’s current rates will not match its current revenue requirement. In the past, the utility bore the risk that rate revenue would become inadequate due to inflation and

¹⁹ *Id.*, p. 12.

²⁰ *AARP Initial Brief*, p. 1.

other factors causing its operating costs to rise. Today, the situation is reversed: ratepayers bear the risk that rate revenue will compensate the utility at a level above that contemplated by the Commission.

AARP goes on to argue that the record herein supports Noranda's overearnings complaint action and that Noranda's case presentation, together with Staff's evidence, constitutes the required "all relevant factors" analysis.²¹ Staff does not agree. In an overearnings case such as this one, past overearnings are relevant *only* to the extent that they signal that an adjustment to rates may be necessary in order to avoid future overearning. In view of the very significant capital additions and other matters raised by Staff, future overearnings are not likely.

MRA:

MRA asserts that a solar rebate amortization should not be incorporated into any rate change ordered as a result of this earnings complaint, but instead should wait until Ameren's current general rate increase case.²² Staff points out that the present case *is* a general rate case. The stipulation in Case No. ET-2014-0085 provides detailed instructions as to how a solar rebate amortization is to be incorporated into Ameren's revenue requirement in its next general rate proceeding, that is, in this case. Furthermore, solar rebate payments are an actual utility expense and cash outlay that does not have an immediate impact on its financial earnings but should nevertheless appropriately be considered for inclusion in rates as an expense (if prudent) once the expenditures have been made. In other words, MRA's suggestion is not well-taken.

²¹ *Id.*, pp. 3-7.

²² *MRA Initial Brief*, p. 1.

Amicus UFM:

Amicus UFM states that “the issue it wishes to address in this brief [is] that granting relief without requiring the Complainants to carry their burden of proof is reversible error.”²³ UFM goes on to argue that the present record is inadequate to support the relief sought by Noranda.²⁴ Staff agrees.

B.

Return on Common Equity

Ameren states, “No evidence has been provided that shows any material changes in the cost of capital since the Company's last rate case.”²⁵ But Ameren has filed the direct testimony of analyst Robert Hevert in this case and in Case No. ER-2014-0258, seeking an *increased* authorized return on common equity (“ROE”). If there has been no material change in the cost of capital since Case ER-2012-0166 was decided, then Ameren has no basis for a higher ROE.

In fact, the truth is that Ameren’s ROE should be lower and not because of any change in the capital markets.²⁶ Staff repeats the point that it made in its *Initial Brief*: Staff did not perform a cost-of-capital study in this case and Staff does not believe that the Commission should either raise or reduce Ameren’s authorized ROE in this case. However, as this case concludes, Case ER-2014-0258 is gathering momentum. In that file-and-suspend general rate case, Staff will perform an audit and submit a comprehensive cost-of-service report, including a study of Ameren’s cost of capital.

²³ *UFM Initial Brief*, p. 2.

²⁴ *Id.*, p. 3 and ff.

²⁵ *Ameren’s Initial Brief*, p. 3.

²⁶ Staff does not concede that there has been no significant change in the capital markets, but defers that question to its upcoming cost-of-capital study in Case No. ER-2014-0258.

Staff advises the Commission that the present case highlights the fact that the cumulative effect of granting various risk-shifting devices to Ameren, particularly the FAC, but also trackers and regulatory assets, has resulted in a fundamental transformation of its operational risk environment such that significant risk has transferred from the utility to the ratepayers. Most troubling is the lack of any corresponding compensation for the ratepayers in the form of a reduced authorized ROE.

One aspect of traditional utility regulation has been the utility's risk that rate revenue will prove inadequate to cover costs. This very real risk has been regarded as a desirable circumstance by regulators and academic commentators because it creates a powerful inducement for the utility to make its operation more efficient. That risk no longer applies in the current regulatory environment. In the not very distant past, Ameren complained bitterly that its unadjusted surveillance reports documented a chronic inability to earn its authorized ROE. Now, Ameren must take pains to explain away the overearnings seemingly revealed by those same reports. As Case ER-2014-0258 proceeds, the Commission should consider this question: how should the ratepayers be compensated for the additional risk they have taken on, to Ameren's benefit?

Conclusion

Staff recommends that the *Complaint* be denied in that Complainants have failed to show that, based upon a consideration of all relevant factors, Ameren Missouri is likely to continue to earn a return materially greater than that authorized by the Commission.

WHEREFORE, Staff prays that the Commission will resolve each contested issue as recommended herein by Staff; and grant such other and further relief as may be just in the circumstances.

Respectfully submitted,

/s/ Kevin A. Thompson

Kevin A. Thompson
Missouri Bar Number 36288
Chief Staff Counsel

Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102
573-751-6514 (Voice)
573-526-6969 (Fax)
kevin.thompson@psc.mo.gov

Attorney for the Staff of the
Missouri Public Service Commission

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this **29th day of August, 2014**, on the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

/s/ Kevin A. Thompson