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Witness: *Mark L. Oligschlaeger*
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MISSOURI PUBLIC SERVICE COMMISSION
FINANCIAL AND BUSINESS ANALYSIS DIVISION

SURREBUTTAL TESTIMONY
OF
MARK L. OLIGSCHLAEGER

UNION ELECTRIC COMPANY,
d/b/a Ameren Missouri

CASE NO. ER-2019-0335

Jefferson City, Missouri
February 2020

Staff Exhibit No. 127
Date 3/11/20 Reporter pmf
File No. ER-2019-0335

1 **SURREBUTTAL TESTIMONY**

2 **OF**

3 **MARK L. OLIGSCHLAEGER**

4 **UNION ELECTRIC COMPANY,**
5 **d/b/a AMEREN MISSOURI**

6 **CASE NO. ER-2019-0335**

7 Q. Please state your name and business address.

8 A. Mark L. Oligschlaeger, P.O. Box 360, Suite 440, Jefferson City, MO 65102.

9 Q. Are you the same Mark L. Oligschlaeger who has previously submitted rebuttal
10 testimony in this proceeding?

11 A. Yes, I am.

12 Q. What is the purpose of your surrebuttal testimony?

13 A. The purpose of this testimony is to respond to the rebuttal testimony filed in
14 this case by the Office of the Public Counsel (“OPC”) witness Robert E. Schallenberg
15 regarding the issue of affiliated transactions.

16 **EXECUTIVE SUMMARY**

17 Q. Please summarize your surrebuttal testimony in this proceeding.

18 A. Based upon its recent reviews of Union Electric Company, d/b/a Ameren
19 Missouri’s (“Ameren Missouri” or “Company”) affiliated transactions, Staff’s position is that
20 OPC’s adjustment to eliminate test year Ameren Services Company (AMS) charges to
21 Ameren Missouri is not justified.

1 AFFILIATED TRANSACTIONS

2 Q. Based upon his rebuttal testimony, what is the primary assumption underlying
3 OPC witness Schallenberg's recommendation that all test year AMS charges be disallowed in
4 this proceeding?

5 A. Mr. Schallenberg appears to be assuming that all types of affiliated transactions
6 present the same regulatory concerns and all should be subject to very strict scrutiny by the
7 Commission before being included in customer rates.

8 Staff disagrees with this premise, as will be explained below.

9 Q. Are there different categories of utility affiliate transactions?

10 A. Yes, with varying degrees of regulatory concern. I classify utility affiliated
11 transactions into three major categories. The first type of affiliated transaction is an exchange
12 of goods and services between a regulated entity and an unregulated affiliate ("regulated –
13 nonregulated transactions"). The second type is an exchange of goods and services between
14 two regulated affiliates ("regulated – regulated transactions"). The third type of affiliated
15 transaction is the provision of services to regulated affiliates by a non-regulated affiliated
16 service company ("regulated – service company transactions").

17 Q. What are the regulatory concerns regarding affiliated transactions between
18 regulated and unregulated utility affiliates?

19 A. These types of transactions can be subject to significant abuse because of the
20 perverse incentives they offer to the corporate parent. The corporate parent can derive greater
21 profits overall if a regulated utility overpays for a good or service from an unregulated
22 affiliate, and the excessive expense amount is then included in a utility's rate levels.
23 Conversely, a corporate parent can also derive greater profits overall if a non-regulated

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1 affiliate underpays for a good or service from a regulated affiliate, and the lower level of
2 revenue is then included in a utility's rate levels. Either course of action, if it occurs, results
3 in the unregulated entity receiving a cross subsidy from the captive customers of the regulated
4 entity, which is an unacceptable outcome.

5 Q. Do the affiliated transaction rules (ATRs) attempt to mitigate the risk of cross
6 subsidy of this nature to the customers of a regulated utility?

7 A. Yes. The "asymmetric pricing" provisions within the ATRs, previously
8 discussed in my rebuttal testimony, require that regulated entities purchasing goods or services
9 from an unregulated affiliate pay the lower of the cost¹ or market value of the good or service,
10 and that regulated entities selling goods or services to an unregulated affiliate charge the
11 higher of the cost or market value of the good or service. Application of the "higher of/lower
12 of" pricing standard to regulated – nonregulated affiliate transactions is an effective means to
13 protect regulated customers from higher rates due to potential cross subsidy.

14 Q. Why are measures such as asymmetric pricing justified for regulated -
15 nonregulated affiliated transactions?

16 A. Absent asymmetric pricing or similar procedures, a corporate parent will have
17 a strong incentive to seek to increase its overall profitability by attempting to cross subsidize
18 its nonregulated business ventures through affiliated transactions. For this reason, this class
19 of transaction is inherently highly suspect from a regulatory perspective and should be
20 subject to strict scrutiny before being passed on in rates. While one alternative might be
21 to simply forbid regulated utilities from doing business with nonregulated affiliates, the

¹ As explained in my rebuttal testimony, in the context of the ATRs "cost" is defined as "fully distributed cost," or FDC.

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1 current ATRs allow these transactions to take place only under the protections offered by
2 asymmetric pricing.

3 Q. Please describe the second category of affiliated transactions.

4 A. This category involves transactions between two regulated utilities.

5 Q. Is this type of affiliated transaction as potentially subject to the same level of
6 abuse as the first category previously discussed?

7 A. No, because both entities involved in the transaction are directly subject to rate
8 regulation and regulatory controls by a public utility commission or commissions.

9 Q. Can asymmetric pricing be applied to transactions between two regulated
10 affiliates?

11 A. Generally, no. As an example, assume two Missouri regulated utility affiliates
12 exchange a good or service. It would be impossible for one participant to pay the higher of
13 the market value or FDC of the good/service, and the other participant to receive in revenues
14 the lower of the market value or FDC of the good/service (assuming any difference between
15 the applicable fully distributed cost and market values). For this reason, it is customary
16 and generally reasonable for transactions between regulated utilities to be priced at cost
17 (i.e., no profit margin).

18 Q. Has the Missouri Commission previously allowed affiliate transactions
19 between two regulated entities to be valued at cost in lieu of the asymmetric pricing standards
20 in the ATRs?

21 A. Yes. In the merger application case of Kansas City Power & Light Company
22 and Aquila United, Inc., Case No. EM-2007-0374, the Commission granted the two
23 companies a waiver from the ATRs which allowed for exchanges of goods and services

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1 between each utility at cost. The Commission also extended this variance to cover transactions
2 between Kansas City Power & Light Company, KCP&L Greater Missouri Operations,²
3 and Westar Energy, Inc.,³ a state regulated utility in the state of Kansas, in Case No.
4 EM-2018-0012.

5 Q. Please discuss the third type of affiliated transaction.

6 A. This type of transaction, usually applicable to utilities operating under holding
7 company structures, involves the centralized provision of services by a “service company” to
8 regulated and unregulated holding company affiliates. Use of service companies to obtain
9 necessary corporate support services for multiple entities under a holding company structure
10 is a common practice for utilities, as it is believed to be an economical approach for provision
11 of these services.

12 Q. Is Ameren Missouri part of a corporate holding company structure?

13 A. Yes, as discussed previously in my rebuttal testimony. Ameren Missouri,
14 along with its affiliates, receives many necessary corporate support services from its
15 affiliate, AMS.

16 Q. Please provide an example of the potential economic benefit to utilities from
17 use of service companies.

18 A. Assume a holding company contains a number of regulated and unregulated
19 affiliates. If a service company were to provide centralized human resources services to a
20 group of affiliates, as an example, and then direct charge or allocate the costs of that service
21 to all of the affiliates including regulated utilities, then it is highly likely that this would be

² Now known as Evergy Metro, Inc., d/b/a Evergy Missouri Metro and Evergy Missouri West, Inc.,
d/b/a/ Evergy Missouri West.

³ Now known as Evergy Kansas Central, Inc.

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1 less costly to each affiliate than if the affiliates had to provide the human resources services
2 for themselves in-house, or possibly attempt to receive these services from an unaffiliated
3 third party.

4 The specific items services included in the definition of "corporate support" in the
5 ATRs are joint corporate oversight, governance, support systems and personnel involving
6 payroll, shareholder services, financial reporting, human resources, employee records,
7 pension management, legal services, and research and development activities. There are
8 apparent economies of scale benefits when such services are offered on a centralized basis to
9 affiliated entities. Most or all of the above listed services are currently provided to Ameren
10 Missouri by AMS.

11 Q. Do utility holding company service companies typically charge a profit margin
12 for the services provided to affiliates?

13 A. No. In fact, the Federal Energy Regulatory Commission ("FERC") currently
14 prohibits centralized service companies under its jurisdiction from charging a profit for
15 corporate support services to affiliated entities. Elimination of profit from service company
16 affiliated transactions tends to make receipt of goods or services from a service company
17 more economical to utilities than obtaining the same good or service from an unaffiliated
18 profit-seeking entity, all other things being equal.

19 Q. Given the economies of scale present in the holding company structure, and
20 the lack of a profit margin in provision of corporate support services, would you expect
21 provision of corporate support services from service companies to be significantly more
22 cost-efficient in most cases than regulated utilities providing the services to itself on a
23 stand-alone basis or obtaining the services from an unaffiliated third party?

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1 A. Yes.

2 Q. As a matter of policy, should services received by a utility via an
3 affiliated service company be subject to as strict regulatory scrutiny as the first category of
4 affiliated transaction?

5 A. Not in Staff's opinion. Unlike the case with regulated – nonregulated affiliated
6 transactions, in which there is inherently a significant risk of utility customer harm, due to
7 economies of scale service company structures in concept are beneficial to participating
8 utilities and, ultimately, their customers. In fact, as previously mentioned in my rebuttal
9 testimony, for many years the FERC required utility holding companies under its jurisdiction
10 to use centralized service company structures for the provision of corporate support services
11 needed by regulated affiliates. While FERC no longer requires the use of service companies
12 for these holding companies, if one is utilized, FERC requires transactions with the service
13 company to be made at cost. The rationale for this is explained clearly in FERC Order 667,
14 one of several rulemaking orders amending FERC's regulations to implement the repeal of
15 the Public Utility Holding Company Act of 1935 and enact the Public Utility Holding
16 Company Act of 2005. This order not only provides that transactions with centralized service
17 companies be made at cost, it also states that FERC will apply a presumption of prudence to
18 centralized service company transactions within a holding company structure.

19 Q. Please explain the concept of "presumption of prudence."

20 A. While I am not an attorney, my understanding is that, under a presumption of
21 prudence, a utility seeking a rate increase is not required to demonstrate in their case-in-chief
22 that all expenditures were prudently incurred. However, when another party to the rate
23 proceeding creates a serious doubt as to the prudence of a particular expenditure by the utility,

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1 the utility then has the burden of dispelling these doubts and proving the expenditure in
2 question to be prudent.

3 The Commission has previously endorsed the concept of “presumption of prudence”
4 in the Matter of Union Electric, 27 Mo PS 183 (UE Nuclear Plant inclusion in Rate Base).

5 Q. While FERC may apply a presumption of prudence for transactions between
6 Ameren Missouri and AMS, has Staff done so in this case and other recent proceedings?

7 A. No. Staff reviews the evidence presented by Ameren Missouri in its direct
8 testimonies before determining whether its service company costs should be included in
9 customer rates. For the present case, it is Staff’s position that Ameren Missouri sufficiently
10 demonstrated, in its case-in-chief, that the costs associated with its transactions with AMS
11 were prudently incurred.

12 Q. In his rebuttal testimony, Mr. Schallenberg states that a prior decision by the
13 Missouri Supreme Court involving Atmos Gas Company should be applied to Ameren
14 Missouri’s affiliated transactions with AMS. What type of transaction did this case concern?

15 A. The issue before the Supreme Court in the Atmos case concerned an affiliate
16 transaction between a regulated and nonregulated entity (purchases of gas by a regulated gas
17 utility from an affiliated nonregulated gas marketer), and ultimately held that the
18 Commission’s reliance on the presumption of prudence in rejecting a proposed disallowance
19 associated with the affiliate transaction was inconsistent with the rationale for the affiliate
20 transaction rules, and with the Commission’s obligation to prevent regulated utilities from
21 subsidizing their nonregulated operations. Essentially, the Court stated that Atmos was
22 required to demonstrate in its case-in-chief that its transaction with its affiliate was prudent.
23 As previously discussed, an affiliated transaction between a regulated and non-regulated,

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1 for-profit, entity provides the potential for a substantial harmful cross subsidy. However, in
2 its Atmos decision, the Supreme Court did not address in any manner appropriate ratemaking
3 treatment of the different type of affiliated transactions involving utilities and affiliated service
4 companies. Service company transactions made at cost do not involve the possibility of
5 abuses such as “self-dealing” that is addressed in the Supreme Court decision for regulated –
6 nonregulated transactions.

7 Q. In his rebuttal testimony, Mr. Schallenberg implies that Ameren Missouri
8 is required under the ATRs to competitively bid for all services received from AMS.
9 Does Staff agree?

10 A. No, and such a result would not be reasonable, particularly in the case of
11 shared corporate support functions. The ATRs either call for competitive bidding for
12 goods/services potentially obtainable from affiliates, or a demonstration as to why competitive
13 bidding is not necessary and appropriate in a particular situation. In both this case and Case
14 No. EO-2017-0176, it is Staff’s position that Ameren Missouri has demonstrated that
15 competitive bidding generally is not necessary and appropriate for the type of services it
16 receives from AMS.

17 Q. Please explain.

18 A. First, the Commission’s ATRs allow for regulated utilities to provide
19 “preferential service” to its affiliates in the context of the provision of corporate support
20 services (20 CSR 4240-20.015(2)(B)). This means, pursuant to the rule, that the utility may
21 share information, act in a way, or treat its affiliates in a way that confers to the affiliate an
22 “unfair advantage” over any of its potential competitors. For purposes of the ATRs,
23 “unfair advantage” is defined as an advantage that cannot be obtained by nonaffiliated entities

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1 or can only be obtained at a competitively prohibitive cost in either time or resource. (20 CSR
2 4240-20.015(1)(J)). It is Staff's understanding that this exemption was added to the rule
3 specifically so Missouri utilities could take advantage of shared corporate support functions.
4 Second, it is Staff's position that the service company model contains inherent economic
5 efficiencies. These inherent efficiencies, combined with the fact that regulated utilities in
6 Missouri are able to provide "preferential service" to its affiliates when transacting for
7 corporate support services, make it unlikely that extensive competitive bidding for services
8 currently received by Ameren Missouri from AMS would be productive or cost-effective.

9 Q. Are you saying that Ameren Missouri need never consider potential
10 alternatives to receipt of services from AMS?

11 A. Not at all. There will be circumstances where a reasonable chance exists that
12 Ameren Missouri could either obtain a particular service more economically from a third party
13 vendor, or perform the service for itself at lower cost than charged by AMS. Ameren Missouri
14 should continually review the services it receives in order to take advantage of any
15 opportunities to receive necessary services at a lower cost. Staff will continue to review
16 Ameren Missouri's activities in this regard in future general rate case filings or other
17 appropriate forums.

18 Q. Does Ameren Missouri currently perform this type of review of AMS services?

19 A. Yes. Ameren Missouri witness Ben Hasse discusses in his rebuttal testimony
20 the process by which Ameren Missouri chooses to obtain corporate services from either AMS
21 or from alternative sources through application of Ameren Missouri's Joint Planning and
22 Procurement policy.

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1 Q. Do you agree with Mr. Schallenberg's point in his rebuttal testimony at
2 pages 20 – 21 that the ATRs require calculation of fully distributed cost values for the
3 regulated utility, Ameren Missouri, and not for the service company, AMS?

4 A. Yes. However, there is little reason to expect substantial differences between
5 the values of FDC calculations for Ameren Missouri and for AMS for the types of services
6 currently provided to Ameren Missouri by AMS. That is because: 1) these services are
7 largely labor intensive; 2) there is no effective difference between Ameren Missouri's
8 and AMS' labor costs; and 3) Ameren Missouri/AMS labor costs are set at market levels.
9 Mr. Schallenberg appears to agree with the latter assumption at page 14, lines 21 - 23 of his
10 rebuttal testimony.

11 Under these specific circumstances, Staff's position is that Ameren Missouri has
12 reasonably justified the amounts charged by AMS for corporate support services in this
13 proceeding as being consistent with the intent of the asymmetric pricing standards contained
14 within the ATRs.

15 Q. Does Ameren Missouri/AMS regularly "benchmark" labor costs?

16 A. Yes, as previously discussed in my rebuttal testimony. Benchmarking is
17 allowed under the ATRs as a substitute for competitive bidding to establish market values for
18 affiliated goods and services.

19 Q. Please summarize Staff's position regarding OPC's proposed disallowances of
20 AMS service company charges in this case.

21 A. Staff's position is that Ameren Missouri has presented sufficient evidence in
22 this case to show that it is substantively complying with the current ATRs, and the costs
23 associated with Ameren Missouri's transactions with AMS were prudently incurred.

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1 Application of the pricing and documentation standards advocated by OPC in this proceeding
2 to service company transactions would be burdensome to Ameren Missouri and unlikely to
3 provide material benefits to Ameren Missouri ratepayers. For these reasons, OPC's proposal
4 to disallow more than \$200 million of AMS service company charges from Ameren
5 Missouri's rates is not reasonable, and should be rejected.

6 Q. Does this conclude your surrebuttal testimony?

7 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company)
d/b/a Ameren Missouri's Tariffs to Decrease) Case No. ER-2019-0335
Its Revenues for Electric Service)

AFFIDAVIT OF MARK L. OLIGSCHLAEGER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

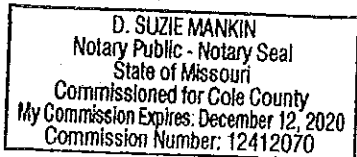
COMES NOW MARK L. OLIGSCHLAEGER and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing *Surrebuttal Testimony of Mark L. Oligschlaeger*; and that the same is true and correct according to his best knowledge and belief.

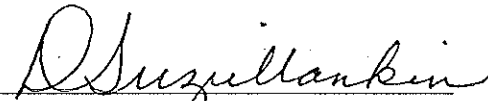
Further the Affiant sayeth not.


MARK L. OLIGSCHLAEGER

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 13th day of February 2020.




Notary Public