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Darryl T. Sagel
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File No. ER-2022-0337

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MISSOURI PUBLIC SERVICE COMMISSION

FILE NO. ER-2022-0337

SURREBUTTAL TESTIMONY

OF

DARRYL T. SAGEL

ON

BEHALF OF

UNION ELECTRIC COMPANY

d/b/a Ameren Missouri

**St. Louis, Missouri
March, 2023**

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1 **II. RESPONSE TO OPC WITNESS DAVID MURRAY'S REBUTTAL TESTIMONY**
2 **REGARDING RECOMMENDED ALLOWED CAPITAL STRUCTURE**

3 **Q. In recommending that the Missouri Public Service Commission (the**
4 **"Commission") utilize Ameren Corporation's parent company capital structure for**
5 **ratemaking purposes, Mr. Murray states that Ameren Corporation has been able to sustain**
6 **additional corporate leverage without negative credit implications due to Moody's Investors**
7 **Service ("Moody's") having lowered its funds from operation ("FFO") to debt ratio¹**
8 **downgrade threshold in March 2019 from 19% to 17%. He further indicates that "[o]ne of**
9 **the primary reasons Moody's cited for allowing less stringent financial metrics was the**
10 **"improved regulatory construct in Missouri facilitating meaningful rate base growth and**
11 **reducing regulatory lag [PISA]."² Do you agree that Ameren Corporation's "flexibility to**
12 **incur more leverage at the holding company level without jeopardizing its credit rating"³**
13 **increased as a result of Moody's action to reduce the FFO to debt ratio downgrade threshold?**

14 **A. Yes. As I stated in my rebuttal testimony, "[t]his change has permitted Ameren**
15 **Corporation more flexibility to take on additional leverage or better absorb negative changes to**
16 **the operating cash flow profile of its utility subsidiaries without negatively impacting its credit**
17 **rating at Moody's."⁴**

¹ Moody's evaluates the FFO to debt ratio utilizing a similar metric – cash flow from operations pre-working capital to debt ratio.

² File No. ER-2022-0337, David Murray Rebuttal Testimony, p. 5.

³ *Id.*

⁴ File No. ER-2022-0337, Darryl Sagel Rebuttal Testimony, p. 36.

1 **Q. Do you agree with Mr. Murray that one of the primary reasons Moody's cited**
2 **for allowing less stringent financial metrics was the improved regulatory construct in**
3 **Missouri?**

4 A. I do not agree with Mr. Murray's statement, because in its March 29, 2019 credit
5 opinion, Moody's does not explicitly state that it made this change due to any one factor. Mr.
6 Murray is simply speculating, based on a Credit Strength mentioned elsewhere in Moody's report
7 – "Improved regulatory construct in Missouri facilitating meaningful rate base growth and
8 reducing regulatory lag," which Moody's in no way ties to its FFO to debt ratio downgrade
9 threshold change. In fact, there are other Credit Strengths highlighted in the report, which Murray
10 ignores, that could just as easily have contributed to Moody's action, and there are also
11 counterbalancing Missouri-related Credit Challenges indicated in the report that might have
12 otherwise impeded Moody's action, including "Negative cash flow implications from both tax
13 reform and Missouri rate freeze until April 2020 will lead to a 500 bps reduction in CFO pre-
14 working capital to debt," and "Transitioning its predominantly coal generation fleet in Missouri."
15 In summary, Mr. Murray' s speculation does not provide a factual basis that supports the cause and
16 effect he claims to exist.

17 **Q. Did Moody's action in March 2019 to reduce Ameren Corporation's FFO to**
18 **debt ratio downgrade threshold have any practical implications on Ameren Missouri's access**
19 **to debt capital, its cost of capital or its debt capacity?**

20 A. No, it did not. Since the March 2019 report was published, Moody's has not taken
21 any action on Ameren Missouri's credit rating or its rating outlook, nor has the agency reduced
22 Ameren Missouri's FFO to debt ratio downgrade threshold. Consequently, it cannot be reasonably
23 inferred that the Company has enhanced access to capital, or a lower cost of capital, since Ameren

1 Missouri issues its own debt (with Ameren Missouri investors looking exclusively at Ameren
2 Missouri's credit profile) and does not rely upon Ameren Corporation for balance sheet support of
3 the Company's financial obligations. In addition, with no change in Ameren Missouri's FFO to
4 debt ratio downgrade threshold, the Company cannot incur incremental debt capacity without
5 facing significant risk of a ratings downgrade at Moody's.

6 **Q. Mr. Murray indicates that the purposes for which Ameren Corporation issued**
7 **holding company debt do not matter in the Commission's deliberation of what capital**
8 **structure to utilize for ratemaking purposes. How do you respond?**

9 A. I disagree, but perhaps more importantly, regulatory experts disagree. I would call
10 attention to a citation from Charles Phillips', The Regulation of Public Utilities – Theory and
11 Practice,⁵ which recommends that "a hypothetical capital structure is used only where a utility's
12 actual capitalization is clearly out of line with those of other utilities in its industry or where a
13 utility is diversified." Mr. Phillips clearly draws a distinction that the use of parent company debt
14 proceeds matter, but only to the extent they are earmarked for non-regulatory purposes. In my
15 rebuttal testimony, I clearly supported Ameren Missouri's common equity ratio of 51.91% as of
16 December 31, 2022, and the fact that Ameren Missouri's common equity ratio is consistent with
17 those authorized, on balance, by the fully-regulated integrated electric operating subsidiaries for
18 publicly-traded utilities in an identified peer group. In addition, neither the Company nor its parent
19 company, Ameren Corporation, is meaningfully diversified into non-regulated activities or
20 businesses, so the proceeds of parent company debt offerings are almost entirely supporting
21 regulated activities.

⁵ Charles F. Phillips, Jr., The Regulation of Public Utilities – Theory and Practice, 1993, Public Utility Reports, Inc., Arlington VA, at 391.

1 **Q. In responding to the direct testimony of Commission Staff witness Seoung**
2 **Joun Won, Mr. Murray states that Ameren Missouri does not operate as an independent**
3 **entity as it relates to the procurement of financing. What is your response?**

4 A. I addressed the issue of financial independence of Ameren Missouri at length in my
5 rebuttal testimony. Specifically, Ameren Missouri finances itself through its own public issuances,
6 maintains its own credit ratings and produces separate filings for the Securities and Exchange
7 Commission. Ameren Missouri's capital structure is managed over time to ensure continued
8 financial strength as well as to maintain a credit profile that provides the Company timely access
9 to required capital in order to fund Ameren Missouri operations and to support its obligations to
10 provide safe and adequate service to all customers in its service territory, at a competitive cost for
11 the benefit of Ameren Missouri customers. In addition, Ameren Missouri's Board of Directors
12 exerts governance oversight of key regulatory, legal, managerial and financial matters, including
13 approval of capital budgets, financings and cash distributions (i.e., dividends) to Ameren
14 Corporation. The fact that Ameren Services Company provides various corporate support services
15 to Ameren's subsidiaries, including the Company, in practice does not impinge on Ameren
16 Missouri's financial independence. This services structure was put in place to take advantage of
17 economies of scale available through centralized functions – with such efficiencies passed on to
18 Ameren Missouri and other subsidiaries' customers in the form of lower costs that, in turn, result
19 in lower customer rates.

20 Mr. Murray further states that "the fact that Ameren Missouri has been relying more heavily
21 on long-term capital (i.e., retained earnings and long-term debt) rather than short-term debt to fund
22 its liquidity needs illustrates Ameren Missouri is not being managed independent of Ameren

1 Corp."⁶ Mr. Murray does not effectively explain why that is the case and I certainly do not follow
2 his logic. Because Ameren Missouri has finite available liquidity through available borrowings
3 under the Missouri revolving credit facility, which it shares with Ameren Corporation, and through
4 potential borrowings via Ameren's utility money pool, the Company needs to be thoughtful about
5 how much short-term debt (e.g., commercial paper) it carries over time. Outstanding commercial
6 paper reduces available borrowing capacity under the Missouri revolving credit facility dollar for
7 dollar. To the extent Ameren Missouri holds higher levels of short-term debt over time, its
8 prospective liquidity position could be constrained, particularly in the event long-term capital was
9 not available on attractive terms. Both rating agencies evaluate how Ameren Corporation and its
10 issuing subsidiaries, including Ameren Missouri, manage their liquidity profiles over time, with
11 such evaluation factored into each of the entities' credit ratings. Consequently, it has been Ameren
12 Missouri's historic practice to term-out (i.e., issue long-term debt to repay short-term debt) its
13 commercial paper exposure when the Company has in the area of \$300 million to \$600 million of
14 commercial paper outstanding, allowing the Company to issue index-eligible, and therefore less-
15 expensive, long-term debt. Given the seasonality of Ameren Missouri's cash flow profile, the
16 Company's commercial paper balances typically increase in the first and fourth quarters of each
17 calendar year, resulting in optimal strategic long-term debt issuances in the March / April / May
18 timeframe within the calendar year.

19 Mr. Murray also references the fact that Ameren Missouri does not possess a stand-alone
20 revolving credit facility, suggesting that Ameren parent benefits through the arrangement. The
21 scale benefit of the shared revolving credit facility actually inures both to Ameren Corporation and
22 Ameren Missouri. If Ameren Missouri were instead to utilize a stand-alone credit facility, the

⁶ File No. ER-2022-0337, David Murray Rebuttal Testimony, p. 10.

1 Company and its customers would be required to pay for 100% of that arrangement, an amount
2 that is likely materially greater than its proportionate percentage of fees associated with a shared
3 credit facility sized to address the Company's and Ameren parent's contemporaneous cash needs.

4 **Q. In disputing the application of Ameren Missouri's stand-alone capital**
5 **structure for purposes of this proceeding and attempting to counter another element of Dr.**
6 **Won's Direct Testimony, Mr. Murray makes a point of highlighting that Standard & Poor's**
7 **Ratings Services ("S&P") does not issue credit ratings for Ameren Missouri based on the**
8 **stand-alone credit quality of the Company. Do you agree?**

9 A. Not entirely. S&P does issue individual credit ratings for Ameren Missouri based
10 on credit considerations distinct to the Company and publishes separate credit opinions for Ameren
11 Missouri. However, S&P's methodology for rating issuer entities that are part of a corporate group
12 (as is the case with Ameren Missouri) takes into consideration the creditworthiness of the group,
13 the stand-alone credit profiles of individual group members, and the status of the issuing entity
14 relative to other group entities. In assigning an issuer credit rating to individual group members,
15 such as Ameren Missouri, the issuer credit rating is based on the entity's stand-alone credit profile
16 and the potential for extraordinary support or extraordinary negative intervention available to the
17 issuer, and any degree of insulation that an individual group member has from potential negative
18 influence by other weaker group entities. So, to state that "S&P assigns a BBB+ rating to Ameren
19 Missouri based on the fact that Ameren Corp.'s rating is BBB+⁷ is an oversimplification. Yet, in
20 Ameren Missouri's case, S&P perceives the Company as "Core" – that is, integral to the group's
21 (i.e., Ameren Corporation's) identity and future strategy – which necessitates that Ameren

⁷ File No. ER-2022-0337, Rebuttal Testimony of David Murray, page 12.

1 Missouri's issuer credit rating (BBB+) be equivalent to Ameren Corporation's group credit profile
2 (bbb+).

3 It is important to note that when Ameren Missouri raises long-term debt, it does so via the
4 offering of first mortgage bonds, secured debt under which holders have primary liens on the
5 property that secures the mortgage and priority claims on the underlying property in the event of
6 default. Because of the secured nature of the debt, both S&P and Moody's rate the first mortgage
7 bonds of Ameren Missouri – the true cost of capital to Ameren Missouri customers – two notches
8 higher (i.e., A+ / A2) than their respective issuer credit ratings of Ameren Missouri. Therefore, it
9 is accurate to state that Ameren Missouri debt rated by the rating agencies is based on the stand-
10 alone credit quality, including the underlying assets, of Ameren Missouri.

11 One additional point that should not be neglected, though, is that Mr. Murray does not
12 dispute the fact that Moody's issuer credit rating for Ameren Missouri is based on Ameren
13 Missouri's stand-alone credit quality, including its stand-alone capital structure, so it is still
14 factually correct to state, as Dr. Won posits, that Ameren Missouri's stand-alone capital structure
15 supports its own issuer credit ratings.

16 **Q. Mr. Murray, in responding to another assertion in Dr. Won's Direct**
17 **Testimony, seems to support the existence of double leverage at Ameren Missouri. What is**
18 **your reaction?**

19 A. It appears that Mr. Murray is not generally familiar with what constitutes double
20 leverage and wants to apply a more expansive definition that is not appropriate in these
21 proceedings. To be clear, double leverage is a financial strategy whereby a parent company issues
22 debt and subsequently contributes the proceeds to its operating subsidiary in the form of an equity
23 investment. In this case, the subsidiary's operations are financed by debt raised at the subsidiary

1 level and by debt financed at the holding company level. By definition, Ameren Missouri cannot
2 be perceived to be deploying double leverage, because its operations are not financed by debt at
3 the holding company level. This is supported by my rebuttal testimony, including evidence that
4 traces recent capital infusions from Ameren parent to Ameren Missouri to distinct Ameren
5 Corporation common equity issuances, and Mr. Murray does not dispute this. Rather, Mr. Murray
6 states that Ameren Corporation's ownership of pure-play regulated utilities allow the parent to
7 issue significant holding company debt, but this phenomenon is not double leverage, as he
8 suggests. Mr. Murray also seems to take issue with the fact that some of the proceeds of Ameren
9 Corporation parent debt has been used to fund investments at Ameren Illinois Company and
10 Ameren Transmission Company of Illinois, both companies outside of the jurisdictional purview
11 of this Commission. The fact that Ameren Corporation may have employed this strategy at other
12 subsidiaries, whose jurisdictional regulators have not taken any issue with the practice, does not
13 have any practical bearing on whether double leverage has been utilized at Ameren Missouri. It
14 has not.

15 **Q. Mr. Murray indicates that "[w]hile Ameren Missouri's common equity ratio**
16 **dropped at June 30, 2022, because Ameren Corp. targets a 52% common equity ratio for**
17 **Ameren Missouri for ratemaking purposes, and the ordered true-up period in this case is**
18 **December 31, 2022, Ameren Corp. is repositioning Ameren Missouri's capital structure to**
19 **meet its 52% target for ratemaking."**⁸ **Is his statement accurate?**

20 A. While Mr. Murray seems to be suggesting a more nefarious approach to Ameren
21 Missouri's capital structure management by Ameren Corporation, in practice the improvement
22 between Ameren Missouri's equity ratio as of June 30, 2022 and its equity ratio as of December

⁸ File No. ER-2022-0337, David Murray Rebuttal Testimony, p. 15.

1 31, 2022 can be explained predominantly by the nature of the Company's seasonal cash flow
2 profile. Ameren Missouri typically generates a disproportionate amount of its electric margins in
3 the summer and swing months, contributing to increased retained earnings in the second half of
4 the calendar year. This is demonstrable in the graphs in Mr. Murray's Rebuttal Testimony on pages
5 14 and 15, in which Ameren Missouri's common equity ratios generally trough in the middle part
6 of each calendar year. This phenomenon similarly occurred in 2022, contributing to the Company's
7 improved common equity ratio during the second half of the year, even as the Company distributed
8 \$45 million of cash to Ameren Corporation in December 2022.

9 III. TRUE-UP CAPITAL STRUCTURE

10 **Q. The Company provided a projected capital structure and weighted average**
11 **cost of capital in its direct testimony. Please update with actual results as of December 31,**
12 **2022.**

13 A. The Company's weighted average cost of capital updated for actual results as of
14 December 31, 2022 is 7.185 percent. Please refer to Schedule DTS-S1 for the supporting
15 calculation and further details.

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

17 A. Yes, it does.

**Union Electric Company d/b/a Ameren Missouri
Capital Structure/Weighted Average Cost of Capital**

at 12/31/2022:

CAPITAL COMPONENT	AMOUNT	PERCENT OF TOTAL	COST	WEIGHTED COST
Long-Term Debt	\$5,798,639,526	47.423%	3.926%	1.862%
Short-Term Debt	\$0	0.000%	4.760%	0.000%
Preferred Stock	\$81,827,509	0.669%	4.180%	0.028%
Common Equity	\$6,347,121,457	51.908%	10.200%	5.295%
TOTAL	\$12,227,588,492	100.000%		7.185%

