*** BEGIN CONFIDENTIAL *** XXXXX *** END CONFIDENTIAL ***

DIRECT TESTIMONY
(PUBLIC VERSION)

of

MICHAEL McNALLY

Finance Department

Financial Analysis Division

Illinois Commerce Commission

Ameren Illinois Company d/b/a Ameren Illinois
Proposed General Increase in Gas Rates

Docket No. 15-0142

June 9, 2015

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WITNESS IDENTIFICATION

Q1. Please state your name and business address.

A1. My name is Michael McNally. My business address is 527 East Capitol Avenue, Springfield, IL 62701.

Q2. What is your current position with the Illinois Commerce Commission ("ICC" or "Commission")?

A2. I am a Senior Financial Analyst in the Finance Department of the Financial Analysis Division.

Q3. Please describe your qualifications and background.

A3. I received both a Bachelor of Arts degree in Economics and a Master of Business Administration degree with a concentration in Finance from the University of Illinois at Urbana-Champaign and I hold the Chartered Financial Analyst designation from the CFA Institute. I have been employed by the Commission since 1999 and have previously testified before the Commission on a variety of financial issues.

Q4. Please state the purpose of your testimony in this proceeding.

A4. The purpose of my testimony is to respond to the direct testimony of AIC witness Steven M. Fetter (AIC Ex. 12.0) and to present my evaluation of the reasonableness of the recovery through rates of fees billed to Ameren Illinois Company ("AIC" or the "Company") by Regulation UnFettered and Sussex Economic Advisors, LLC ("Sussex") related to the cost of common equity testimonies of Mr. Fetter and Mr. Robert B. Hevert (AIC Ex. 5.0 (Rev.)), respectively.

RESPONSE TO MR. FETTER

Q5. Please provide an overview of Mr. Fetter's direct testimony.

A5. Mr. Fetter's direct testimony relates almost exclusively to credit ratings: the effect that the regulatory environment has on them and the effect they have on utilities and their customers. He also endorses Mr. Hevert's cost of capital recommendations. (AIC Ex. 12.0, 4-5.)

Q6. Mr. Fetter warns several times of "financial crisis" and "disruptions to credit markets" and the potential dire effects on utilities if such conditions arise. (AIC Ex. 12.0, 5, 9-10, 21.) Please comment.

A6. Despite the recently experienced "turmoil in the financial markets" that according to Mr. Fetter "tested the financial standing of the utility sector like never before," when asked to identify any Illinois utility that defaulted on its debt obligations or failed to provide acceptable service as a result of those purportedly unprecedented conditions, he states that he is not aware of any. (AIC Ex. 12.0, 9; see Attachment A, 10.) He also cautions that a credit rating downgrade for AIC, which *could* result from a "less than constructive" return on common equity ("ROE") decision from the Commission, "would be very financially injurious to both customers and investors," yet could not identify any specific threat to AIC to prompt such a hypothetical warning, just the general concern that accompanies any rate case in any regulatory jurisdiction. (AIC Ex. 12.0, 17; see Attachment A, 4.)

Q7. Mr. Fetter notes that "Illinois is viewed by the market as among the less credit supportive states." (AIC Ex. 12.0, 4.) Please comment.

A7. Mr. Fetter's characterization represents a relative ranking rather than an absolute description. That is to say, simply because Illinois may be viewed as less credit supportive than other states does not mean that it is not credit supportive generally and does not indicate that the regulatory framework in Illinois is unjust or unreasonable. Indeed, S&P classifies the Illinois regulatory environment as "Strong/Adequate," the second-highest of its five categories, which indicates that the Illinois regulatory environment is credit supportive. (Standard & Poor's, "Utility Regulatory Assessments For U.S. Investor-Owned Utilities", January 7, 2014) Similarly, Moody's states that The Peoples Gas Light and Coke Company ("Peoples"), which operates in the same regulatory environment as AIC, has a "fairly supportive regulatory environment." (Moody's Investors Service, "Credit Opinion: Peoples Gas Light and Coke Company," May 26, 2015.) Likewise, S&P states that Nicor Gas Co. has "moderately <u>low</u> regulatory risk in Illinois that Nicor manages better than its peers." (Standard & Poor's Ratings Services, "Summary: Nicor Gas Co.," June 3, 2015, 2 (emphasis added).) This not only demonstrates that the relative description "less supportive" does not equate to high regulatory risk, but also that a utility's absolute regulatory risk assessment is a function of how well that utility manages its regulatory environment. Even in relative terms, Mr. Fetter notes that Illinois is ranked by S&P as the 35th most credit-supportive jurisdiction of the 53 regulatory bodies assessed. (AIC Ex. 12.0, 14.) That puts Illinois in the middle third of all jurisdictions - hardly an outlier. More importantly, such relative rankings fail to indicate how much more or less supportive Illinois is than other jurisdictions. For example, the difference between Illinois and California, the highest ranked jurisdiction in S&P's "Strong/Adequate" category, is not disclosed. (Standard & Poor's, "Utility Regulatory Assessments For U.S. Investor-Owned Utilities", January 7, 2014.)

In fact, Mr. Fetter could not name a single Illinois utility experiencing default or service failure despite never-before seen economic turmoil. (See Attachment A, 10.) Further, he acknowledges that AIC's BBB+ S&P issuer credit rating is precisely the rating that AIC management has set as the Company's target rating.[1] He does not contend that AIC management's chosen target credit rating is too low; to the contrary, he concludes that "'BBB+' is adequate for the utility's investors and customers" and that BBB+ is a "level that should allow a utility to access the capital markets upon reasonable terms even during times of stress within the capital markets." (AIC Ex. 12.0, 7, 10.) Thus, even Mr. Fetter implicitly acknowledges that the Illinois regulatory environment has been more than sufficiently credit supportive to maintain AIC's target credit rating. In fact, he notes that achieving a higher credit rating could come at a higher cost to customers, such as through a significantly stronger capital structure. (AIC Ex. 12.0, 10.)

Q8. Please respond to Mr. Fetter's discussion of S&P's rating methodology.

A8. Mr. Fetter devotes a great deal (approximately 20%) of his testimony to describing in detail S&P's rating methodology. (AIC Ex. 12.0, 7-8, 15-19) At the conclusion of his recitation, he broadly proclaims a truism that a "constructive decision" would allow the Company to maintain or improve it current rating.

Mr. Fetter's overview of S&P's rating methodology overlooks a critical aspect of that methodology, namely, that S&P's ratings reflect a consolidated perspective. That is, as stated in AIC's most recent credit rating report, "the BBB+ ICR [issuer credit rating] on AI reflects parent Ameren Corp.'s group credit profile." (Standard & Poor's Ratings Services, "Summary: Ameren Illinois Co.,'" May 14, 2015, 3.) Therefore, a "constructive decision," however that is defined, might have no effect on AIC's S&P credit rating at all. In contrast, Moody's credit ratings are evaluated

[1] In fact, AIC maintains the same BBB+ rating that the Company targets or higher from each of the three primary credit rating agencies (i.e., S&P, Moody's Investors Service ("Moody's"), and Fitch Ratings ("Fitch")).

predominantly on a stand-alone basis. (Moody's Investors Service, "Rating Methodology: Regulated Electric and Gas Utilities," December 23, 2013.) On that stand-alone basis, Moody's rates AIC A3 (the equivalent of an A– rating from S&P), to which it was just upgraded in April of this year. (AIC Resp. to Staff DR SK 3.02, Attach. 1.) This is significant in two respects. First, that AIC was *upgraded* to a credit rating even higher than its target credit rating in the midst of the very same regulatory environment that Mr. Fetter warns could lead to a credit rating downgrade, further undermines Mr. Fetter's implication that the Illinois regulatory environment is less than credit supportive. Second, AIC's A3 credit rating on a standalone basis, combined with the lower Baa1 rating Moody's currently assigns Ameren Corp. and Ameren Missouri, indicate, contrary to Mr. Fetter's implication, that AIC's S&P credit rating is not suppressed by the Illinois regulatory environment, but by AIC's affiliation with Ameren Corp. and Ameren Missouri. (AIC Resp. to Staff DR SK 3.02, Attach. 1.)

Q9. Mr. Fetter compares certain recent Commission-authorized ROEs to those authorized for other gas utilities in 2013 and 2014 throughout the country. (AIC Ex. 12.0, 13.) Please comment.

A9. It is not clear precisely what role Mr. Fetter believes ROEs authorized outside of Illinois should play in the Commission's approach to rate setting. First, his discussion of authorized ROEs is presented as a part of a general discussion of the Illinois regulatory environment and is not directly related to the appropriate authorized ROE in this proceeding. Second, he states that "outside ROE judgments should not necessarily influence the setting of ROEs within a particular state." Nonetheless, he does seem to indicate that ROEs authorized outside of Illinois should be considered to some degree in Commission decision making.

However, as presented, that outside ROE data is uninformative with respect to determining AIC's required rate of return on common equity. Mr. Fetter's testimony fails to specify many critical factors that influenced the allowed returns in those outside proceedings. For instance, Mr. Fetter does not identify the relative risk, as exemplified by credit rating or any other metric, of each of the utilities involved in those return decisions. Nor does he identify the capital structure that was adopted or the amount of the common stock flotation cost adjustment, if any, that was included in each of those decisions. He also fails to provide any context regarding the market environment in which those decisions were made. Further, despite his emphasis on the regulatory environment as it relates to AIC, he presents no information regarding the regulatory environment under which each of those outside ROEs was determined, such as the ability of a utility to achieve its authorized rate of return. Without such data, any evaluation of the proper ROE in this proceeding via comparison to the returns authorized in those outside cases is useless, since we have no basis on which to assess comparability.

Q10. Mr. Fetter suggests that the gas ROEs the ICC has authorized would "seriously jeopardiz[e] AIC's credit standing" if not for electric formula rates. (AIC Ex. 12.0, 19-20.) Do you agree?

A10. No. His suggestion that AIC is reliant upon electric formula rates to support both its electric and gas capital requirements because authorized gas ROEs are inadequate is baseless. When asked for any analysis or support that led to his characterization, he replied that he had performed no analysis. Rather, he indicates his conclusion is an extrapolation construed from his review of rating agency statements that cite formula rates for AIC's improving credit position. (Attachment A, 16.) However, in that same discussion, he acknowledges that he cannot say AIC's improving regulatory profile is due solely to formula rates. Even if one could isolate the effects of formula rates from the multitude of factors influencing AIC's credit ratings and conclusively determine that its improving credit strength is due solely to formula rates, to conclude that the Commission-authorized gas rates, and ROEs in particular, represent a "financial hurdle" is without support. The absence from credit rating reports of explicit citations to AIC's authorized gas ROEs as a basis for its improving credit position in no way demonstrates that AIC's gas rates, and ROEs specifically, would seriously jeopardize AIC's credit standing if not for electric formula rates. The example of Peoples Gas invalidates Mr. Fetter's argument. Peoples Gas, which does not have electric formula rates to "support" its credit worthiness, was authorized an ROE of 9.05% in its last rate case, yet maintains an even higher Moody's credit rating (A2) than AIC. The Peoples Gas Light and Coke Co. *et al.*, ICC Order Docket Nos. 14-0224/14-0225 (Cons.), 134 (January 21, 2015); (Moody's Investors Service, "Credit Opinion: Peoples Gas Light and Coke Company," May 26, 2015.)

RATE CASE EXPENSE – ROE WITNESSES

Q11. What documents did you review with regard to rate case expenses?

A11. I reviewed AIC Exhibits 2.0 (Rev.), 2.12, 2.13, 5.0 (Rev.), and 12.0, work paper WPC-10, and the Company's responses to Staff data requests MGM 1.01 through 1.20 and TEE 1.02. Those documents outline the rate case expenses incurred, or expected to be incurred, in association with cost of capital testimony in this docket.

Q12. Do you propose an adjustment to the rate case expense associated with Mr. Fetter's direct testimony?

A12. Yes. I propose that Mr. Fetter's consulting fees, estimated to be *** BEGIN CONFIDENTIAL *** XXXXXX *** END CONFIDENTIAL *** in AIC work paper

WPC-10 and Attachment 1 to AIC's response to Staff data request TEE 1.02, be disallowed.

Q13. Please explain why you propose to disallow Mr. Fetter's fees.

A13. Mr. Fetter's testimony is duplicative of that provided by other AIC witnesses. As noted previously, Mr. Fetter does not present any analysis or an independent estimate of AIC's cost of capital. In fact, when specifically asked to provide any studies or analysis underlying his positions, he declined ten times. (See Attachment A.) For the essentials on AIC's cost of capital, Mr. Fetter directs the reader to the testimony of AIC witness Hevert. Further, Mr. Fetter's work relates entirely to credit ratings and regulatory environment. Mr. Nelson, Mr. Martin, and Mr. Hevert already address those issues. (AIC Ex. 1.0, 5-7; AIC Ex. 4.0R, 5-8; AIC Ex. 5.0 (Rev.), 32-35.)

Additionally, Mr. Fetter was hired "to provide testimony supporting AIC's requested return on equity," which Mr. Hevert presents. (AIC Ex. 2.0 (Rev.), 33.) Yet Mr. Fetter's estimated fee is higher than Mr. Hevert's fee, which reflects Mr. Hevert's work on not only the actual analysis of the cost of common equity, but on a capital structure whitepaper detailing a study of the appropriate capital structure. Mr. Fetter's testimony does not address either of those issues. Even Mr. Fetter's expense estimate, which, primarily for travel and lodging, should not differ greatly from Mr. Hevert's, is *** BEGIN CONFIDENTIAL *** XXXXXXXX *** END CONFIDENTIAL *** than Mr. Hevert's. Further, AIC has not provided any documentation showing the details for the work hours that Mr. Fetter actually billed, only an estimate from before he even began working on the case. Absent proper supporting documentation the subject expense cannot be deemed just and reasonable.

Q14. Do you propose an adjustment to the rate case expense associated Mr. Hevert's direct testimony?

A14. Not at this time. However, I will be reviewing additional invoices and data request responses throughout the proceeding to determine if an adjustment is warranted.

Q15. Does this conclude your direct testimony?

A15. Yes, it does.

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MGM 1.01

Regarding the sentence that begins on line 90 and ends on line 92 of Ameren Exhibit 12.0:

a) Does Mr. Fetter believe there exists an "optimal rating"? If so, please define "optimal rating." Provide all supporting documentations.
b) Does Mr. Fetter mean that an A rating is the optimal rating AIC could hope to achieve if the Commission were to adopt Mr. Hevert's ROE and capital structure recommendations, that an A rating is the optimal rating for AIC generally, or something else?
c) If Mr. Fetter means that an A rating is the optimal rating AIC could hope to achieve if the Commission adopted Mr. Hevert's ROE and capital structure recommendations, please provide any and all analysis performed that led Mr. Fetter to that conclusion.
d) If Mr. Fetter means that an A rating is the optimal for AIC rating generally, please provide any studies performed or documentation relied on that led Mr. Fetter to that conclusion.
e) If Mr. Fetter means something other than the interpretations noted in parts (c) and (d) above, please explain.

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

a) Mr. Fetter believes that if, through appropriate utility management policies and constructive regulatory decision-making, a rating in the "A" category is reasonably achievable by a regulated utility, it is in the interest of both customers and investors for that to be a goal.
b) No. Mr. Fetter was speaking in general terms. Please see his answer to subpart a) above.
c) Mr. Fetter has not performed a detailed analysis to support a proposition that an A rating is the optimal rating for AIC or that Mr. Hevert's ROE and capital structure would result in an A rating, all other things being equal.
d) Mr. Fetter bases his opinion on the difficulty of "BBB" category issuers accessing the commercial paper markets for a period of time as the global crisis ensued in 2008, and also the greater spreads they had to pay as compared to "A" category issuers during the financial crisis. He also has done substantial work in Canada, where no "BBB" regulated utility accessed the capital markets for long-term debt for an extended period after the global financial crisis ensued. Mr. Fetter has not performed a detailed or specific study in this regard; rather he is relying on his general knowledge of utility access to capital markets.
e) See responses to all of the above subparts.

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MGM 1.02

On page 7 of Ameren Exhibit 12.0, Mr. Fetter states that "the lower a utility's credit rating, the more the utility must pay to raise funds from debt and equity investors to carry out is capital-intensive operations."

a) Is it Mr. Fetter's contention that, all else equal, a higher credit rating will necessarily produce a lower overall cost of capital? If so, please provide any and all analyses and documentation supporting that contention.
b) Does Mr. Fetter agree that, all else equal, a continuously strengthening credit rating will, at some point, begin to produce a higher overall cost of capital? If not, please explain why not, including any analyses relied on to make that conclusion.
c) Has Mr. Fetter performed any analyses to determine the optimal credit rating (i.e., credit rating associated with the lowest cost of capital over the long-term) for a regulated utility? If so, please provide such analyses.

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

a) Mr. Fetter believes that, all else being equal, a higher credit rating will produce a lower cost of debt. He does not believe that that situation necessarily follows with regard to the cost of equity.
b) Yes, Mr. Fetter agrees. Mr. Fetter appreciates the point of this question, and thus stated in 1.01(a) above: "a rating in the "A" category is reasonably achievable."
c) No.

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MGM 1.03

Regarding Mr. Fetter's statement, on page 5 of Ameren Exhibit 12.0, that "a less than constructive decision by the ICC in this case could lead to negative credit rating actions":

a) Please define what Mr. Fetter means by a "less than constructive decision."
b) Under what conditions would a "less than constructive decision" lead to negative credit rating actions? Please provide any studies performed, or documentation in support of, that conclusion.
c) Under what conditions would a "less than constructive decision" not lead to negative credit rating actions? Please provide any studies performed, or documentation in support of, that conclusion.

RESPONSE

Prepared By: Steve M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

a) Mr. Fetter believes that the following types of issues can result in a "less than constructive decision": A decision that does not provide for full recovery of prudently-incurred costs; or produces an undue delay in cost recovery; or authorizes a cost of capital well below the norm for similarly-situated regulated utilities.
b) Mr. Fetter believes that a "less than constructive decision" always results in a weakening of a state's regulated utilities' credit profiles, although not always to the extent that such weakening will definitely result in a rating downgrade. No studies performed.
c) Where the weakening of a regulated utility's credit profile, considered with all other rating factors, does not lead the rating agencies' rating committees to conclude that the negative impact merits a lowering of the utility's existing credit rating.

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MGM 1.04

Regarding Mr. Fetter's conclusion, on page 17 of Ameren Exhibit 12.0, that downgrades "would be very financially injurious to both customers and investors":

a) What is the basis for Mr. Fetter warning of that hypothetical scenario?
b) Is there a specific threat that is causing Mr. Fetter's concern regarding that hypothetical scenario?
c) Please define, in both qualitative and quantitative terms, what Mr. Fetter means by "very financially injurious."
d) Please provide any studies performed, or documentation in support of, the conclusion that downgrades would be very financially injurious to both customers and investors.

<u>RESPONSE</u>

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

a) Mr. Fetter notes the positive trend in the Commission's recent decision-making and encourages it to continue. He notes that "the Company's forecasted substantial capital investment" makes this a very sensitive time, one in which a downgrade "would be very financially injurious to both customers and investors." He is not predicting that such a circumstance will occur.
b) Just the concern among the financial community that accompanies any rate case in any regulatory jurisdiction, especially when substantial capital investment is forecasted.
c) By "very financially injurious," Mr. Fetter means substantial capital investment that must be raised at a higher rate of interest from an investment community that has already suffered a degree of financial harm. That higher cost usually translates into higher customer rates.
d) No study necessary. A downgrade increases the cost of debt. After a downgrade, the class of investors from which the debt must be raised will in most cases be smaller. That increased cost of debt in most cases will result in higher customer rates.

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MGM 1.05

Referring to page 7 of Ameren Exhibit 12.0, what is the basis for Mr. Fetter's conclusion that a regulated utility should maintain credit ratings no lower than "BBB+" / "Baa1"? Please provide any studies performed, or documentation in support of, that conclusion.

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

No study done. Please see response to subpart d) of data request MGM 1.01.

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MGM 1.06

Referring to page 7 of Ameren Exhibit 12.0, please provide any studies performed, or documentation in support of, Mr. Fetter's contention that a regulated utility rated "BBB+" / "Baa1" should be able to access the capital markets upon reasonable terms even during times of stress within the capital markets?

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

No study done. Mr. Fetter notes that he believes that an "A" category rating should allow market access even in the event of another global financial crisis. Putting aside such potential global crisis, Mr. Fetter believes that a regulated utility holding "BBB+"/"Baa1" ratings should be able to finance its investments under most market stress circumstances.

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MGM 1.07

Referring to page 7 of Ameren Exhibit 12.0, is it Mr. Fetter's contention that a regulated utility rated "BBB" / "Baa2" would not be able to access the capital markets upon reasonable terms during times of stress within the capital markets? If so, please provide any studies performed, or documentation in support of, that conclusion.

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

Mr. Fetter is not contending that a regulated utility would definitely not have access in such a situation. Rather, Mr. Fetter has a concern whether a regulated utility holding a rating two notches above the investment-grade/non-investment grade dividing line would have ready access to the capital markets under stressful market conditions. The lower a regulated utility's rating, the more likely it is that it would be unable to access the capital markets on reasonable terms in such circumstances. What the Commission should be considering, among things, is the level of risk that a regulated utility might find itself shut out of the capital markets in certain circumstances. The fact that it may not have happened yet does not mean or even suggest that there is no risk (as many of these discovery requests seem to imply). That would be a very dangerous line of reasoning to take.

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MGM 1.08

Has Mr. Fetter performed any analyses to determine the effect the adoption of Mr. Hevert's ROE and capital structure recommendations would have on the Company's credit ratings? If so, please provide such analyses.

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

Mr. Fetter has reviewed Mr. Hevert's testimony but has not analyzed its effects. Having testified in several cases in which Mr. Hevert has testified as an ROE witness, Mr. Fetter has a good deal of respect for the professionalism and industry and financial knowledge of Mr. Hevert.

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MGM 1.09

Has Mr. Fetter performed any analyses to determine the minimal ROE and capital structure the Commission could adopt and still avoid a credit rating downgrade? If so, please provide such analyses.

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

No, and Mr. Fetter further notes that the phrase "avoid a credit rating downgrade" does not indicate any particular time frame. Mr. Fetter assumes that the question implies an immediate downgrade, and Mr. Fetter notes that an ROE determination can contribute to an erosion of credit worthiness without necessarily leading to immediate ratings implications.

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MGM 1.10

On page 9 of Ameren Exhibit 12.0, Mr. Fetter states, "The turmoil in the financial markets that erupted six years ago tested the financial standing of the utility sector like never before." Is Mr. Fetter aware of any Illinois utility that defaulted on its debt obligations or failed to provide acceptable service as a result of those purportedly unprecedented conditions? If so, name that utility and, if applicable, describe how its service was not acceptable and over what time period its service remained unacceptable.

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

Mr. Fetter is not aware of any such defaults or service failures. However, this does not mean that the Commission can necessarily conclude that no change in its ROE approach is necessary. That the utilities in Illinois managed to avoid such calamities does not imply or even suggest that its ROEs were adequate – it indicates only that the worst possible results did not occur at that time.

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MGM 1.11

Referring to page 10 of Ameren Exhibit 12.0, please explain how has the negative global economic crisis that started during the Fall of 2008 illustrated that “BBB” category utilities are much more vulnerable than “A” category utilities when capital market are in a state of upheaval? Provide any studies or statistics that demonstrate that alleged vulnerability.

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

See MGM 1.11 Attach.

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MGM 1.12

Please provide the source document(s) for the Fitch Ratings commentary discussed on lines 250-256 and 333-348 of Ameren Exhibit 12.0.

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

See MGM 1.12 Attach 1, 2 and 3.

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MGM 1.13

Please provide the source document(s) for the Moody's commentary discussed on lines 257-266 and 304-314 of Ameren Exhibit 12.0.

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

See MGM 1.13 Attach 1 and 2.

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MGM 1.14

Please provide the source(s) for the Regulatory Research Associates findings discussed on lines 276-285 of Ameren Exhibit 12.0.

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

See MGM 1.14 Attach 1 and 2 which are designated **CONFIDENTIAL and PROPRIETARY**, and are being provided pursuant to the Protective Order issued in this case.

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MGM 1.15

Referring to page 13 of Ameren Exhibit 12.0, please provide evidence to support the accusation that the Commission holds a “general unwillingness to consider ROE authorizations in other jurisdictions in its decision-making.”

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

I am aware of at least two such instances.

First, in *North Shore Gas Co., et al.*, Docket 11-0280/0281, Order at 137 (Jan. 10, 2012), the Commission stated it "is completely uninformed as to the [cost of capital] decisions from other these other jurisdictions where we have no evidence that circumstances are comparable. Such comparisons are not relevant.”
Second, in *North Shore Gas Co., et al.*, Docket 07-0241/0242, Order at 99 (Feb. 5, 2008), the Commission stated, “evidence regarding the allowed ROEs in other cases cannot inform as to the appropriate ROE in the present case.”
Mr. Fetter wishes to make clear that he is not suggesting in any way that the Commission simply look at ROEs in other jurisdictions to determine the ROE for a particular Illinois utility. However, at the very least, ROEs in other jurisdictions can serve as a reality check for the Commission (as they did for him when he served as chairman of the Michigan Public Service Commission). If they are consistently and materially different than this Commission’s ROE determinations, the Commission might benefit from investigating and understanding why this is so.

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MGM 1.16

On pages 19-20 of Ameren Exhibit 12.0, Mr. Fetter states, “The ICC is, in essence able to issue gas orders with extremely low ROEs without seriously jeopardizing AIC’s credit standing only because of the electric formula rates.”

a) Please provide the analyses Mr. Fetter performed that led to, or documentation in support of, that conclusion.
b) Please provide any analyses or other evidence that AIC’s authorized gas ROEs are suppressing the credit standing that AIC would otherwise achieve.

RESPONSE

Prepared By: Steven M. Fetter
Title: President, Regulation UnFettered
Phone Number: 732-693-2349

a) Mr. Fetter has performed no analysis beyond reviewing rating agency statements that attribute the improvement in AIC’s credit worthiness to the electric formula rate law.
b) See response to subpart a) above.

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MGM 1.17

On page 20 of Ameren Exhibit 12.0, Mr. Fetter states that "recent rate orders seem to show an agency that appears to shift its approach without a meaningful explanation of why it is doing so."

a) Please identify the apparent shifts in approach to which Mr. Fetter refers, including specific citations to orders demonstrating the change.
b) Please explain how each alleged shift identified in part (a) above indicates a shift in approach?
c) Please specify the period during which, in Mr. Fetter's estimation, these unexplained shifts in approach occurred.
d) To Mr. Fetter's knowledge, was there a period during which the Commission generally did not shift its approach without a meaningful explanation of why it is doing so? If so, please identify that period.

RESPONSE

Prepared By: Steven M. Fetter
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a) The Commission has shifted its approach to certain elements of the return on equity analysis. For example, in Dockets 09-0306, et al. (cons.), the Commission accepted a Staff proposal to use a non-constant growth rate, stating it had "begun using a non-constant growth model as analysts projected growth rates for utilities have exceeded the growth rate of the U.S. economy as a whole." *Central Ill. Light Co.*, Dockets 09-0306 et al., (cons.), Order at 215 (May 6, 2010). The Commission rejected Ameren's proposal, which included a constant growth measure. Only a few months before that Order, the Commission had *rejected* a Staff proposal to use a non-constant growth rate, stating that there were "numerous unanswered questions" regarding the non-constant growth model, and that it represented "a fundamental change in the cost of equity methodology." *North Shore Gas Co.*, Dockets 09-0166/0617 (cons.), Order at 125 (March 17, 2010).

   Also in Dockets 09-0306, et al., (cons.), the Commission used Staff's CAPM, which was based on spot yields, finding that it was "without material flaws." Dockets 09-0306 et al., (cons.), Order at 219. In Docket 09-0166, Staff provided two CAPM analyses – one using spot yields and one using forecast yields – and the Commission averaged these results in light of the "unreliability of solely using spot data." Docket 09-0166, Order at 127.

   In Docket 11-0282, the Commission approved Staff's proposal to adjust Ameren's return on equity by 16.25 basis points to account for lower risk associated with the implementation of an uncollectibles rider. *Ameren Ill. Co.*, Docket 11-0282, Order at 125-26 (Jan 10, 2012). In earlier cases concerning other utilities, the Commission had either made no similar adjustment, or a significantly smaller adjustment. For example, in Nicor's Docket 08-0363, the Commission adopted a 6.5-basis point adjustment to return on equity in connection with an uncollectibles rider. *Northern Ill. Gas Co.*, Docket 08-0363, Order at 71 (March 5, 2009). Similarly, in Dockets 11-0280/0281, the Commission approved a 10-basis point adjustment to return on equity in connection with an uncollectibles rider.

In addition to shifting its approach to elements of the return on equity analysis, the Commission has shifted its approach to the method by which the final ROE is calculated from the parties' proposals.

For example, in Dockets 11-0280/0281 (cons.), the Commission averaged all parties CAPM and DCF results to calculate the utilities' return on equity, finding that "[N]o party's position is held without flaw as indicated by the parties' respective testimony … However, the Commission does not believe the imperfections in the models presented in this case are so flawed as to warrant an outright dismissal of the model for purposes of determining a reasonable rate of return." *North Shore Gas Co.*, Dockets 11-0280/0281 (cons.), Order at 139-40 (Jan. 10, 2012). Similarly, in Docket 12-0511/0512, the Commission averaged all parties' CAPM and DCF results. *North Shore Gas Co.*, Dockets 12-0511/0512, Order at 208 (June 18, 2013). Again, in Docket 14-0371, the Commission averaged the parties' CAPM and DCF results although the Commission stated that it "does not endorse every input to the CAPM analyses, or rationale therefore, presented by the Company or Staff." *Liberty Utilities*, Docket 14-0371, Order at 66 (Feb. 11, 2015).

But in Docket 13-0192, the Commission excluded AIC's CAPM result from the averaging calculation entirely, on the basis that the beta period was 18-24 months rather than 60 months, and that it was inappropriate to use companies that do not pay dividends. *Ameren Ill. Co.*, Docket 13-0192, Order at 164-65 (Dec. 18, 2013). In Dockets 12-0511/0512, the Commission included the utilities' CAPM – which used 60-month betas and included companies that do not pay dividends – in an averaging calculation to reach the return on equity. *North Shore Gas Co.*, Dockets 12-0511/0512, Order at 208 (June 18, 2013).

b) The differences described above indicate two types of shifts in the Commission's approach. First, the Commission shifts its approach to elements of the models used to calculate return on equity. Second, the Commission shifts its approach to the method by which it uses the proposals offered by parties to calculate the return on equity approved for a utility.

c) Mr. Fetter testified that the Commission's "recent rate orders" indicate shifts in approach. The "recent rate orders" to which Mr. Fetter referred are described in subpart a) above. The response to subpart a) is not intended to be comprehensive, and the Commission may have engaged in unexplained shifts in approach prior to issuing the rate orders described in subpart a).

d) AIC objects to this request as argumentative and intended for the purpose of harassment. Subject to and without waiving this objection, AIC states as follows:
Mr. Fetter did not testify that the Commission is never consistent.

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MGM 1.18

How many utility credit analyses did Mr. Fetter perform during his time with Fitch Ratings? Please provide copies of those analyses.

RESPONSE

Prepared By: Steven M. Fetter
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Mr. Fetter was originally hired by Fitch Ratings in 1993 to interpret the impact of regulatory and legislative developments on utility credit ratings, a responsibility he continued to have during his entire 8 ½ year tenure at Fitch. Credit rating determinations are made through a committee process involving individuals with knowledge of a company, its industry, and its regulatory environment. Mr. Fetter contributed his views on regulation into virtually every credit rating analysis done during his tenure. He does not possess copies of any of the reports Fitch issued during the period 1993-2002.

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MGM 1.19

How many rating committees was Mr. Fetter a part of during his time with Fitch Ratings? Please identify the companies involved.

RESPONSE

Prepared By: Steven M. Fetter
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Phone Number: 732-693-2349

During Mr. Fetter's 8 ½ year tenure at Fitch, he estimates that he participated as chair or member of over 1,000 utility rating committees. He does not possess a list of the companies involved, but he believes accessing a list of the companies Fitch's utility group currently rates (at www.fitchratings.com) should provide a reasonable facsimile of the companies covered during those committees.

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MGM 1.20

Has Mr. Fetter ever worked for S&P? If so, when and in what capacity?

RESPONSE

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No