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Evidentiary Hearing

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In the Matter of Union Electric)File No.
Company d/b/a Ameren Missouri's)ER-2012-0166
Tariffs to Increase Its Annual)
Revenues for Electric Service)

MORRIS WOODRUFF, Presiding
CHIEF REGULATORY LAW JUDGE

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P R O C E E D I N G S

JUDGE WOODRUFF: All right. Welcome back to another day of the Ameren rate case hearing. And let me ask the parties -- I understand we'll be doing the return on equity and -- issues today. Were we going to take up another witness before we started that?

MR. THOMPSON: We're going to take up Lisa Ferguson out of order, but not at the beginning

JUDGE WOODRUFF: Not at the beginning.

MR. THOMPSON: We're going to take her up, I think, after lunch is my understanding.

JUDGE WOODRUFF: Okay. That would be fine. So we will start on the return on common equity issue, and we'll start with mini openings, beginning with Ameren. Openings for Ameren?

MR. BYRNE: Oh, sure.

COMMISSIONER KENNEY: Thank you.

MR. THOMPSON: Thank you.

MS. BAKER: Thank you.

MS. ILES: Thank you, Tom.

MR. BYRNE: May it please the Commission.

OPENING STATEMENT

BY MR. BYRNE:

MR. BYRNE: We are here today to discuss return on equity, which is the largest dollar value issue in this case. All three of the ROE witnesses in this case agree that the legal principles that govern the determination of the appropriate return to be authorized for Ameren Missouri in this case are set forth in Federal Power Commission versus Hope Natural Gas Company and Bluefield Water Works and Improvement Company versus Public Service Commission of West Virginia, two United States Supreme Court decisions that have long set the standard in this area.

As Ameren Missouri witness Robert Hevert explains in his direct testimony, the Hope and Bluefield decisions require that the Commission provide the company with an opportunity to earn an ROE that is, No. 1, adequate to attract capital at reasonable terms, thereby enabling it to provide safe and continuing reliable electric service.

No. 2, sufficient to ensure the facility's financial integrity. No. 3, commensurate with returns on investments in enterprises having corresponding risk.

Only one of the three ROE witness' recommendations satisfies this standard. Ameren Missouri witness Robert Hevert is recommending a return on equity range of 10.2 percent to 11 percent with a specific ROE recommendation of 10.5 percent based primarily on his multi-stage discounted cash flow or DCF analysis, an analysis that this Commission has relied on in many previous cases.

Mr. Hevert has also supported his recommendation with other analyses that are commonly relied upon in setting an ROE, including different forms of the DCF model, the capital asset pricing model and risk premium analyses.

Mr. Hevert's recommendation is in line with ROEs this Commission has approved in recent cases, and it is in line with recently authorized returns from Commissions in other jurisdictions.

The recommendations of the other return on equity witnesses filing testimony in this case are so low that they are completely unreasonable and would be extremely damaging to Ameren Missouri if they are adopted.

They do not meet the standards in Hope and Bluefield. If adopted, they will not permit Ameren Missouri to attract capital at reasonable terms to invest in its system, and they are certainly not commensurate with returns on investment in enterprises having corresponding risks because they are far below the authorized returns for other similar utilities across the country.

Staff witness David Murray's recommendation, which is a range of 8 percent to 9 percent, is a full 120 to 220 basis points below the ROE authorized by this Commission for Ameren Missouri just over a year ago for rates that took effect in July of 2011.

It is unimaginable that the cost of equity could have fallen so far in such a short time. Mr. Murray's recommendation is even further below the national average for authorized returns that is currently hovering just above 10.2 percent.

Even more significant, Mr. Murray acknowledges that his recommended range is not supported by any of the unconventional, and in some cases, illegitimate rate of return analyses that he performed.

His analyses would support a recommendation below 8 percent, but he arbitrarily raised his recommendation to 9 percent because he knows that this Commission could never even consider adopting a recommendation that low. In fact, some of his analyses were explicitly rejected by the Commission just over a year ago, but he is back with them again in this case.

The evidence will show that Mr. Murray has no expectation that this Commission will adopt his recommendation. Nor should he. His analysis is extremely unconventional. His recommended return is unsupported by even that analysis, and he remains far outside the mainstream in his approach to estimating the cost of capital.

Public Counsel's not sponsoring a witness on this issue, but they have latched on to the low end of the ROE range recommended by Mr. Murray. Even Mr. Murray won't support such an extremely low ROE, and there's certainly no valid reason for this Commission to do so.

The MIEC has presented the testimony of witness Mr. Gorman. Mr. Gorman is a well-respected ROE expert who performs conventional and legitimate return on equity analyses. But in this case, Mr. Gorman has selected inputs for his analyses and exercises judgment in selecting which results he will rely on that make his recommendation almost as unreasonable as Mr. Murray's.

Specifically, Mr. Gorman's 9.3 percent return on equity is 90 basis points below the ROE authorized by this Commission just over a year ago for Ameren Missouri and a little over 90 basis points below the national average of authorized ROEs, which, again, is hovering just a little above 10.2 percent.

His recommendation is much further from the mainstream than it has been in some previous cases where this Commission has relied on Mr. Gorman's analyses as a starting point for determining an ROE for Ameren Missouri.

At a minimum, Mr. Gorman's analyses must be adjusted to include reasonable inputs and reasonable selection of results before they could be properly considered in setting Ameren Missouri's return on equity.

In some past cases, this Commission has used a zone of reasonableness to help it evaluate competing ROE recommendations. The zone of reasonableness has been a hundred basis points around the national average. So if the national average was 10.2 or so, it would -- the zone of reasonableness would be 9.2 or so to 11.2 or so.

There are two reasons that the zone of reasonableness has been considered useful by this Commission. First, it ties to the standards from the Hope and the Bluefield decisions. Other integrated electric utilities or enterprises having corresponding risk to Ameren Missouri and their authorized returns are unquestionably relevant to the return that Ameren Missouri should be authorized.

Second, considering the ROEs authorized in other jurisdictions is valuable because it helps to put the subjective recommendations of a few witnesses presenting testimony today into a more objective context.

As I said before, estimating ROE is a surprisingly subjective undertaking. Even though lots of the experts use the same type of analyses, their results depend on inputs that they subjectively decide to put in the models and subjective decisions they make about which results to use in making their recommendation.

And the problem is that their subjective decisions are often buried in the math. They're in schedules attached to their testimony or in work papers. We'll get into some of those issues today. But the fact is it's difficult to measure exactly how the subjective assumptions of an expert are influencing his results.

Looking at how Commissions in the other 49 states are dealing with this issue provides a somewhat more objective context in which to view the subjective recommendations in this case, a somewhat more objective context in which to review the subjective recommendations in this case.

I don't know if the Commission will use the zone of reasonableness in this case like it has in the past. But if it does, Public Counsel's recommendation is too low to be considered. Staff's recommendation is too low to be considered.

Mr. Gorman's recommendation is barely within the zone of reasonableness, at the low end of the zone. He's at 10.3 in the zone. The very bottom of the zone would be 10 point -- I'm sorry. He's at 9.3, and the very bottom of the zone would be 9.2 something.

In some ways, return on equity is a very boring issue. It revolves around extremely detailed and complicated analyses, and it's easy for anyone to get lost in those analyses. I plan to get into some of those details in cross-examination with the witnesses, but I don't want to do that in my opening statement.

So let me leave with you this simple message. If you're confused by this issue, if you don't know what to believe on this issue, if you remember nothing else from my opening statement after you hear five other opening statements, or six, please keep this chart in mind.

And I passed it out on paper, but it's on the -- on the easel. The chart was included in Mr. Hevert's surrebuttal testimony, and it shows the national average ROE authorized by Public Utility Commissions across the country. And is shows where the recommendations of each of the witnesses filing testimony in this case fall with respect to that average.

Mr. Hevert's range starts just above the national average. The national average here is 10.2 percent, maybe just a little above. His range starts at 10.5 -- or 10.25 and his point recommendation is right here at 10.5 percent, which is just a little above the average.

Mr. Hevert believes that this is justifiable based not only on the results of his analyses, but also because the regulatory framework in Missouri, which we discussed, you know, in spite of this Commission's steps to improve it remains less credit supportive than average around the country.

On the other hand, Mr. Gorman's recommendation of 9.3 percent is far below the tenth percentile of authorized returns on equity. The -- I -- the dark blue line is the 25th percentile -- or the dark blue area is the 25th percentile, and the light blue line is the 10th percentile, which goes down to about -- maybe a little below 10 percent. Mr. Gorman's recommendation is far below the 10th percentile. OPC's recommendation is almost literally off the chart, and Staff's in between.

I would encourage the Commission to adopt an ROE in this case commensurate with Mr. Hevert's recommendation, one that is in the mainstream of authorized ROEs across the country, one that is based on conventional analyses and reasonable inputs, one that will allow us to attract the investments that we need to invest in our system, maintain our access to capital on reasonable returns and provide the company with a return commensurate with enterprises having similar risk as is required by Hope and Bluefield. Thank you.

JUDGE WOODRUFF: Thank you. Any questions? Thank you, Mr. Byrne.

MR. BYRNE: Okay.
JUDGE WOODRUFF: Opening for Staff?
MR. THOMPSON: Thank you, Judge. Why don't you leave that up, Tom?
MR. BYRNE: Sure.
MR. THOMPSON: It's pretty. I like it.

OPENING STATEMENT

BY MR. THOMPSON:

MR. THOMPSON: May it please the Commission. In addition to being the largest dollar issue that you're going to face in this case, it is also one of the most complex, detailed and frustrating.

As Mr. Byrne told you, rate of return recommendations and rate of return analyses are surprisingly subjective. We bring in experts and we listen to them. And we have to understand and always remember that there's a lot of art in what they're telling us.

It's not science. It's not a generating plant. It's not something where the constraints of the physical world, cause and effect operate or at least operate as clearly as lay people can see it in a generating plant.

This is a rarified area, an area of expert knowledge, expert analysis, expert opinion. And it's easy for lay people to lose their way when dealing with so esoteric a subject.

Now, Mr. Byrne spoke of a mainstream, mainly to say that all the recommendations besides Mr. Hevert's were well outside of it. And I asked him to leave this chart up because, boy, that looks like a stream, doesn't it, meandering through a valley?

And I assume -- he never told us in his opening statement what the mainstream was. But I assume the mainstream to which he refers is, in fact, this line, this average of ROE awards by Commissions across the nation over a recent period of time.

And you put that on a chart, and it's pretty, and it looks authoritative. And there it is. It's a thing. You can't deny it. It even looks scientific, right? Scientists choose graphs all the time.

But this particular graph is misleading because there is a serious, serious, serious flaw in looking to the decisions of other Commissions as your primary starting point for awarding an ROE.

What is that flaw? It's circular reasoning. That's the flaw. That's the flaw. If you look at the report of ROE decisions by RRA, Regulatory Research Associates, which is where these numbers come from, you will see that they tend to cluster around the average.

And, in fact, for the statisticians among you,

you understand that the term average or mean is a measure of central tendency. It's a measure of central tendency. If you take a data set, the average will tell you what's the mid point? Not mid point between the extremes, but the weighted mid point of that data set. Okay? It is one way to talk about a data set. But it's far from the only way.

Now, Mr. Byrne told you that the recommendations made by Mr. Murray here and his low end adopted by OPC here and even the recommendation of Mr. Gorman here are so out -- so far outside the mainstream as to be unreasonable. He even said they are so far outside that mainstream that if you were to adopt any of those numbers, it would violate the Constitutional prerequisites set out in the Hope and Bluefield decisions.

But I wonder if the Constitution wouldn't be better satisfied by comparing what you award Ameren not to other awarded ROEs, but how about to earned ROEs? After all, the return the investor receives has nothing to do with what the Commission awards. It has to do with the performance of the company in the world. It has to do with market forces.

It is, in fact, the earned actual achieved return on equity, not the Commission-awarded return on equity. Think about that first.

And as you have already seen in this case from your examination of Mr. Baxter's bar charts and Staff's Exhibit 237 and the prolonged testimony we've had on how those were developed and how they could be reconciled, you've already seen that, No. 1, regulated electric utility companies earn under their awarded ROE much of the time. Not always, but much of the time. At least that seems to be the case with this company.

The other thing you've learned is that this ROE thing, it's slippery. It's like a fish. It wiggles. It's hard to get a hold of. You can calculate it in any number of different ways depending on the point you're trying to make. And that's something I want you to keep in mind as you listen to this expert testimony today and as you evaluate this testimony in making your decision.

It's math, yes. And Mr. Byrne was absolutely truthful when he told you that the art is hidden in the numbers. We all know that any equation will produce a result dependent on the inputs. Depends on the inputs.

I can select inputs for any equation to produce the output is that I want. That's the skill. That's the art of these experts. You are, in a sense, trusting them to have selected the right inputs to give you the answers you need for this case. That's what you're depending on their skill and their integrity to bring to you.

The actual equations are fairly simple. And they all use variations of the same three. There's the -- the discounted cash flow model. There's the capital asset pricing model. There's the risk premium analysis. They're all ways of measuring risk. And they're all equations used by investors to decide what's the right price to pay for an investment? That's what they are used for. That's why they were invented.

We have a very, very robust investment market in this nation, and you are all aware of that. You can invest in bonds, stocks. You can invest in all kinds of things, depending on whether you're risk adverse or whether you're seeking a high return. And these formuli are used by investors and their advisors in deciding what to invest in, in deciding what's the right amount to pay for the expected return.

These formuli were not invented to do what we're using them for, which is to figure out what the cost of capital is for a regulated electrical utility company. But, theoretically, they can be adapted to that purpose. And all over this nation, they are used for that purpose. That is the mainstream in doing this work.

Now, I want to talk about this zone of reasonableness. And I talked about this in my general opening, and you heard Mr. Byrne talk about it. There is, indeed, a zone of reasonableness created by the United States Supreme Court and referred to by that Court, and it is different from the zone of reasonableness this Commission has used. And I mention it because I think it's important and I believe the Commission should use the Supreme Court's method rather than the one you have been using.

Why is that? Because as I started out telling you, the one you're using that keys onto the average has that flaw of circular reasoning. If you're going to be looking at what all the other Commissions are doing in setting a rate, then the rate you set is going to depend on the judgment of those Commissions and not on the judgment of the evidence in front of you. So that's the flaw, the logical flaw in zone of reasonableness tool that you have used in the past.

I suggest you use the Supreme Court tool. That tool is based on the Constitutional requirements. You know that a -- a signed return or allowed return that is too low is confiscatory and is unconstitutional, is unlawful.

After all, these are private companies owned by private persons. You can't take their property without compensation. But how much compensation? That's the Constitutional question, right? How much compensation is enough? Whereas the Supreme Court has put it, what is the lowest reasonable rate? They don't say you have to set the ROE at the lowest reasonable rate. No. That's a further step. They just say you've got to figure out where it is. That is the proper point to key your analysis from.

And then you go from there to set the ROE where it will accomplish the appropriate regulatory purposes as you have identified. Two steps. I suggest to you that the lowest reasonable rate has to be -- has to be the actual cost of common equity.

After all, if you're giving the company -- if you're assigning an ROE that will cover its actual cost of capital, then there is no confiscation. They're getting enough money to pay for what they're doing. So the lowest reasonable rate is the cost of equity, COE the experts refer to it.

The actual cost of common equity is the lowest reasonable rate. But the return on equity that you assign is not necessarily the same number. In fact, that's your discretion. That's your discretion. You decide where to set the return on equity. And I suggest that you key that off the cost of common equity because you cannot go lower. It would be unlawful.

And I suggest to you further there's also a rate-making ceiling. It is also confiscation if you set the return on equity so high that customers are paying an outlandish and unreasonable amount for the service they're receiving.

There is some point that is so high, it is also unconstitutional. Where is that point? I don't know. But it is between those points that the zone of reasonableness described by the United States Supreme Court can be found. That's the zone of reasonableness.

In this case, I suggest to you that Mr. Murray, with his recommendation of 8 to 9, has brought you the actual cost of common equity. That is what it is costing Ameren Missouri for equity capital.

Is that where you should set the rate? Well, we say at the top of that range. And other parties go even higher. I think you can set it wherever you want within that range as long as you state a rational, regulatory purpose for going higher, construction risk, small company risk, financial -- whatever it might be. It's your discretion.

And you know and I know the Courts are not going to inquire deeply into any ROE that you set within a zone of reasonableness. That's your discretion in this case. But, please, key off of the right number, which is the actual cost of common equity.

Does that mean you can't look at what the other Commissions are doing? Absolutely not. That's a relevant factor. But I don't think it's the appropriate starting point. It's something to consider.

And when you're making this decision and you're setting the return on equity for this company, you have a myriad of things to consider, a myriad of things that have been brought to you by the policy witnesses we heard at the outset of this case.

Among them are the continued sluggish economy and its effects on the ratepayers, the company's earning history, which has been described to you by the company witnesses, the possible effects of various levels of ROE that you might assign, which there is also testimony on.

It is Staff's position that 9 percent -- 9 percent is an appropriate ROE award. It is well above the zone of confiscation. Not much above it. In fact, at the top of it. But it satisfies the Constitutional requirements. Thank you.

JUDGE WOODRUFF: Questions?

COMMISSIONER KENNEY: Just one.

JUDGE WOODRUFF: Go ahead.

COMMISSIONER KENNEY: Thanks, Mr. Thompson. Did I hear you correctly that you concede the fact that Ameren is -- has earned beneath its allowed ROE?

MR. THOMPSON: I think more often than not, it has.

COMMISSIONER KENNEY: Okay. All right. Thank you.

JUDGE WOODRUFF: Thank you, Mr. Thompson. For Public Counsel?

MS. BAKER: Thank you.

OPENING STATEMENT

BY MS. BAKER:

May it please the Commission. Public Counsel has not sponsored a witness on ROE in this particular case. But the Commission has before it four experts basing their opinion on what they feel are the proper market-based and economical-based indicators to make their particular range of reasonable ROE statements toward the Commission.

As you've heard already, the reasonable ROE that the U.S. Supreme Court has stated is one for Ameren that is adequate to attract capital at reasonable terms, thereby allowing Ameren Missouri to provide safe and reliable electric service that is sufficient to ensure Ameren Missouri's financial integrity and is commensurate with the return on investments in enterprises having corresponding risks.

So this is the statement of what is a reasonable

ROE. And everyone has agreed to that, that this is the statement of a reasonable ROE. And a reasonable ROE is one that is not detrimental to the utility. And it is also one that is not detrimental to the -- to the customer.

The Commission's charge is to set just and reasonable rates. And part of that determination is to set affordable rates that are not detrimental to the utility. Nearly 45 percent of the revenue requirement of Ameren in this case is based on the issue of return on equity.

Customers have gone directly to the Commissioners with their concerns regarding affordable rates in this economy and with the number of rate cases that they are facing in multiple types of utilities.

Public Counsel asks that once the Commission sets a reasonable range for the ROE that the Commission implement the low end of that reasonable range to promote affordability for Ameren's customers. Thank you.

JUDGE WOODRUFF: Thank you. For MIEC?

OPENING STATEMENT

BY MS. ILES:

MS. ILES: Good morning. May it please the Commission. My name is Carole Iles. I'm here on behalf of the Missouri Industrial Energy Consumers. We will introduce the testimony of Mike Gorman. The other attorneys have already mentioned that he is our expert.

And in his testimony, Mr. Gorman recommends that the Commission authorize an ROE for Ameren Missouri in a range of 9.2 to 9.4 percent. And, specifically, he recommends that the Commission adopt an ROE of 9.3 percent, the mid point of his range.

And I'm going to point out something about Mr. Byrne's chart here. I just want it to be clear that this apparently shows, based on what he has written here, the allowed ROE calculated as a 12-month rolling average.

So when you look at this number here for July of 2012, that's telling you the -- that's looking at the average, I guess, from the beginning of the year. Or it's a rolling, so it goes back to July of --

MR. BYRNE: Twelve months. Twelve months.

MS. ILES: Twelve months. Sorry. So at any rate, an interesting fact that we'll introduce in our testimony is that actually if you look at the second quarter of 2012 and the average authorized ROEs for electric utilities in this country, it is below 10 percent. It's 9.92 percent.

So there's a lot of different ways you can look at numbers. But when you talk about an ROE below ten being just completely unreasonable, well, if you look at the average for the second quarter of 2012 for electric utilities, and we'll introduce evidence on that issue, it is below 10 percent, even though this chart doesn't reflect that because it -- the average is still above there at this point in the year.

And it's significant that the evidence in this case, not just Mr. Gorman's testimony, but the testimony of Mr. Hevert and Mr. Murray all show that the cost of equity has significantly declined since Ameren Missouri's last rate case. And the current trend is for it to continue to decline.

Bond yields have declined, both utility bonds and Treasury bonds. And the cost of common equity has declined whether you look at -- regardless of the method of estimating what that cost is, whether you look at a risk premium analysis, which takes into account those bond yields, or if you're looking at a DCF model that simply looks at dividends and capital appreciation, stock appreciation. Either way you look at it, there has been a significant decline in the cost of capital since the last rate case.

Mr. Gorman's testimony will also explain why the ROE recommended by Ameren Missouri's witness, Mr. Hevert, should be rejected. As Mr. Byrne explained, Mr. Hevert recommends an ROE in the range of 10.25 to 11. And his specific recommendation is 10.5. And that's significant.

What he's asking you to do, what the company's asking you to do is to increase its authorized ROE over the last rate case despite clear evidence that the cost of equity has declined since the last rate case.

In sum, the evidence presented to the Commission in this case will show that the appropriate return on equity for Ameren Missouri at this time is, as Mr. Gorman recommends, in the range of 9.2 to 9.4 percent.

We recommend that the Commission adopt an ROE of 9.3 percent in this case. I also want to note that Mr. Gorman was listed as a witness for the first day of testimony in this case on policy issues. And his testimony does include a discussion of those issues. And so he is certainly available to answer the Commission's questions on that topic as well this morning.

We appreciate the Commission accommodating us and taking him out of time on that issue. Thank you.

JUDGE WOODRUFF: Thank you. All right. I believe that's all the openings. Mr. Byrne?

MR. BYRNE: Judge, there is a short issue on -- I believe on capital structure or cost of debt. We have Mr. Ryan Martin here to testify. And I think MIEC has some questions for him. We were hoping we could take him first because it's a -- I think it will be not as long as the rest of it.

JUDGE WOODRUFF: That's fine. All right. Call Mr. Martin then. If you'll please right your right hand, and I'll swear you in.

RYAN MARTIN,

being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified as follows:

DIRECT EXAMINATION

BY MS. TATRO:

JUDGE WOODRUFF: Thank you. You may inquire.

Q (By Ms. Tatro) Would you state your name and business address for the Commission, please?

A My name is Ryan Martin, One Ameren Plaza, 1901 Chouteau Avenue, St. Louis, Missouri, 63103.

Q And are you the same Ryan J. Martin who prefiled direct testimony in this case?

A I am.

Q Do you have any additions or corrections to make to your testimony?

A I do not.

Q And if I were to ask you the same questions that are listed in your prefiled written testimony, would your answers be the same?

A Yes.

MS. TATRO: I move for admission of Exhibit 23 and tender the witness for cross-examination.

JUDGE WOODRUFF: All right. Exhibit 23 has been offered. Any objections to its he receipt? Hearing none, it will be received.

(Exhibit 23 was offered and received into evidence.)

JUDGE WOODRUFF: Cross-examination, we'll begin with MIEC.

MS. ILES: Thank you, your Honor. Is my microphone working?

JUDGE WOODRUFF: I think so.

MS. ILES: Okay. Thank you.

CROSS-EXAMINATION

BY MS. ILES:

Q Mr. Martin, good morning.

A Good morning.

Q My name is Carole Iles. I'm going to ask you just a few questions. At page 5 of your direct testimony, you're sponsoring the company's proposed capital structure in this case, correct?

A Correct.

Q And the common equity ratio you're recommending in this case is 53 percent, correct?

A I believe on page 5 refers to the -- the recommended capital structure as of September 30th, 2001.

Q Okay.

A The structure recommended in the case as of the true-up date of July 31st is on page 7.

Q All right. And what's the common equity ratio you're recommending on page 7?

A 52.1 percent.

Q Okay. So a little bit lower. 52.1 percent. All right. You're the Assistant Treasurer and Manager of Corporate Finance for Ameren Services Company; is that correct?

A I am.

Q And as a part of your duties as Assistant Treasurer and Manager of Corporate Finance, you perform studies to estimate ways to maintain the company's financial integrity but minimize its overall cost of capital, correct?

A Correct.

Q So has the company done any studies that examine whether or not it can reduce its cost of capital while maintaining its current investment grade bond rating?

A We are -- we are always evaluating market opportunities. One example would be, recently, we contemplated a transaction to refinance existing higher rate bonds at a lower rate pursuant to a tender offer. That transaction was completed in the third quarter of this year.

Q Look -- sorry -- so -- I'm sorry. Let's talk a little bit about that refinance of the bonds at this point.

A Uh-huh.

Q When did that happen?

A The -- the bonds themselves were issued on September 6th, but the -- the transaction was actually initiated on August 20th pursuant to a tender offer. It was actually -- there were two parts to the transaction.

One, the intent of the first part was to refinance a portion of higher rate debt at a lower rate given current market conditions. And the second part was to refinance a bond maturity that was coming due in September for Ameren Missouri.

Q And as a result of doing that, you were able to borrow at significantly lower interest rates; is that correct?

A We borrowed at a lower rate. The new bonds, 485 million, was issued at a coupon of 3.9 percent.

Q Do you know what the anticipated annual savings from this transaction is?

A We estimate that at -- in terms of the entire transaction should generate annual savings of up to $5 million.

MS. ILES: Okay. I have an exhibit that I need to have marked.

JUDGE WOODRUFF: Okay. Your next number is 528.

MS. TATRO: I'm sorry. What number was that, Judge?

JUDGE WOODRUFF: 528.

MS. ILES: Do you need to mark it before I go forward, or can I mark it and -- I should hand this out to everyone. This will be 528.

MR. THOMPSON: Thank you. And what number is this going to be?

MS. ILES: 528.

Q (By Ms. Iles) I'm handing you what's been marked as Exhibit 528. What is that? Do you know what it is?

A It's a Data Request from MIEC and our response.

Q All right. And what information did this Data Request ask for?

A Well, it says, Please provide the anticipated revenue requirement savings produced by Ameren Missouri's recent bond offer is the question.

Q And how did the company respond?

A Company responded, Ameren Missouri's recent debt issuance occurred after the true-up cutoff date in this case. Consequently, the debt issue has had no impact on the revenue requirement in this case.

Q All right. And that's the same transaction that we were just talking about --

A Correct.

Q -- that you stated will -- you estimate will cost -- will save the company approximately $5 million?

A Correct.

Q Annually, but it will not be included in the -- it wasn't included in the test year or the true-up period of this case, correct?

A The transaction was completed after the true-up date in this case. That's correct.

Q Okay. Thank you.

MS. ILES: I'd like to move for admission of Exhibit 528.

JUDGE WOODRUFF: 528 has been offered. Any objections to its receipt? Hearing none, it will be received.

(Exhibit 528 was offered and received into evidence.)

Q (By Ms. Iles) All right. Let's go back to be what we were talking about at the outset. And that was the capital structure of the company.

A Uh-huh.

Q And that's when we got into this idea -- or the discussion we just pursued about the refinance of the

bonds. what about the capital structure of the company in itself? Do you ever do any kind of studies to determine whether you need more debt versus common equity, that kind of thing?

A Yeah. We're constantly -- or consistently on a regular basis evaluating capital structure in a variety of ways. We evaluate the company's average -- average weighted cost of debt, the average tenor. We look at key credit metrics that impact credit ratings, try to interpret those to make sure that we have the optimal mix of debt and equity.

Again, this is more of an art than a science. The intent here is to balance -- to come up with a reasonable cost of capital and also maintain financial strength and stability that will allow the company to access capital markets as a reasonable cost on a regular basis.

Q And which is more expensive, debt or equity?

A Well, traditionally -- I guess it could vary, but, traditionally, equity is more expensive than debt.

Q And that's true at this time, correct?

A That is true.

Q Do you know or can you tell me the revenue requirement cost of customers of common equity capital assuming the Commission approves, for example, just for

example purposes, a return on equity of say, 10 percent? What would the cost to the customers be?

A You're asking me what the revenue requirement impact of that is?

Q Correct.

A I -- I do not have that information.

Q Okay. Would you agree -- when you take a 10 percent return on equity and you're determining what the impact is going to be on the revenue requirement, you have to gross up the income taxes, correct, to figure out that?

A Correct.

Q And would be it be reasonable to conclude that it -- the revenue requirement cost would go from 10 percent to around 16 percent because of that tax difference? Is that about right?

A You know, without doing the specific calculation, I'm not really in a position to confirm or --

Q All right. But it's going to be more than 10 percent because of the tax effect?

A Correct. It's going to be more because of the tax. Directionally, yes, it would be higher.

Q Okay. And what would the cost to customers be if, say, your marginal cost of debt was 5 percent? It would just be 5 percent, correct? You don't do a gross up on the tax on those number?

A You know, I'm not responsible for preparing the revenue requirement calculation, so you're asking me questions that I am not directly involved with.

Q Okay. All right. I appreciate that. Thank you. I guess what I was trying get at is there is -- it's more than just -- there's more to comparing the numbers than just the straight ROE amount. It's -- when we're determining the cost of common equity, there's more to it than that, correct?

A More to what? I'm sorry.

Q To determining what the revenue requirement cost is for that common equity.

A I -- again, you know, my responsibility in the Treasury Department is to maintain a reasonable capital structure, reasonable mix between debt and equity, factoring in all the costs and benefits of each type of -- of financing or capital. I am not responsible for calculating the impact on the revenue requirement to the customers.

Q Okay. All right. Well, let's talk about something else, then. How about book value for the company's shareholders? All right. Would you agree that when you build up the common equity ratio, as the common equity ratio increases and you increase your rates to support the greater amount of common equity ratio, that's

a way of expanding book value for the company's
shareholders?
A You're saying if we increase common equity and that results in an increased revenue requirement, does that increase the book value of the company?
Q Correct.
A You know, one of the ways the equity value is increased is through retained earnings. So to the extent retained earnings are higher or lower, it would impact the book value of the company.
Q Does expanding the book value of the company increase the dollar earnings per share of stock if the return on equity doesn't change?
A It could or could not. An increase in the book vale of the company does not necessarily translate into an increase in earnings per share.
Q When you're making capital structure decisions at your company, do you primarily focus on enhancing your shareholders' earnings and minimizing your cost of capital while preserving your financial status?
A It's -- in determining the optimal capital structure, again, it's a subtle balance. It's a bit of an art. On one hand, you have the cost of capital. Obviously, you'd want to keep that as low as possible.
On the other hand, you have financial strength

and stability. As you've -- as you've mentioned, debt is typically a lower cost form of capital. But to the extent that you have an over-reliance upon debt, you increase your cost of financial distress, you weaken your financial strength. That, in turn, could result in an increase in your cost of capital.

So there's a subtle balance to look at how much -- what balance is appropriate to give you that reasonable cost of capital and allow you to obtain -- I'm sorry -- to maintain financial strength and security necessary to access markets and access capital when you need it.

Q Thank you. Mr. Martin, as Assistant Treasurer and Manager of Finance, do you ever meet with credit rating agencies concerning the bond rating of Ameren Missouri or Ameren Illinois?

A I do.

Q And in your meetings with these bond rating agencies, do your discussions include management's perspective on regulatory risk and regulatory mechanisms in the jurisdictions where you operate?

A When we meet with them, we generally give them updates on regulatory proceedings. In terms of our perceptions of the risk, we don't -- that is not really the focus. The focus is more on what our experience has been. On their own, the agencies come up with their own perceptions of -- of regulatory risk. For example, Moody's specifically rates the -- their perception of the supportiveness of the regulatory environment in the different jurisdictions.

Q Well, do you know whether they rely on the information that you provide them about that?

A Do they rely upon the information that we provide them on rate case proceedings?

Q Regulatory environment.

A We provide them information and they have their own process for how they process that and how it translates into their rating.

Q But it is something you provide to them?

A We provide them with updates, yes.

Q Okay.

A They may -- they may call and ask for an update. They may -- we have regular annual meetings. We go out and provide them with an update on significant company issues. They take that information. They evaluate it independently, and they come up with their credit ratings and positions.

Q When you're in those discussions, I mean, you're saying that they -- that they evaluate them independently. Do you ever get any push-back on the information that you provide them? Is there anything that they do in those

meetings that indicates to you they don't accept what you're telling them?

A No. They rely upon us for factual information. And they take that information and they interpret it as they may, you know, based on how they see it.

Q Okay.

MS. ILES: I have no further questions.

JUDGE WOODRUFF: For Public Counsel?

MS. BAKER: Thank you. Just a couple.

CROSS-EXAMINATION

BY MS. BAKER:

Q You only filed direct testimony in this case; is that correct?

A That's correct.

Q And your direct testimony was filed in February of 2012?

A That is correct.

Q And your direct testimony on common equity cost was based on a reasonable range of ROE for Ameren between 10.5 and 11.00; is that correct?

A Correct.

Q And you are aware that Ameren has now lowered its reasonable range for ROE for Ameren to be anywhere between 10.25 and 11.00?

A Correct.

MS. BAKER: No further questions.

JUDGE WOODRUFF: All right. For Staff?

CROSS-EXAMINATION

BY MR. THOMPSON:

Q Good morning, sir.

A Good morning.

Q I wonder if you could tell me what Ameren Missouri's imbedded cost of debts is?

A Are you asking for it as of a particular date? As of the cutoff date, September -- I'm sorry -- July 31st, 2012, it was 5.87.

Q How about as of September 30th, if you know?

A September 30th, 2011, or are you talking about --

Q Of this year.

A Of this year. I -- I do not have that specific calculation. Based on our recent -- our transaction in September, it would be slightly lower. I would estimate maybe -- maybe 15, 20 basis points lower.

Q Okay. I think in your testimony you state that if the company receives an ROE award that allows it to earn its weighted average cost of capital that is an adequate ROE award?

A I think in my testimony I comment that I believe the interest of the company and its ratepayers would be balanced if it is allowed to earn a return equivalent to its weighted average cost of capital. That's in my testimony.

Q Okay. Thank you.

MR. THOMPSON: No further questions.

JUDGE WOODRUFF: All right. Come up for questions from the Bench. Mr. Chairman?

CHAIRMAN GUNN: I don't have anything.

JUDGE WOODRUFF: Commissioner Jarrett?

CROSS-EXAMINATION

BY COMMISSIONER JARRETT:

Q Good morning. I just have a couple.

A Good morning.

Q You remember Ms. Iles was asking you some questions about meetings with credit agencies -- agencies?

A Correct.

Q And you indicated that you attended those meetings regularly; is that correct?

A Uh-huh. Correct. Uh-huh.

Q And there's various information that you share with those rating agencies. Would you characterize that information as facts or opinion?

A Fact. I would say it's definitely facts.

Q Okay.

A It's similar to what we might -- we give -- we give more information to rating agencies than we would necessarily, say, the investment community at times because they are considered insiders. So we do provide them with -- with company specific data, again, that we believe would help them form a, you know, appropriate opinion of the company, give them all the information they need to draw reasonable conclusions.

Q Okay. So --

A But -- I'm sorry. They may ask questions, and we respond to their questions, but they are, I would say, overwhelmingly fact-based type inquiries.

Q Well, for example, do you give them information about rate cases that you have --

A Yes.

Q -- of Ameren's?

A Yes. But it would be -- that information would be presented to -- as a -- either an update on existing proceedings or a summary of proceedings that have just been completed.

Q All right. Let's talk a little bit about summaries that have been completed.

A Uh-huh.

Q What do those summaries consist of? What kind of --

A They would consist of -- for example, they would be a summary of the company's position and the position of the Intervenors when you're talking about, you know, for example, the -- the ROE differences in terms of what was put forth as appropriate, the different issues that were being negotiated, you know, certain changes of things we were asking for in terms of, you know, trackers or different mechanisms like that. Just, basically, the specifics of the actual proceeding.

Q Okay. Do you ever get asked questions about, you know, what's your opinion on the regulatory climate in Missouri?

A No. I think once in a while, there will be a question as how we would characterize the relationship with -- with the Commission. And we kind of -- I mean, generally, in those responses, we talk about what we are working with the Commissions on in terms of what may be constructive changes that would benefit ratepayers and the company. We're asked those types of questions occasionally.

Q Okay. But I guess at this -- what I'm getting at is that --

A I'm sorry.

Q You know, there's been -- I'll have to look back in the record, but there's either been testimony or

argument that Missouri is less than average when it comes to a regulatory climate.

A Okay.

Q I guess what I'm asking is, you know, does Ameren ever go in and characterize these rating agencies and say, you know, We got -- we got the shaft in this rate case from the Commission?

A No. No. I think we provide the facts and we give updates on maybe certain mechanisms we have been pushing for or requesting that either have been approved or denied. That factors into their decision.

And you talk about unsupportive. They -- they do specifically Moody's. They rate, you know, the jurisdictions on their kind of traditional scale. And Missouri is having a lower rating, a less supportive rating, not unsupportive, but less supportive because I think they compare it to other states and other utilities that could have maybe a more beneficial cost recovery mechanism, for example.

And they rate it based on that. I think they have their own processes internally where they look at all the options available to the company. Some companies have them. Some don't. And they kind of look at that relatively speaking, and that's how they rate in environment. So we look at their information on -- and, actually, a lot of it is public as well, so we allow them to form their own conclusions. But we don't -- we don't add color to it. We basically give them the facts of, you know, what we're asking for, how the outcome of a proceeding was.

COMMISSIONER JARRETT: Thank you. That's all I have.

JUDGE WOODRUFF: Commissioner Kenney?

CROSS-EXAMINATION

BY COMMISSIONER KENNEY:

Q Good morning.

A Good morning.

Q I have some similar questions in a similar vein regarding the credit rating agencies and their analysis. You said that you provide them factual information, and they evaluate it independently. Do you know whether they conduct any independent research and gather facts separate and apart from what Ameren would provide to them?

A I think they do their own market research. And on occasion, they will prepare a piece that expends beyond maybe just an Ameren concern that maybe talks about the whole utility industry, and they will -- they will ask us for information that may contribute to that. But, again, it would be fact -- fact-based information.

Q So they may seek out additional research

regarding the -- the regulatory environment generally?

A Or the industry.

Q Right.

A Right.

Q Or the industry?

A Right.

Q Do you know whether they conduct any independent research and gather additional factual information about Ameren specifically?

A From another source?

Q Yes.

A I don't know that.

Q Okay. You don't know whether they do or don't?

A I don't know if they do or do not.

Q And which credit rating agencies does Ameren have its relationship with?

A We have Standard & Poor's, Moody's and Fitch.

Q So all three?

A All three. Uh-huh.

Q Okay. You indicated that you will prepare -- or that Ameren will prepare summaries of a rate proceeding to provide to them, and there's no colorized factual illustration?

A Right.

Q Who would prepare that?

A It would be prepared within my group. Generally, I would lead that effort. To give you an example, in October, generally October of each year, we go up to New York, and we provide them with an overall company update.

In advance of that, we provide them with a slide deck presentation. I think that was provided in this case, an example or the actual document that we presented to them last year. So we'll be going -- going through that process again in the next few weeks in anticipation of our trip up there in the next few months.

That's really the most formal communication we have with them. Otherwise, it would be phone calls with -- with just general questions they may have.

Q And as a part of that slide deck presentation, do you provide any of the documents or the pleadings that are actually in the case, supporting information from which you've prepared your summary?

A We don't. We don't provide the actual proceedings. I believe most of those are publicly available. We may -- I think I have seen some presentations where we have links to the different resources where they could get that information. But we don't provide them directly.

Q And the rating agencies in analyzing the credit

supportive nature of a regulatory environment are primarily concerned with Ameren's ability to recover it's costs through rates, correct?

A Correct. Their average cost to earn a reasonable return, yes.

Q They don't take into account the reasonableness and prudence of Ameren's expenses, just whether those can be recovered through rates, correct?

A It's hard to speak as to what they specifically look at. But I would think, yeah, they were more concerned with the mechanisms in place within the State for a utility to recover its, you know, in theory, prudent and incurred costs.

Q But they're not --

A They're not evaluating Ameren.

Q They're not undertaking an independent analysis to determine whether those costs were prudently incurred, just whether they can get them back in rate base?

A I do not believe so. Without -- without speaking for them, I believe their evaluation would be based on our specifics costs, the nature of them.

Q Okay. Credit metrics was a phrase that you used before.

A Uh-huh. Uh-huh.

Q These credit metrics, what exactly does that

phrase refer to?

A You know, it refers to key measures of either the company's, you know, liquidity, cash flows, their ability to service their debt, their financial strength. For example, you get one of the -- one of the key ratios is kind of a covered ratio that looks at the funds available to service debt relative to the interest cost.

So the higher your ratio in that specific case, the more comfort you would have that the company will be able to service its obligations and not fault on its debt.

Another one would be the leverage ratio. We look at the amounts of debt relative to total capitalization. And some rating agencies are a little bit more specific than others in providing guidance as to what type of ratios they would expect for certain rating levels.

Q So the credit metrics are metrics that the credit rating agencies use to determine the financial health and then ultimately to assign their ratings?

A It's one part of it. For -- again, some of the agencies are a little bit more transparent than others. I would say Moody's is very transparent. They basically give you a report card. They tell you what factors are involved. They tell you what the weight is assigned to each factor.

For example, I believe the credit metrics in the Moody's or factored into the Moody's rating account for 30 percent of the ratings. And that, for example, is supportive in the regulatory environment accounts for 25 percent. Cost recovery mechanisms count for 25 percent. Right there, you have 50 percent that's somewhat subjective based on kind of the overall regulatory environment. Relative 30 percent is assigned to the credit metrics.

Q 50 percent of their overall rating would be --

A Well, 25 percent is supportive of the regulatory environment. 25 percent is kind of evaluation of cost of recovery mechanisms.

Q Regulatory mechanisms?

A Regulatory mechanisms. Right.

Q And you characterized that 50 percent as subjective?

A Well, it's their subjective evaluation relative to credit metrics, which are very, you know, returnable.

Q Can be -- they can be easily determined through some objective measures?

A Right. And they have -- they have a formula. We apply the formula. We can measure our actual metrics relative to their guidance for certain ratings.

Q But the other 50 percent is a subjective

analysis based upon the regulatory environment which we've already established isn't a result of reasonable and prudence, just your ability to recover your cost of rates?

A I believe so.

Q All right. And then Moody's is relatively transparent. What about S&P and Fitch?

A They're a -- S&P is a little bit less transparent. They assign, you know, business risk and financial rate. In terms of actual weightings, they don't provide that. But it's the same type of mix between the business environment and your financial risk.

Q But their formula is more proprietary. They don't tell you what it is?

A Right.

Q Okay. Which of those three, would you say, carries the most weight?

A Again, it's hard to say. Just from my -- from my position and experience, it seems like S&P and Moody's carry more weight than Fitch.

Q And as between Moody's and S&P?

A That's hard to tell between the two. I would say they seem fairly on equal ground.

Q So if Moody's credit metrics determinations are transparent, another analyst could come up with its own measure of what an appropriate ROE is and using Moody's

formula to figure out --

A Uh-huh. Well --

Q -- how credit-worthy Ameren would be based upon their representation of an ROE. Would you agree with that?

A What they could do is they could evaluate that specific part of the equation, which the leverage ratio that we talked about that -- or I guess RO -- I'm sorry -- ROE would factor probably more into the regulatory environment, I would think, is the score that would go there.

So, again, that would be -- you'd have to make a subjective determination of how you believe they would rate a certain ROE. And, again, this is one part of the overall valuation, I would believe.

Q Okay. And -- and how does -- how does it work with Moody's, S&P and Fitch providing the ratings to companies in general? How is that -- what's the relationship between the company that's requesting the rating and the company providing it? Is it -- is it a client?

A Oh, we -- well, I believe they --

Q Do you pay for it?

A We do pay for it.

Q All right.

A We pay for the service. But I believe in some cases, the rating agencies will rate that even if they're not being paid. I think it's more rare, but in these cases, yeah, we do pay for the service.

Q Okay. All right.

COMMISSIONER KENNEY: That's all the questions I have. Thank you.

A Thank you.

JUDGE WOODRUFF: Commissioner Stoll?

COMMISSIONER STOLL: I have no questions at this time, your Honor. Thank you.

JUDGE WOODRUFF: Recross on questions from the Bench, then, beginning with MIEC?

MS. ILES: None, your Honor.

JUDGE WOODRUFF: Public Counsel?

MS. BAKER: None. Thank you.

JUDGE WOODRUFF: Staff?

MR. THOMPSON: None. Thank you.

JUDGE WOODRUFF: Redirect?

MS. TATRO: Thank you.

REDIRECT EXAMINATION

BY MS. TATRO:

Q Mr. Martin, do you recall when Ms. Iles handed you DR Request MIEC 243?

A I do.

Q Do you still have that in front of you?
A I do.
Q And that Data Request answer indicated that the refinancing occurred outside of the true-up period?
A Correct.
Q Can you explain why that occurred after the true-up period rather than before?
A Sure. There were, I would say, three main factors that kind of curve the timing of that -- of that transaction. None of them related to specific -- none of them related to the true-up date.

The first was really the timing of the approval for the transaction. I believe we started speaking to Staff about the -- the concept of the transaction in May of this year. We filed our application in late June. And we received approval on August 1st, which was, of course, the day after the true-up period. So shortly after that approval on August 1st. We lost the transaction on August 20th.

Another factor would have been the timing of Ameren's second quarter end, which was on June 30th. It's generally our practice and we believe it's prudent not to access the market or try to sell bonds when the company is in possession of material non-public information.

So during that month of July after our June 30th closing date for the quarter, we were in the process of putting together financial statements, putting together disclosures that go into our Form 10-Q, which was filed in this case, I believe, on August 8th.

So while the company is in material and preparing those -- I'm sorry -- in possession of material non-public information and preparing disclosures that will go into that 10-Q, we avoid kind of access to the market, and, you know, we consider it somewhat of a quiet period. So that really would have ruled out any kind of transaction during that month of July.

And then, lastly, you know, the timing of the transaction was, you know, somewhat -- it was meant somewhat to coincide with the September maturity that I spoke of earlier. Ameren Missouri had $173 million of bonds maturing in September. So a portion of the proceeds from this new offered transaction of 485 million was used to refinance the $173 million maturity.

Had we done this transaction earlier, say, you know, in June, we would have had to carry that extra debt for a couple months and pay additional interest in advance of using the proceeds to pay off that 173 million.

So those were really the three -- three basic reasons for the transaction being timed the way it was.

Q Thank you. And then in response to some

questions from Ms. Iles and also from a couple of Commissioners, you talked about the communications that you've had with the credit rating agencies.

A Uh-huh.

Q Do you remember that line of questioning?

A Yes.

Q And you had indicated that the -- these agencies use other sources besides just the information they get from a company. What other sources might that be?

A Again, I can -- I don't mean to speak for the agencies, but my -- my assumption is they're doing their own market research as they are preparing industry pieces. You know, they'll ask us questions, but, you know, my belief is that they are also using other sources and information outside of company specific data to put together their broader industry analysis.

Q And do you suppose that they'd be looking at other utilities in the state of Missouri?

A I believe -- depending on what the focus of their -- of their study or piece was, they could, yeah.

Q Specifically, whether they talk about -- I guess it's Moody's that talks about the regulatory climate --

A Yes.

Q -- whether it's supportive or less supportive?

A Right.

Q So when they come up with that, would they look at Commission orders for KCPL?

A I believe so. I believe you would reasonably expect utilities in the same state to have the same regulatory supportive ranking from Moody's. I haven't confirmed that or looked at that, but that would seem reasonable.

Q Do they -- and I think you said they compare that to results in other states, and that's kind of how they come up with this ranking?

A Well, yeah. The ranking isn't necessarily whether a state is supportive or not supportive. It's -- I think the way they characterize it, it could be more supportive to -- most supportive, more supportive, less supportive, least supportive. So, yeah, they do make -- they do make evaluations between the jurisdictions.

Q Okay. Commissioner Kenney asked you the question about whether or not the credit agencies look at prudence of an expenditure. Do you remember that conversation?

A Uh-huh.

Q And you indicated that they really do not, but that they look at the results or the structures?

A Uh-huh.

Q So you what types of structures do these

agencies, in your opinion, believe is the most important?

A Well, I think they are looking -- when they look at kind of our cost structure and our cash flows, they're looking at out metrics, I would say. And they want to make sure we have strong metrics that suggests an ability to finance our debt, that generates sufficient cash flows, to maintain financial strength and stability.

I think the prudence is evaluated probably more in that perspective in terms of looking at specific costs that maybe go into those different inputs into the -- into the metrics themselves.

Q So do cost recovery mechanisms play a role?

A Well, cost recovery mechanisms would -- I mean, it would certainly play a role in their evaluation of the environment. They would certainly play a role in the strength of the credit metrics.

Q So a utility that has different -- more or -- more easily accessible cost recovery mechanisms, is that considered more supportive or less supportive?

A Yes. That would be -- yeah. That would probably help the rating in a couple of different ways, both in the evaluation -- a subjective evaluation of the regulatory supportiveness and also would show up in the strength of their credit metrics.

MS. TATRO: Thank you. I have no further

questions.

JUDGE WOODRUFF: All right. Then Mr. Martin, you can step down.

MR. MARTIN: Thank you.

JUDGE WOODRUFF: Let's take a break now before we go on to the next witness. We'll come back at 10:00.

(Break in proceedings.)

JUDGE WOODRUFF: Let's come to order, please. And we're back from our break. And Mr. Hevert is taking the stage -- or the stand.

MR. THOMPSON: Same thing.

JUDGE WOODRUFF: Yeah. Please raise your right hand.

ROBERT HEVERT,

being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified as follows:

DIRECT EXAMINATION

BY MR. BYRNE:

JUDGE WOODRUFF: Thank you. You may inquire.

MR. BYRNE: Thank you, your Honor.

Q (By Mr. Byrne) Can you please state your name for the record?

A My name is Robert Hevert. Last name is spelled H-e-v, as in Victor, -e-r-t.

Q And that's Robert Hevert, not Hevert?

JUDGE WOODRUFF: My apologies.

A I've heard it every possible way, and I know who you mean.

Q (By Mr. Byrne) Mr. Hevert, by whom are you employed?

A I am managing partner of Sussex, S-u-s-s-e-x, Economic Advisors.

Q And are you the same Robert Hevert who caused to be filed in this case prefiled direct testimony that's been marked as Exhibit 20, prefiled rebuttal testimony that's been marked as Exhibit 21 and prefiled surrebuttal testimony in Highly Confidential and Non-Proprietary form that has been marked as Exhibit 22?

A Yes, I am.

Q And is the information contained -- well, do you have any corrections to any of that testimony?

A No, I do not.

Q And is the information contained in that pre-filed testimony true and correct to the best of your knowledge and belief?

A Yes, it is.

Q And if I were to ask you the questions contained in that prefiled testimony today when you're here under oath, would your answers be the same?

A Yes, they would.

MR. BYRNE: Your Honor, I'd offer Exhibits 20, 21 and 22 and tender Mr. Hevert for cross-examination.

JUDGE WOODRUFF: All right. 20, 21 and 22 have been offered. Any objections to their receipt?

MR. THOMPSON: No objection.

JUDGE WOODRUFF: Hearing none, they will be received.

(Exhibits 20, 21, 22HC, 22NP were offered and admitted into evidence.)

JUDGE WOODRUFF: For cross-examination, we'll begin with MIEC.

MS. ILES: Judge, may I have a moment? I have an exhibit that I was going to ask Mr. Hevert to look at it. And I just noticed when I printed it, the footnotes had dropped off for some unknown reason, and I just need to make a few additions if I could just have a couple of minutes before I do that, before I start. I'm so sorry.

JUDGE WOODRUFF: All right. Back off the record for a minute.

(Break in proceedings.)

JUDGE WOODRUFF: All right. We're back on the record, then.

MS. ILES: I should know better than to print documents after 8:00 at night.

CROSS-EXAMINATION

BY MS. ILES:

Q Okay. Mr. Hevert, I'm going have this marked as an exhibit and have you take a look at it.

JUDGE WOODRUFF: Next number is 529. Thank you.

COMMISSIONER KENNEY: Thank you.

MR. THOMPSON: Thank you.

MR. BYRNE: Thanks.

A Do you have an extra?

Q (By Ms. Iles) I'm sorry. I'll give you the one that's marked.

A Thank you.

Q You'll notice on that document there are some little numbers, reference numbers for footnotes. However, there are no footnotes on the document due to an error on my part.

And I want to let you know that the first footnote should refer to your direct testimony in the case ER-2011-0028, which is the last Ameren rate case. That's ER-2011-0028, Hevert Direct at 54.

The second footnote should be ER-2012-0166, the current case, Hevert Direct at 49. And the third should be ER-2012-0166, Hevert Rebuttal at 113.

And the final footnote, No. 4, the utility bond yields come from Mr. Gorman's testimony. I believe it's his direct at page 5.

MR. BYRNE: Ms. Iles, what -- footnote to what page number was that again?

MS. ILES: 49, direct at 49.

Q (By Ms. Iles) So as you can see, these are numbers that I've taken from your testimony and Mr. Gorman's testimony on the issue of cost of capital. Are you -- did you want to have a minute to doublecheck those numbers?

A If you don't mind.

Q Would you like to see a copy of your testimony from the last case so you can doublecheck that as well?

A No. That's fine.

Q Okay.

A Yes. Thank you.

Q You're ready to proceed? Thank you. All right. And let's just kind of walk through this. The first column, Column 1 of this exhibit, shows your constant growth DCF results from Ameren Missouri's last rate case, correct?

A Yes.

Q Then the numbers that are shown on there are your mean results. I think you had three and you had a range and that's the mean.

A Well, let's be clear about that.

Q Okay.

A What I show when I produce the constant growth results -- and this is, of course, because of the limitations inherent in the constant growth model -- are three measures of the mean. The mean low, the mean, the mean high.

Q Okay.

A The mean high being the average DCF result based on the highest of three growth rates that we used, the mean being the average based on the average of the growth rates that I use, and the mean low, of course, being the average of the low the three growth rates that I use. And that's a convention that I have consistently applied.

And that is, in part, the method by which I used to understand what the range of results and, therefore, the range of estimates may be.

Q And the only numbers -- numbers I've shown on this exhibit are the mean numbers, correct?

A That is correct.

Q All right. And then column 2, Rows 1 through 4, show the constant growth DCF results included in your direct testimony from this case. The final line is an average of those three. And, again, it's just the mean, not all of your results.

A I'm sorry. Can you state that one more time?

Q Column 2 of this exhibit shows the constant

growth DCF results included in your direct testimony from this case?

A Yes. That's correct.

Q And finally, Column 3 shows the constant growth DCF results included in your rebuttal testimony from this case, correct?

A That's correct.

Q And then when I get over to Columns 4 and 5, we show -- I show the difference or the change -- I call it the change, but it's actually the difference between your constant growth DCF results in the prior rate case and this rate case, correct?

A Yes. That's correct. For -- again, for the limited purpose of the mean results of the constant growth DCF model. That's correct.

Q It's just this one -- now, you looked at -- and you did a number of different analyses, correct?

A I did.

Q And you looked at a lot of different data points, correct, a lot of different data in determining your recommendation for ROE in this case?

A Well, I used a lot of data. And the data, of course, are inputs to the models, and the models, of course, have results. So when you say data, I'm not quite sure what you're referring to.

Q When I say data, I'm including both your inputs and your results. I'm just saying you looked at a lot of different things, and this is just one part of what you considered in making your recommendation. I just wanted to be clear on that.

A I think that's fair, yes.

Q I'm not trying to represent in this exhibit everything you looked at. I'm just trying to tease out one thing so we can get a little clarity on how that one that thing has changed since the last rate case.

A I appreciate that.

Q Is that clear?

A Yes.

Q Okay. So 4 and 5 -- Columns 4 and 5 show us what the change has been since the last rate case between your direct testimony in this case and the prior case and between your rebuttal testimony in the last rate case, correct?

A Those are the differences, yes.

Q The differences. And so they show that the constant growth DCF results declined since the last rate case, at least as you calculated them, correct?

A Based on what we have right here, yes. Correct.

Q Well, they don't show they go up, do they?

A No. No. I'm just saying that, as you mentioned earlier, there's a fair amount of data in the testimony. But as -- with respect to this particular method, I would agree with it.

Q All right. And let's talk a little bit about the DCF -- the constant growth DCF methodology. When you -- when you do that calculation, your points include stock price, correct?

A That's an input, yes.

Q And dividends?

A Correct.

Q And do you look at bond yields in that calculation?

A Bond yield is not an input to the calculation, no.

Q That's right. So you're just looking at stock, not bond yields and not risk premium. It's not a risk premium analysis?

A Risk premium analyses, of course, are other methodologies that we use. But in the bond crisis are not an input to this particular model.

Q Okay. So when we talk about the constant growth DCF results, we're talking about results that are calculated based on data that have to do with stock price and dividends and various aspects relating to stock value, correct?

A I'm not sure what you mean by various aspects relating to stock value. The direct inputs are stock prices, dividends and growth rates.

Q Okay. Stock growth rates, right?

A That's -- that's a very good question. The growth rate, of course, is meant to -- the growth rate, of course, is meant to replicate or represent the rate of capital appreciation over time. So what the model basically is telling you or is trying to represent is you buy a share of stock, and you get two things.

You get the yield, and you get the capital appreciation in that stock. The capital appreciation, of course, is the extent to which the price increases over the term during which you hold the stock.

And while there are different approaches that people sometimes use, Mr. Gorman and I both use estimated earnings per share growth as the important and relevant measure of growth over time, the idea being, of course, that earnings per share are most closely related to capital appreciation over time.

Q Okay. And I'm not sure if I was clear on this before. But when we look at Columns 4 and 5, don't they suggest that the cost of equity as calculated based on your constant growth DCF calculations have gone down since Ameren Missouri's last rate case?

A Well, I think there are two important issues here. One is that I don't disagree that the cost of equity has gone down since the last rate case. The question is by how much.

Q Okay.

A 91 basis points, 62 basis points, I don't think is -- is correct. And one of the reasons that I use, that other people use other models such as the multi-stage DCF model is that there are several limiting assumptions associated with the constant growth model itself. And in large measure, that's why I tend to calculate the results the way I do. We --

Q Okay. Can I interrupt you right there? I think we all understand that you didn't rely solely on this constant growth DCF, and that's what you're telling me, correct?

A What I'm telling you is that there are limitations in the model. And to draw any conclusions with respect to the absolute decrease in the cost of equity as a result of the mean results of this one model, which is subject to many limiting assumptions and constraints, is not something that I would agree with.

Q Okay. So you would not make that conclusion?

A The -- again, when you say that --

Q It's just -- I mean, you just told me you

wouldn't make that?

A It's not a yes or no. When you say that conclusion, I agree that the cost of equity has declined somewhat. I don't agree that it has declined to the extent represented in Columns 4 and 5.

Q All right. Fair enough. Okay. Let's -- let's look at utility bond yields that are shown. Now, I told you that these -- these numbers are reported in Mr. Gorman's testimony. But do they appear to be correct to you? Do you have any -- I don't think you contested that or disagreed with that part of his testimony.

A Oh, no. I have no particular reason to disagree with these.

Q Okay. And so, again, we have the A rated utility bond yields shown in Column 1 for the 13-week period ended July 8, 2011, which is around the time of the last Ameren rate case. I think that report and order was issued in July of 2011.

And then we have in Column 2, the A rated utility bond yields for the 13-week period ending June 15th, 2012. We have the same information for the BAA rated bonds; is that correct?

A Yes. That's correct.

Q All right. And then, again, over to the right, there's a column that's headed Change. And it shows the

difference or how those bond yield rates have changed since July -- or during that period, correct?

A And, of course, What that shows is the change in the total. It's not broken down between the change in the Treasury yield, which was probably 120 basis points, the long-term Treasury yield relative to the change in credit spreads. The change in credit spreads, of course, which really truly is the measure of incremental risk associated utilities from a fixed income investor's perspective has not decreased that way.

Q But I think -- I'm sorry. So what you just said in that last statement is that Treasury bond yields actually decreased more than the utility bond?

A What I'm saying is that --

Q No. But I mean, what I just said -- I mean, I know you said more than that. But that's one of the things you just told us, correct? I've only written down here utility bond yields. But you've also indicated the Treasury bond yields have also declined during that period and actually more than utility bond yields?

A The -- the -- when you look at bond yields, to me, the -- the important issue is looking at the decrease in the underlying -- the underlying Treasury security of, say, comparable maturity and then the change in the credit spreads.

And as we look at credit spreads, one of the things we've noted -- I've noted is that what we refer to as the -- sort of the incremental credit spread, the BAA to A credit spread has actually increased over that time.

So I agree with you that the absolute numbers are down, but I don't agree that the analysis should end there.

Q Well, certainly. I'm not suggesting that. I'm just trying, for some of us who don't quite have the comprehension of all the complexities, to get some numbers that we can kind of get our hands around. And that's something that at least I am able to do.

A I appreciate that.

Q All right. Thank you. All right. Now, what about -- do you know anything about how these bond yield rates have -- what they've done since June 15th of this year? They've continued to go down, haven't they? They're actually lower today than they -- than is reported on this exhibit?

A I -- I couldn't answer that offhand.

MS. ILES: Okay. I'd like to move for the admission of this exhibit. I'm sorry.

JUDGE WOODRUFF: 529 has been moved. Any objections to its receipt? Hearing none, it will be received.

(Exhibit 529 was offered and received into evidence.)

MS. ILES: All right. I'd like to have this marked as an exhibit.

JUDGE WOODRUFF: All right. This will be 530.

A May I -- may I have --

MS. ILES: I'm sorry.

MR. LOWERY: He's the most important one.

Q (By Ms. Iles) That is correct. Let me be clear about what we're looking at right one.

A It's only just Bob.

Q I know.

A It's okay.

Q I said I was handing it to you, and I didn't. I apologize. Can you tell me what that is?

A Yes. This is the Regulatory Research Associates' summary of what they refer to as major rate case decisions for January through June 2012.

Q All right. So what information does this report?

A I'm sorry. What?

Q What information does this report?

A Well, the -- typically, what these reports are are authorized overall rates of return, authorized equity returns, authorized capital structures, the type of rate base convention, the eventual revenue increase.

And there's additional information in the reports as to whether or not a certain case was -- with respect to a distribution only company, whether it included certain elements such as a multi-year rate plan, whether there were elements that were stipulated in the case.

So it's a -- it's a report that includes a fair amount of information. I think people typically look at it for issues regarding authorized returns, authorized capital structures and then, again, some of the qualifications around those.

Q All right. And by looking at this document, does it tell us what the average ROE authorized for electric utilities was in the United States in the first quarter of 2012?

A It -- it does. On 2012 for the first quarter, the mean is 10.84. The median is 10.5.

Q And that's reported on page 4 of this document?

A Yes. I'm sorry. I should have made that clear.

Q And does the document also explain that those -- that average is higher due to the inclusion of some decisions in Virginia?

A Yes. And that's one of the points I was making before. RRA does, for example, in the case of Virginia where the company has incentives, the company, largely Virginia Electric Power Company, has incentives with respect to investments in generating assets.

And some of these numbers, for example, I believe the 12.4 percent would fall in that category. Yes. And that footnote which is then noted on page 5 explains that.

Q Could you read the first paragraph of this document that explains that so we'll have that in the record?

A I'm sorry. The first paragraph of --

Q On page 1.

A On page 1.

Q Uh-huh.

A The -- the entire first paragraph?

Q Yes, please.

A Sure. The average return on equity (ROE) authorized electric utilities in the first six months of 2012 was 10.36 percent (25 observations), slightly higher than the 10.22 percent in calendar 2011.

This increase was driven by several surcharge/rider generation cases in Virginia that incorporate ROE premiums. Virginia Statutes authorize the State Corporation Commission to approve ROE premiums of up to 200 basis points for certain generation projects (see the Virginia Commission profile).

Excluding these Virginia surcharge/rider generation cases from the data, the average authorized electric ROE was 10.05 percent for the first six months of 2012.

The average ROE authorized gas utilities for the first six months of 2012 was 9.75 percent (13 observations), slightly lower than the 9.92 percent in calendar 2011. We note that this report utilizes the simple mean for the return averages.

Q Okay. And does this document also show us what the second quarter average ROE for electric utilities is?

A Yes, it does.

Q And what -- what is that number?

A Well, for the second quarter for electric, again, on page 4, the average was 9.92. That, of course, included the distribution returns for Commonwealth Edison and for Orange and Rockland. And it also included the really extraordinarily low return of 9.25 percent for Northern State Powers in South Dakota.

Q Now, why do you believe that one's extraordinarily low?

A Because it is relative to the data.

Q All right. It's just a low number. But there's not any explanation you have that suggests that is in a

different category than the other companies?

A Well, again, this is footnote -- footnoted as B, which says the order followed stipulation or settlement by the parties. Decision particulars are not necessarily precedent setting or specifically adopted by the regulatory body.

Q I'm sorry. And then right above it, there's one that's nine six. Would you consider that extraordinarily low?

A I think nine six is low. Yes.

Q All right.

A I wouldn't say it's as low as 9.25. Even I can do that math. But it is lower.

MS. ILES: I'd like to move for the admission of --

JUDGE WOODRUFF: It will be 530.

MS. ILES: -- Exhibit 530.

JUDGE WOODRUFF: 530 has been offered. Any objections to its receipt? Hearing none, it will be received.

(Exhibit 530 was offered and admitted into evidence.)

Q (By Ms. Iles) These are some that are two-sided and some that are one-sided. They're all the same thing.

JUDGE WOODRUFF: This will be No. 531.
MR. THOMPSON: Thank you.
Q (By Ms. Iles) Mr. Hevert, I've handed you what's been marked as Exhibit 531. Here's the marked one if you want to see it's the same. You can have that one.
A Oh, no. Thank you.
Q All right. Can you tell us what that is?
A This, again, is another report dated October third, 2012, by S&L, which is the company that holds within it Regulatory Research Associates.
Q And what does this report tell us?
A Well, I don't know. I've not seen it.
Q Okay. Does it report major rate case decisions from July 12 through September 12 on page 2?
A Oh, there we go. Thank you. Yes. I see that now.
Q And it includes both electric and gas, but it tells you on that chart the service type, correct?
A Yes, it does.
Q So from looking at this, can you tell us what the authorized return for the electric companies that were reported during this period?
A Well, I guess my question is what kind of electric companies? We've got Atomic Electric Power in DC that's a distribution company. Delmarva Power in Maryland

is a distribution company. Patomic in Maryland is a distribution company.

Q So those three are distribution. Are the other -- are the other electric companies shown, integrated electric companies?

A Oh, sorry. I missed Ameren Illinois. So we've got Idaho Power. We've got Entergy, Texas. We've got PacifiCorp, and we've got Oklahoma Gas & Electric.

Q So what are the returns on there?

A I'm sorry. Pacific -- I'm sorry. I just need to go through my little checklist here again.

Q Why don't we just start at the top, and we can just go through them, and you can tell us what your -- I think that will be helpful to everyone if you can tell us what kind of company and what return on equity is.

A That's a good system.

Q Okay. We'll start with Patomic Electric Power Company.

A Distribution.

Q And what was its return on equity?

A 9.5 percent.

Q And then we have South Carolina Electric and Gas. But it doesn't tell us their ROE on that one.

A Right.

Q We have to go down to PacifiCorp.

A PacifiCorp is integrated.

Q And what was its authorized ROE?

A 9.8 percent.

Q All right. And we have Ameren Illinois?

A Not integrated.

Q And what was its ROE?

A 10.05, which is, of course, interesting for it being not an integrated company with a return above T&D companies, but 10.05.

Q And then we have Entergy Texas?

A Integrated company.

Q And what was its ROE?

A 9.8 percent. Texas, of course, being recognized as a -- most least credit supported jurisdictions.

Q Okay. Then we have Delmarva Power & Light?

A Distribution.

Q And what was its ROE?

A Delmarva in Maryland was 9.81 percent.

Q Okay. And then we have Patomic Electric Power Company.

A Which is a distribution company in Maryland. It is, of course, affiliated with or a sister company of Delmarva. The 50 basis point difference there had to do with issues surrounding the company's response to storm restoration, so it reflected a -- a reduction for that reason.

Q And what was the ROE for that company?

A Prior to the reduction, it was 9.81 percent. Afterwards, it was a 9.31 reported.

Q That was the authorized, 9.31?

A Correct. Yes. After the deduction.

Q All right. Then we have PacifiCorp, I think?

A Pacificorp, 9.8 percent. Oh, I'm sorry. I forgot to say vertically integrated.

Q Integrated. Oklahoma Gas & Electric?

A Vertically integrated, 10.2 percent.

Q All right. Thank you. I apologize for that. I know it's hard to read.

A No. That's okay. Your approach was better than mine.

MS. ILES: I'll move for the admission of Exhibit 531.

JUDGE WOODRUFF: 531 has been offered. Any objections to its receipt? Hearing none, it will be received.

(Exhibit 531 was offered and received into evidence.)

Q (By Ms. Iles) Mr. Hevert, you state in your testimony -- you stated in your testimony that -- I think it was on page 47 of your direct, you talk about

regulatory lag and earnings attrition and that they were among the things you took in account in arriving at your recommended ROE.

A I'm sorry. Can you point me to the page and the line?

Q Is that correct? Well, I'm sorry.

A Oh, direct testimony.

Q Direct. It's on page 47. I don't have the line in my notes.

A Yes. On 47, we refer to a comment by Moody's and also refer to the extent to which some of the proxy group companies are able to do things such as include construction work and process in rate base used to forecast test years and other types of structures, yes.

Q And you took that -- am I correct in stating that you did take that into account in arriving at your recommended ROE?

A It was a consideration, yes.

Q I believe earlier this week when Barnes testified for the company that it was something that reduced your ROE -- or increased, I said that wrong, your ROE recommendation.

A It -- it's a -- it's a consideration -- I think there was discussion this morning regarding the necessity of judgment in this process. And it was a consideration on my part, the fact that while the Commission certainly has done a lot recently to -- to improve the company's situation, vis-a-vis the proxy group, the proxy group companies still have mechanisms available to them that are not available to the company. So, yes, it was -- it was a consideration. I will say I did not attach specific basis points to it.

Q So it's not something you can quantify?

A I think it's -- I think it's -- it can be difficult to quantify. We can look at things like bond yields. We can look at -- and I've looked at this, the extent to which companies may trade in a different pattern before or after, for example, the implementation of a revenue decoupling mechanism or formulate a rate plan.

And I think what you can often identify is the presence or not of an effect. But I think putting the effect in specific basis points, at least in my view, is -- is difficult.

Q So you can tell us that it was something you considered, but you can't tell us exactly how much it increased your recommendation? Is that what you're saying?

A I think that's right. But if you look at my recommendation in the context of the range, of course, my original recommendation was at the mid-point of the range and now with the revised recommendations somewhat below the mid-point of that range.

And so, again, while I think that this is an issue that does represent an element of incremental risk, I took it into consideration in determining where I think the returns lies within that range.

MS. ILES: Okay. No further questions.

JUDGE WOODRUFF: Okay. Public Counsel?

MS. BAKER: Thank you.

CROSS-EXAMINATION

BY MS. BAKER:

Q Good morning, Mr. Hevert. I will say it right.

A That was very -- that was very nice of you. That makes me nervous, actually.

Q All right. From the questioning before, looking at the overall big picture of the way things are right now, you were -- you were asked questions about -- that the overall cost of capital has gone down in the past few years. Would you agree with that on an overall basis?

A Yes. I would agree with that.

Q And -- and also when asked earlier, the overall yield is also down?

A That's correct. Yes. In large measure because of the fairly significant drop in Treasury yields.

Q All right. And would you say that this has,

basically, been what's happening since about 2005?

A I'll take a look real quick. Sometimes I think even I have too much paper. I think that's -- I think that's fair, yes.

Q So it's been a good almost seven years of this?

A I -- I would say yes, there's been a -- I refer to it as sort of a drift downward. It's -- it's not a steady sort of linear decline. The numbers bump around a little bit. But I would agree that there's been a -- a long-term secular downward drift in the numbers.

Q All right. And so is there an expectation that the economy will rebound substantially within the next few years?

A I -- I am not -- boy, I wish I knew the answer to that. That --

Q But your sense of what is going on.

A My -- my sense of what's going on and how it affects the return on equity is -- quite frankly, goes beyond the extent to which the economy may recover. Excuse me.

Q Right. Right.

A For example, I think we've already started to see over the past couple of weeks even increases in expected inflation rates.

Q Right. But as you said, these things do drift

up and down. But you said that the overall cost of capital has gone down and the overall yield has gone down since 2005?

A I -- I think that's fair. Yes.

Q All right. So it would be fair to say that given -- given the ups and downs of it all that the economy, as it is today, is a new normal?

A I -- I've heard that expression. I've never bought into it. The -- when you look at downward drift in the cost of capital, it's really, I think, important to understand what drives those numbers.

And -- and that's why, in my view, while it is true that Treasury yields, for example, have fallen considerably, you can't look at the absolute change in Treasury yields and say that the cost of equity has fallen to a corresponding degree.

And I think that while there is a downward drift in those numbers, there appears to be -- I don't want to say a limit, but there certainly is not the same type of drop in -- in the cost of equity as there are in Treasury.

And so as to the issue of a new normal, I really can't say. We've got so many uncertainties facing the economy right now, the fiscal cliff. Again, the issue of -- sometimes referred to as quantitative easing infinity, the effect that that could have on inflation, which, of course, would then have a reversal in terms of the effect on yields.

And so I have a hard time saying that what we're seeing right now will be normal in perpetuity. And, of course, it's in perpetuity that we're looking at for the purpose of cost of equity.

Q Well, I mean, what is normal has now lasted for seven years and is not expected to change in the next few years. So we're looking at -- at something that basically is here to stay for -- for the foreseeable future?

A I'm sorry. When you say here to stay, I think the notion of just extrapolating this trend -- this trend that we see here in -- in reduced ROEs, authorized ROEs is inappropriate.

I don't think you can say that there will be a continued decline in the cost of equity, again, because while it may be true that things such as Treasury yields have fallen over time, you have to look at why.

And if you -- if you understand or -- or if you recognize that in large measure part of the reason for the decline in Treasury yields has been investors looking to preserve capital, to avoid the risk of equity loss, so they buy Treasury yield -- excuse me -- buy Treasury securities for the relative safety.

And as they buy securities, of course, the yield goes down. You can't say that the resulting lower yield is a function of people being less risk averse. In fact, they're more risk averse. And so that's why it's a more complicated calculus, I think, than looking at the trend and extrapolating it.

Q All right. So as it is, this movement in the business world, then, basically, it's just part of doing business. These things go up. These things go down. So you're saying this is a business risk, that it is seen by every business, including Ameren?

A I'm -- I'm sorry. I just want to be sure I understand your question. The -- when you say this is a business risk, I think a lot of companies and a lot of individuals look at capital markets right now and they see uncertainties.

And when they see uncertainty, again, they will move to the relative security of Treasuries. And that, of course, brings the yield down. The -- looking forward, there's always uncertainty in the market. Whether or not that uncertainty will be greater or less than the long-term history, I -- I think is a -- is a good question. I think right now there's considerable uncertainty in the market.

Q And there has been since 2005, seven years ago?

A Well, I think it's -- it's fair to say that there have been periods during that time, of course, fall of 2008, early 2009, when uncertainty was considerably greater, which brings up another, I think, important point.

You talked about sort of the new normal and the -- and the way companies do business now. One of the things that I've seen in working with clients is that since 2008, I think there's been a renewed focus on the part of investors on risk and, in particular, on what's sometimes referred to as -- it's tail risk, the risk associated with a very adverse, possibly low probability, but significant event.

I think people now look at risk as not necessarily something that may happen as good and something that may necessarily happen that's bad. But I think they may look at risk as -- as what we saw in late 2008, which is that there's a significant disruption in the market, and that disruption means that even highly rated utilities have a difficult time accessing capital. And so --

Q I'm going to cut you off. At this point, I think we're moving beyond a little bit of -- of what I'm asking for this.

A Okay. I misunderstood.

Q We're back to -- we're back to -- yes, I

understand and we agree that there are movements up and down within -- within. But focusing on the overall picture of the economy, it is -- what I'm trying to do -- moving on from that, during the local public hearings, you're aware that there's been a lot of customer concern over the affordability of rates. You understand that?

A Yes, I do.

Q Okay. And you would agree that the goal for the Commission is to set rates that are just and reasonable?

A I agree with that. Yes.

Q And would you agree that part of determining a reasonable rate is to make rates as affordable as possible without causing detriment to the utility?

A I think -- I think that's a -- a way of characterizing the -- the important task that the Commission has of balancing the interests of -- of ratepayers and investors.

Q All right. And in your testimony, you state that you calculate a reasonable range of ROE for Ameren to be anywhere between 10.25 and 11.00; is that correct?

A In my rebuttal testimony, correct.

Q And that is -- and -- and based on this reasonable range, Your recommendation to the Commission is 10.5 percent?

A Yes. That is correct.

Q And -- and as you said in your original filing of the case, you calculated a reasonable range to be anywhere between 10.5 and 11.00?

A Correct.

Q With an original recommendation of 10.75?

A That is correct.

Q All right. So between February when -- when your direct testimony was filed and now, your recommendation has moved to what was the bottom of your original range?

A Yes. I did two things. One is I moved the low end of the range because, as I said, I recognize that some of the model results have changed. And while you can look at some indicators suggesting that perhaps the -- the model results are not fully indicative of the cost of equity or changes in the cost of equity, I recognize that they've fallen and I think it's fair and important to recognize that and reflect that in the recommendation.

Q Okay. So now the -- the 10.25 is your lower end of the reasonable range?

A Yes. That is correct.

Q All right. And according to your testimony, you believe that the regulatory environment in Missouri is less credit supportive than the regulatory environment prevailing in other most other states. Therefore, your

recommendation of an ROE of 10.5 is appropriate; is that correct?

A As we talked about a little bit ago, it is -- it is a factor that I considered.

Q All right. And I -- I assume that you agree with what you stated before, that a reasonable ROE for Ameren is one that is adequate to attract capital at reasonable terms, thereby enabling Ameren Missouri to provide safe and reliable electric service that's sufficient to insure Ameren Missouri's financial integrity and commensurate with returns on investments in enterprises having corresponding risk; is that correct?

A That's correct. And I certainly don't intend to belabor the point. But capital attraction, after what we saw in 2008 is, in my view, a very important criteria.

Q All right. So an ROE that meets those requirements of a reasonable -- or that I stated, the three points, would be reasonable and not detrimental to Ameren, in your view?

A Yes. That's correct.

MS. BAKER: No further questions.

JUDGE WOODRUFF: All right. For Staff?

MR. THOMPSON: Thank you.

CROSS-EXAMINATION

BY MR. THOMPSON:

Q Good morning, Mr. Hevert.
A Good morning, Mr. Thompson.
Q I'm sorry. I apologize. I'll probably mispronounce your name all through this. I apologize in advance. It's not on purpose.
A No offense taken, believe me.
Q Now, you testified in Ameren Missouri's last rate case, correct?
A I did.
Q And at that time, you were an employee of Concentric; is that not right?
A Concentric Energy Advisors, correct.
Q And you are no longer with Concentric Energy Advisors?
A That is correct.
Q Okay. And you're being paid for your testimony today and for the analyses you've conducted in this case; isn't that correct?
A That is correct.
Q And I wonder if you could tell us how much you're being paid.
A Boy, that is a good question. It's -- it's through a subcontract agreement with Concentric. I do not know the exact hourly rate. My best guess, it's in the $450 range.

Q Do you know what the estimated total for your services is?

A No. Because I'm no longer at Concentric, I really have no sort of insight to that right now.

Q Okay. And you have a Master's in Business Administration; is that correct?

A I do.

Q And you're also a chartered financial analyst?

A I am.

Q And Mr. Murray also has a Master's in Business Administration; is that correct?

A He does.

Q And he's also a chartered financial analyst?

A He, too, endured the pain. Yes.

Q And it's my understanding that is a difficult credential to obtain.

A In my view, it is. I agree.

Q And Mr. Gorman also has a Master's in Business Administration; isn't that correct?

A He does.

Q And he is also a chartered financial analyst?

A You would think we were the only three in the world, but, yeah, he does, too. That's right.

Q And I know you don't agree with the recommendations that either Mr. Murray or Mr. Gorman has

made in this case, but you accept both of them as expert financial analysts, do you not?

A I -- I certainly recognize their credentials, yes.

Q Okay. Now, I sent you a DR in which I asked you what you believed your role in this proceeding is. Do you recall that?

A No. Well, if I could have a copy of that, it might make it easier.

MR. THOMPSON: May I approach?

JUDGE WOODRUFF: You may.

Q (By Mr. Thompson) I think it's paragraph 2 there.

A Yes.

Q Okay. I wonder if you could read your response there, paragraph 2?

A Paragraph 2, my understanding is that my role in this proceeding is to estimate the required return on equity for Ameren Missouri by using one or more analytical techniques that rely on market-based data for quantifying investor expectations regarding required equity returns adjusted for certain incremental costs and risks consistent with the standards established in Hope and Bluefield that return is based on those available from investments of comparable risk.

While I am not an attorney and -- and am not expressing a legal opinion, my understanding is that the company's authorized return on equity should be neither excessive nor confiscatory.

Q Thank you. If I could get that back. Thank you, sir. What sort of ROE award would you consider to be excessive?

A Well, I think the -- the range that I have established, 10.25 to 11 percent, generally establishes the range that I think is reasonable and would set balance on both ends.

Q Okay. So it's your testimony, then, if I understand you correctly, that an ROE award below 10.5 would be confiscatory?

A No. That's not correct.

Q Okay. Well, then, please explain to me how I misunderstood you.

A My range of 10.25 percent to 11 is the range would set the -- in my view, the bounds. So the low end of 10.25 percent is what I say rather than the 10.5 that you just mentioned.

Q I'm sorry. I misspoke. So correcting that question, it's your testimony that an award at below 10.25 would be confiscatory?

A Again, I'm not an attorney. And as to what is confiscatory or what is excessive, I suspect it's more a legal issue as I noted in my discovery response. And I look to the Hope and Bluefield standards as guidelines. I don't look at them as an attorney would look at them. I look at them as an analyst would look at them. And so in my view, the lower bounds, excuse me, of 10.25 percent would satisfy those three criteria.

Q Okay. Is it your opinion that the cost of equity and the return on equity set by this Commission are the same thing?

A It's my view that the -- excuse me. I'm so sorry. Excuse me for one second. When you called me Mr. Hevert, it really upset me.

Q I apologize again.

A That's okay. I'll get over it. I'm sorry. After all the excitement, I forgot your question.

Q I'm not sure I remember it either.

MR. THOMPSON: Could you read it back, please?

(The previous question was read back.)

A It -- it's -- well, it's my view that the Commission has broad discretion in setting the -- the allowed return on equity. And the Commission takes into consideration factors that it deems to be relevant and gives them the weight that the things should be afforded.

What I provide is my estimate of the cost of equity. Whether or not the Commission sets it at my recommendation, of course, is a function of a number of things. But my recommendation represents the cost of equity.

Q (By Mr. Thompson) Okay. Isn't it true that investors are flying to utility stocks because they are safe and less volatile than other stocks?

A Well, let's break that down. Let's talk first about safer and less volatile than other stocks. I don't think there's any disagreement among anyone here that utilities are less risky and that the market utilities typically have beta coefficients of less than one. And beta coefficients, of course, are a measure of the relative volatility of a stock.

And when I say relative, I mean relative to the broader market. So in that sense, we all agree that utility stocks are less volatile than the overall market and, therefore, are less risky than the overall market. I would agree with that.

As to the issue of flying to utility stocks, I'm not sure I agree with that. I recognize that utility stocks are, in some measure, dividend investments. I spent a lot of years at a utility issuing securities. I understand that.

But in my view, investors don't own utilities simply for the dividend. And in my view, it's -- I don't believe that an investor would be indifferent between the secured security of a bond and the unsecured and residual claims associated with equity.

Q Well, aren't utility stocks, in fact, much like bonds?

A I -- I strongly disagree that any equity is like a bond. And -- and -- and let me explain why. Bond investors, of course, have two things. They have security by the underlying provisions of the bond itself, and they have a priority claim on the cash flows.

Bond investors are focused on the company's ability to meet its financial obligations, its debt service obligations in a timely manner during the period over which they hold the bond.

Equity investors have no contractual claim on either the cash flows or the assets. Equity investors take the residual risk, which means they get the cash left after the bond holders have been paid.

To the extent that you are suggesting that an investor, again, would differentiate between one security, which is secured, which has priority, which has a contractual obligation to make interest and principal payments with a secure that has no such obligation and for which you are the residual claimant on the cash flows, I disagree that investors are indifferent between the two.

Q Okay. Looking at Exhibit 531 -- do you still have that there?

A I'm not sure if I do. So this is the RRA October 3rd report?

Q Yes, sir.

A Yes. I have that.

Q And as you went down through them line by line, I think you identified four integrated utilities for which an ROE award is reported here. And they would be PacifiCorp and Entergy Texas and PacifiCorp again and Oklahoma Gas and Electric. Did I read that correctly?

A Yes. Four. Correct.

Q Okay. And would you agree with me that three of the four, the reported ROE award is 9.8?

A Yes. I would agree with that.

Q And for the fourth one, the reported ROE award is 10.2?

A Yes. That is correct.

Q And would you agree with me that the average of those four numbers is 9.9?

A As it turns out, I would agree with that.

Q Thank you. Turn to page 113 in your rebuttal testimony.

A Yes. I have that.

Q Now, on pages 113 and 114, both of those pages are taken up by charts; isn't that correct?
A That is correct.
Q And on Table -- excuse me. On page 113 is Table 19-A?
A Correct.
Q Summary of Updated Results, Hevert Revised Proxy Group?
A Correct.
Q And on page 114 is Table 19-B, Summary of Updated Results Combined Proxy Group?
A Correct.
Q And these tables report the results of your updated analyses, correct?
A That is correct.
Q Is that the very analyses that are summed up when you say that your range was 10.25 to 11 and your point recommendation is 10.5?
A Correct.
Q Okay. Now, with respect to each of these two proxy groups, you performed three different constant growth DCF analyses; isn't that correct?
A No. I -- I performed three DCF analyses, one constant growth.
Q Okay. You can see how easily an attorney

becomes confused, or at least this particular attorney. So when you report under constant growth DCF, and I'm looking at the top off Table 19-A, you have a 30-day average, 90-day average and 180-day average. Those are not separate analyses?

A Well, they -- they're separate in the sense that the -- what they do is the 30-day average takes each of the companies' stock prices, averages them over a 30-day period and calculates the dividend yield based on that 30-day average.

The 90-day and 180-day are the same thing. They simply extend the period over which the dividend yield is calculated. And, again, this model calculates the cost of equity as the sum of -- basically, as the sum of the dividend yield and the expected growth rate.

Q Okay. Let's talk about growth rate. What growth rate did you use for your constant growth DCF analysis?

A Well, if you turn to -- it's -- it's Schedule RBHER-10, you'll see there that we have three different measures of growth. Well, they're not -- that's probably a poor way of explaining it.

What I used, as we mentioned earlier, is expected growth and earnings per share. And for the purpose of developing that information, I looked to three sources. First call, Zack's and Value Line. First Call and Zack's are what are referred to as consensus projections. Basically, they serve the analysts covering that particular company and find either the mean or the median growth rate that those analysts project over the coming three to five years.

So Value Line -- excuse me -- Zack's and First Call both, then, are consents of services. Value Line, of course, is simply a value line. And it's the growth expectation of the particular value line analyst covering that company.

Q So are you telling me that there is no single number you can give me in response to that question?

A I'm sorry. When you say single number, what do you mean?

Q I mean, did you use a series of growth rates in conducting your constant growth DCF analysis, or did you use one growth rate?

A The answer is yes. The -- I used one growth rate, which is the expected growth and earnings per share. But I used three sources for that growth rate and took those sources for each of the companies. And so it is one number, and that one number is meant to represent the expected growth and earnings per share, but it comes from three different sources.

Q Okay. Did you average what you found in each of those sources?

A Yes. And as we talked about a little bit earlier, the average is what goes into the calculation of the mean or the average DCF result.

Q Okay. So -- and what was that average?

A The -- the average over -- excuse me -- in the rebuttal testimony, which is for the period ending July 30th, 2012, the average earnings adequate growth rate was 5.07 percent.

Q Now, you also performed two multi-stage DCF analyses; isn't that correct?

A Yes. That's correct.

Q And it's true, is it not, that a multi-stage DCF uses more than one growth rate?

A Yes. the -- the whole point is to -- well, I'll back up. I had mentioned earlier the constant growth model is subject to a number of assumptions and constraints, one of which is the growth rate, the payout ratio, the PE ratio, the PB ratio all stay constant in perpetuity. And I think we all know that that's not necessarily the case.

And so the multi-stage model allows you to apply assumptions with respect to your -- what the growth will be over varying stages and the interest of typically timing periods, which I mentioned is a period covered by analysts.

The way I run the model, and other people perhaps could come to different thing, a second stage from the transition from the second stage to the long-term period. And there's a long-term growth rate. So, yes, growth rates change, but the model, depending on the construction, allows you to change other assumptions as well.

Q Okay. Let me make sure I understood what you just said. You used an initial short-term growth rate. Then there was a second transitional stage. And then, finally, a third long-term stage; is that correct?

A That's the first half.

Q That the first half. Okay.

A That's the first half. Okay. The second half is -- well, we'll back up one step further. The way the -- this model works and the way I've constructed it is that we model cash flows. That's two things. As we talked about earlier, it's the dividend that you receive while you're holding the stock and the price at which you would sell the stock at the end of the holding period. We refer to that as the terminal value. So the price that you would expect to receive when you sell it.

Now, not to get complicated, but depending on how you develop the model, that terminal price could be the same thing as just running the model out into forever.

But in order to calculate the dividends, the way I run the model is we project the earning per share. We multiply that by the expected payout ratio in order to get the dividends per share.

And that's what I said earlier. It's important to recognize that under the constant growth model, which assumes the dividend ratio stays constant in perpetuity, there could be situations where that's not the case. So that's why I model dividends as the product of the expected earnings and the expected payout ratio.

Q With respect to the first of your multi-stage analyses, the Gordon growth terminal value --

A Yes.

Q -- can you tell me the average growth rate you used for Stage 1?

A The -- well, again it depends on what we mean by growth rate. The average Stage 1 growth rate in earnings would be that same 5.70 percent. The growth rate in dividends, though, I believe would be less than that because the payout ratio over that period declined.

And so while the earnings may have grown at 5.07 percent, declining payout ratio means that dividends were slightly lower. So the actual dividend rate would be lower, but I don't know what that number is.

Q Okay. And the fact that you don't know what it is, does that suggest you didn't find that to be material?

A Not -- not in the least. It simply is a function of the calculation. And, again, I think that the way I developed the model has a degree of insight. I think that's important, which is to say that to the extent that companies or an industry may have changes in its payout ratio, I think is a very important consideration.

Q Okay. And what was the value for the transitional stage?

A Well, the transitional stage, again, moved from the -- from the short-term growth rate to the long-term growth rate. And so it's a -- it's sort of the -- it's the compound growth rate that moves from one to the other. It's not exactly linear, but it's pretty close.

Q Okay. Is there a single number you can give me?

A No. Because it changes each year.

Q Okay. And how about the long-term growth rate?

A The long-term growth rate is 5.67 percent.

Q Okay. And in the second multi-stage that you performed, the historical PE terminal value multi-stage model, what was the average growth rate that you used for the first stage in that model?

A The same construct.

Q Very good. And, again, are you able to tell me what the figure was for the transition stage?

A Well, once again, the transition stage goes from the average. Let's talk about the average of 5.07 percent to 5.67 percent on a pro rata basis -- well, on a geometric basis.

Q I understand. Thank you. And, again, you used 5.67 for the terminal stage; is that correct?

A Correct.

Q Thank you.

MR. THOMPSON: I have a question that is highly confidential.

JUDGE WOODRUFF: All right. We will go in-camera.

REPORTER'S NOTE: At this point, an in-camera session was held, which is contained in Vol. 27, page 1588.

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JUDGE WOODRUFF: And we are back in regular session.

MR. THOMPSON: Thank you.

Q (By Mr. Thompson) And I wonder if you were aware, Mr. Hevert, that one of the things that Ameren Corporation or Ameren Missouri does, excuse me, with respect to this Commission is to provide an integrated resource plan?

A I'm aware of many companies providing integrated resource plans, yes.

Q Okay. And would you be surprised to know that in the most recent integrated resource plan update provided by Ameren Missouri to this Commission, expected load growth over the next 20 years was estimated at .75 percent?

A That wouldn't surprise me. No.

Q Okay. Thank you. I wonder if you could tell me, sir, what a ring fence is?

A A -- well, ring fence is a -- a fairly generic term having to do with the ability to separate sometimes functionally, sometimes physically, sometimes contractually and sometimes administratively the actions of one affiliate from another.

Q Okay. And are you aware that Ameren Corporation owns unregulated merchant generation operation?

A I am, yes.

Q And are you also aware that its performance has not been good lately?

A Well --

Q Of course, that's in layman's terms.

A The same could be said for me. But I'm aware of the results. Yes.

Q The opinion has been expressed by Mr. Murray at least that Ameren Missouri's credit rating has been pulled down, to use a lay term, by the effects of the Ameren Corporation merchant generation operation. Are you aware of that testimony?

A I'm aware -- I am aware -- I am aware of that testimony, and I am aware that the Standard & Poor's as a matter of a process and practice, typically, looks to the consolidated operations when considering the rating agencies of a subsidiary affiliate. That, of course, is not necessarily the same approach as Moody's or Fitch.

Q Okay. So are you aware that the Ameren Board of Directors has considered ring fencing in order to reduce the drag of the merchant generation operation on the credit rating of Ameren Missouri?

A I'm not aware of that. But it would not surprise me.

MR. THOMPSON: Okay. I have no further

questions. Thank you.
JUDGE WOODRUFF: All right. We'll come up for questions from the Bench. Mr. Chairman?
CHAIRMAN GUNN: I have a couple. Thanks very much.
JUDGE WOODRUFF: Thank you.

CROSS-EXAMINATION

BY CHAIRMAN GUNN:

Q I want to follow-up just really quick on what Mr. Thompson just asked. I can't buy Ameren Missouri stock, correct?
A Correct.
Q It's just Ameren Corporation?
A Correct.
Q So when Standard & Poor's is looking at it, they're looking at it at the corporate level rather than the Ameren Missouri level. So they have to -- or at least they choose to take all the -- all the affiliates and subsidiaries, regulated and non-regulated into account when they're -- when they're doing the ratings?
A Well, I think from Standard & Poor's perspective, because they're a credit rating facility and their focus is on the fixed income investor, they look at specific operations of the -- the subject company, in this case, Ameren Missouri. But in the case of Standard &

Poor's, they do note and, in fact, typically, it's one of the first sentences that's in their report that says their opinion reflects the effects of the consolidated company.

Q I want to -- I want to look at -- take a look at this chart real quick. So Ameren's current allowed ROE is 10.2?

A Yes, sir.

Q So in the past year, has -- have the conditions improved or not improved, the market conditions?

A I think general market conditions have remained -- have remained uncertain. There are certain measures that have gotten a little bit worse. For example, we look at the -- what I refer to as the incremental credit spread, which is the difference between BAA and A stocks, which, in my view, represents the increment of risk that fixed income investors look at moving from a A to -- down to BAA.

And that's going up, so that suggests to me that over the past year, that incremental credit spread would suggest slightly higher degree of risk as viewed by the -- the fixed income investors.

Q And that's not offset by any decrease in cost of equity that you were describing before?

A Well, the -- I think the -- the interaction there is with respect to the Treasury rates because they both -- you can look at long-term Treasury rates and you could say, yeah, the -- the long-term bond rate is a matter of Treasury yields plus a credit spread. At least for the BAA companies, the credit spread does not necessarily stay constant, but has perhaps gone up a little bit.

The Treasury yields have gone down. And I think that's in part one of the reasons I would see and I've noticed a somewhat larger cost of equity, which is why I reflected my numbers downwards.

The question, of course, becomes, by how much? If the long-term credit has fallen by 120 basis points, is it reasonable to think that cost of equity has fallen 120 basis points? I don't think so.

Q So there's no explanation between that, but it does reflect some decrease in cost?

A It does. And that's why, again, I reduced my recommendation somewhat.

Q And -- and the ten-year Treasury yield has decreased significantly since the -- from the first quarter of 2010 to the second quarter of 2012, correct?

A It -- it has, as have the longer term maturity Treasuries.

Q All right. I want to -- I want to take you back to this -- the -- well, I think MIEC's exhibit. And this

-- this says that the -- makes an allowance in computing the average. Or at least mentions that.

Virginia seems to have unusually high -- or when taking into account the calculation, Virginia's Regulatory Commission allows premiums on the ROE if they hit certain targets.

A That's correct.

Q And they specifically mention that they don't think it's -- it's unusual enough for them to note and say, it -- it does skew the average higher.

A And I agree with that. And when I look at this data myself, I take out those returns because I -- I think that's fair. I don't think that looking -- or trying to sort of impute that -- that bonus, whatever it turns out to be, should be then reflected.

Q Now, you mentioned when -- in your cross-examination, there was one that you thought was unreasonably low, the 9.2 or 9.25?

A The 9.25, which was Northern State Powers of South Dakota, I believe, return, it was -- it was very low. My understanding is that, in that case, there was an issue as to whether or not certain renewable assets would be included in rate base. And there was an offset in terms of the offsets and the ROE to be included in the rate base. But even putting that aside, it was a low number.

Q But it wasn't low enough or wasn't unusual enough for Regulatory Research Associates to make a specific mention of it and say, This skews the average lower?

A Well, that's a really good question.

Q Well, the question is, it's not in this regulatory -- I'll get to the second question. I'll let you explain yourself.

A Okay.

Q But I just want to be clear. They don't mention it as an unusual event worth note that gives people pause when looking at the averages?

A In this report?

Q In this report.

A Right. Right. But Regulatory Research, of course, looks at the specific rate case outcomes in separate reports for specific rate cases. And I -- I don't know offhand, but it could well be that in their review of that particular case they did mention that.

Q Are you familiar with Edison Electric Institute?

A Yes, sir.

Q And are you familiar with their rate case summary reports that they put out?

A I do. And my understanding is that much of that is based on this same data source.

Q And Ameren is -- is Ameren a member of Edison Electric Institute?

A I don't know. But I would not be surprised.

Q It's the -- it's the Electric Utility Trade Association, essentially?

A Yes, sir.

Q All right. I have a financial update rate case summary from the first quarter of 2012 from the Edison Electric Institute. And I'm going to ask if any of the parties object to me asking a couple questions about this.

MR. BYRNE: No, your Honor. No, Chairman.

CHAIRMAN GUNN: Does everybody -- well -- and people can inspect it and see that I've printed it directly off of that. Everybody have any problem with agreeing that the information here is -- I guess you don't have to go as far as saying accurate, but you're free to cross-examine. But we'll at least for this point say that, for what it's worth, it's a relatively reliable source.

MR. THOMPSON: Would it be possible to eventually get a copy?

CHAIRMAN GUNN: And I can -- I can get printed copies for everybody.

MR. BYRNE: Yeah. I guess I'll agree -- I've never seen it before, but I guess I'll agree it's what Edison Electric Institute says.

CHAIRMAN GUNN: That's what I'm saying. Everyone agrees I'm not misrepresenting what Edison Electric Institute says, and I'll provide everybody a copy of this for everybody.

Q (By Chairman Gunn) But you're familiar with these reports?

A Yes, sir, I am.

Q All right. And you say it's based on -- and these two reports, there's not a lot of the subjective stuff that goes in here. In -- in EEI's report, there actually is some commentary.

A Right.

Q But a lot of this is just a reflection of what happened. It's not necessarily -- I don't want to say spinning or -- or -- or commenting on the numbers. Most of what it is saying is, Here's what the data says that we've seen in the last quarter.

A I -- I would agree with that. As you say, there is some commentary on some specific issues, but as to the data --

Q And I'll give you an example of the some of the commentary that is stated. So it says, for example, on page 1, Shareholder owned electric utilities filed 17

cases in Quarter 1 2012, which is a factual statement.

But then it follows up saying, A number consistent with the trend of rising rate case activity since the early 2000s. That would be an example of some of the commentary that they appeared in.

A Yes, sir.

Q But, again, even that is probably based on historical -- historical --

A I agree.

Q Okay. So I'm going to -- I'm going to read you a -- a paragraph, again, from page 1 and page -- and page 2. And it says, The average awarded ROE in Quarter 1 was 10.84 percent, which is slightly high -- I'm now stepping out of the quote and saying which is slightly higher than what the Regulatory Research Associates said.

And I'm going to go back to the quote. A jump upward from the level in recent years and the highest ROE for any quarter since 2005. And then, However, we do not believe the number indicates a trend change. Virginia Utilities settled five rate cases that reflect premiums earned from performance and other factors, skewing the reported average or the ROE upward.

If the Virginia cases are removed from the data set, the average ROE was 10.3 percent, a level much closer to that of recent quarters. The disparity is further

reflected in comparison with an averaged requested ROE which for Quarter 1 was 10.57. This is the first time in almost twelve years that the average requested ROE for a quarter was lower than the average.

That's probably more than necessary, but I wanted to make sure people didn't think I was reading anything out of context. So EEI also mentioned the Virginia skewing upwards.

A Right.

Q But they don't mention any other -- any skewing downwards in that, correct?

A I would agree with that. And I think that 10.84 number is the same --

Q It may very well be the same.

A Yeah. And it's got the same Virginia cases in there.

Q Now, Quarter 2, I have another EEI report from Quarter 2 of 2012. I'm assuming everyone feels the same way about it. They state that the average ROE in Quarter 2, 2012, was 9.92, a record low for recent decades. But they do mention -- well, I guess they don't mention -- they don't mention any specific rate cases that caused that to go down.

But they also note that the average regulatory lag for Quarter 2 shoots through the roof to 11.5 in that

quarter. And -- and -- and I'll say, too -- I'll read the quote. It says, Average regulatory lag for Quarter 2, 2012 was 11.4 months, well above the ten-month average for recent years.

During industry restructuring in the late 1990s and the early 2000s, the volatile regulatory lag increased and the duration rose to almost 13 months. Outside that period, regulatory lag has been fairly consistent at around ten months. Consequently, the increase in Quarter 2 is generally unwelcome news.

Then they go on to point out that why one of the reasons the regulatory lag has increased is because Hawaii had three cases during the quarter each lasting more than 20 months. Everybody here should be happy we're not in Hawaii.

MR. BYRNE: I'm not happy about Hawaii.

MR. LOWERY: Depends on the reason.

Q (By Chairman Gunn) As a regulated utility. Let me put it that way. Fair point. But they -- but they mention a reason why -- they specifically mention an unusual thing which skews those percentages upwards.

And, again, I'll -- I'll let everybody see these at the break or even afterwards to make sure that I'm -- I'm quoting that correctly. My point is that -- is that there is -- both Regulatory Research Associates as well as

EEI mention unusual events that caused that average to be -- to have upward pressure or to look higher than they believe it actually reflects what's happening, correct?

A With respect to the rate case lag?

Q Well, no. Well -- right. In regulatory -- in the regulatory assets, they mentioned Virginia and EEI mentions Virginia when it comes to rate cases.

A Correct.

Q There is no corresponding in any form, any rate case decision in the first quarter or the first two quarters of 2012, which the Regulatory -- Regulatory Research Associates covers as well. There is no corresponding -- no corresponding mention of a -- of a case that unusually would cause the average to skew lower.

A I don't want to speak for them. Oh, I'm sorry. In terms of your question, I agree with that.

Q My question is --

A Yeah. Agreed.

Q -- there is no mention in there that says that?

A Agreed.

Q Now, as to your point, there may be individual reports out there that I don't have that say, We think North Dakota or South Dakota, whichever one it is, is a really low ROE. But they haven't chosen to put it into their six month wrap-up of where -- where ROEs are. Fair

point?

A Fair point. But I think I may have a -- a sense of what's going on with that. When you look at the first quarter, as we mentioned, the Virginia case is where one, two, three, four, five of --

Q Seventeen.

A In the first quarter?

Q Actually, 25.

A Well, the RRA data has 12 cases that gave the 10.84 percent average. And of those 12, five were Virginia generation cases. And so, clearly, that would skew the results.

Q Well, but this says -- if you look at the first sentence on July 26th, it says, Average return on equity authorizing a utility in the first six months of 2012 of 10.36, 25 observations. So --

A For the first -- for the first -- I understand.

Q For the first six months, so --

A I'm sorry. I thought you said three.

Q So it's -- the Virginia cases account for five out of 25, not 5 out of 12?

A Correct.

Q And that's -- and that's what they point out, not -- not -- in the first -- EEI does it in the first quarter, but RRA does it within the entire six months?

A Agreed. Agreed.
Q All right.
A And RRA also breaks it out by quarter as well so you can look at the average. And then on -- and, again, I recognize your point that they speak to the first six months. But in that second quarter with respect to lag, you're right, you've got Hawaiian Electric, and you also have Arizona which has a pretty low --
Q Yeah. I'm not -- I'm not talking about lag because it's --
A Yeah. Understood.
Q We're talking about ROEs here. I just -- my -- my point is that EEI especially is consistent with RRA. I don't know -- I don't know -- and I -- although Ameren uses ROE, I don't know who makes up ROE.
A It's --
Q I don't know where they're coming from. EEI is actually the trade association for the electric utilities. So I would assume that what they would put out -- and while I believe they're -- they're very well-respected and I think they are, and I -- I have great respect for them, I would assume that if there was something that significantly caused that ROE number to be pulled down that they would mention it.
But, instead, what you have is basically a

statement against interest pulling out -- which I give them great credit for, which makes it look like ROEs are higher than they believe that they actually are.

A Right. And all I would say to that is whether you look at number of observations, even five and 25 will skew the result. One out of 25 might not affect the mean so much. Perhaps that's why they don't address that.

Q Fair enough. So let me ask you the question. When you're looking at -- it is much important and we're in the -- we're in election politics right, so people will tell you don't look at individual polls, look at the trends.

A Right.

Q And isn't -- isn't the same thing important here? It's not individual numbers. It's not individual ROEs that are being rewarded. You have to look at the trends?

A I -- I agree with that.

Q And the trend right now, for at least the past six months, is to see ROE awards either stable or going down?

A And that's what I say in my testimony.

Q Right. They're not going up?

A That's correct.

Q Okay. So -- thank you for that. All right.

Now, I'm going to move on to -- I'm going to move on to your proxy group, and I just have a quick question. So -- so you had -- in your original proxy group, you excluded Empire, Empire District?

A Correct.

Q And that was because they had suspended their dividend after the tornado?

A Correct.

Q But then in the -- in the revised proxy group, you added them back in because of the reinstitution of their dividend after a certain period of time being able to financially recover from the tornado?

A There were two factors. One is that they had reinstated the dividend. And the second was the expectation that it would not be suspended again in the future.

Q Fair enough.

A So it would be sustainable.

Q And my question isn't so much about that as much as what exactly -- because that's the only change in your revised proxy group, correct? That was the only company that was added in? There were no other revisions to the companies that you took?

A Correct.

Q What exactly was the effect of adding Empire

back in? How did -- how did your numbers change based on the adding in of Empire?

A Well, I may have -- I'm sorry.

Q That's all right. Take your time.

A I don't think it's specifically spelled out. It's certainly something that I can -- it is certainly something that I can calculate. But I don't know that I have it. I don't know that I say it in my testimony.

Q That's one of the reasons why I'm asking you.

A It's -- it's a good question.

Q And I'm by no means an expert, you know. I went to law school because there is no math on the Bar exam, and there is a lot of math. So I'm asking just for a little bit of -- of an explanation.

A I'm sorry. It's not in there. Although it certainly is a number that I can calculate.

CHAIRMAN GUNN: Okay. Well, all right. I'll ask that that number -- number be given to us at some point, maybe even -- I don't know when that's appropriate to do that.

MR. BYRNE: Sure. I -- Judge -- or, Mr. Chairman, here's what I was thinking about asking, and maybe this would be worth throwing out now.

You asked him a bunch of questions on those EEI reports, which I don't think he's looked at. I was wondering if we might take a break for lunch so he could read those and after that --

CHAIRMAN GUNN: Sure. Absolutely.

MR. BYRNE: I'm sure they're what you say they are, but maybe there's something else that would be relevant. And then we could maybe -- I don't know, Mr. Hevert. Can -- how hard is it to do that Empire calculation? Could you do it over lunch?

A I'll give it a try. Yes.

CHAIRMAN GUNN: Which I think it -- I will stop now. I think we can do the rest of the Commissioners, and then we can -- it will probably be just about time for a break or after if we can get everything else done and we can come back.

And by the way, if you don't feel comfortable doing it and you don't feel comfortable with how I've characterized this report, I absolutely want you to let me know that.

A I appreciate that.

CHAIRMAN GUNN: And we can -- we can deal with it at the time. I think it's an absolutely fair point. I sprung it on you. I asked the Judge if it was a problem. And I certainly want to give all the -- all the parties an opportunity to review these and make sure that how I -- how I described them is accurate and fair to all the parties.

So they're pretty short. They're within -- they're -- I think one is nine pages and one is ten pages. And most of them are historical -- it's historic data. So -- but they're right up here, and we can get a copy for everybody. I'll ask for the folks to start bringing down copies as we're doing it. So that's all the questions I have. Thank you very much. I appreciate your testimony.

A Thank you.

JUDGE WOODRUFF: Commissioner Jarrett?

COMMISSIONER JARRETT: Yes.

CROSS-EXAMINATION

BY COMMISSIONER JARRETT:

Q It's still morning. Good morning, Mr. Hevert.

A Good morning.

Q You also testified in the Ameren's previous rate case ER-2011-0028; isn't that right?

A Yes, sir, I did.

Q Okay. And are you somewhat familiar with the report and order that we issued in that case?

A Yes, sir, I am.

Q All right. In that case, we found that the national average allowed ROE was 10.3 percent.

A Yes.

Q What period would that have reflected?

A I -- I believe that was -- it was either the most recent six or twelve months. I don't recall which.

Q Okay. And you were here when Mr. Byrne gave his opening and he indicated that the current national average for ROE was around 10.2?

A About that.

Q Do you agree with that?

A Yeah. That's -- I think for the -- well, hold on one second. And -- and I know there are, depending upon the time frame as we're sitting here, depending upon the time frame that you choose and the companies that you include or exclude, it can be a little bit different over time. I'm sorry.

Yeah. I believe it's -- it's about 10.2. For some reason, I'm thinking I may have calculated 10.15 -- oh, here we go. The 12 months ended June 30th, 2012, I had calculated, and this is on page 4 of my rebuttal testimony, the average as being 10.15, but among the contiguous states, of course, there's only one, which was OG&E, and that was 10.2. So in that range.

Q So anywhere from 10.15 to 10.2? Is that what you're saying?

A For -- for the -- for the purpose of the -- the average that I calculated during that time. Yes.

Q Okay. I believe the average for the last

calendar year, 2011, was 10.22. Does that sound right?

A I -- I don't know offhand, but that does not sound off base.

Q Well, I'm just trying -- you know, because in the past, the Commission has used the zone of reasonableness.

A Yes, sir.

Q And I'm trying to get some specificity as to what we should use as the average to go 100 basis points above and 100 basis points below. Should we use 10.2?

A I think 10.2 is a good number.

Q Okay. Thank you. I wanted to ask a few questions about Exhibit 530, which is the RRA report. Do you still have that with you?

A Yes, sir. I do.

Q And just to be clear, and I think you cleared it up with Chairman Gunn, the data on page 4 is essentially the exact same data that's in the EEI reports. The 2012 first quarter average RR -- or RRA reports is 10.84, the same as the EEI?

A Correct.

Q And for second quarter, it is 9.92, the same as EEI?

A Yes, sir.

Q Okay. I want to focus on page 4, the 2012 rate

cases that are listed there. Now, you had mentioned, I think, in -- in some of the examination from -- I can't remember which attorney, but you had referenced Footnote B, which is on page 5. And what is Footnote B on page 5?

A Footnote B on page 5 relates to -- Footnote B on page 5 simply reads, Order followed, stipulation or settlements by parties. Decision particulars not necessarily precedent setting or specifically adopted by the regulatory body.

Q Okay. So now as I -- as I look down that list of electric companies, starting with Hawaii Electric Light Company, it has D by it. So does that mean that that was -- that was -- case was reached by settlement?

A Oh, I'm sorry. Here we are. Yeah. Excuse me. I think the -- there's either in total or in part reached by settlement. And that's -- that's part of one of the issues here where there's a stipulation, it could be a stipulation as to -- it could be a partial stipulation.

Q Okay. We don't know if that 10.0, for example, whether that was a settlement number or whether that was a number that was actually awarded by the Commission absent a settlement?

A That's -- that's -- that's correct.

Q Okay.

A And I'm sorry for hesitating. I should know this because I have filed testimony for Hawaii Electric, but I just can't recall whether that was a litigated or a settled number.

Q And, actually, if you look at -- at the list, seven of those, there was at least a partial settlement?

A Right. Right.

Q And like I said, we don't know on those ROEs whether that was a settled number or whether it was a disputed number that the Commission ultimately decided?

A That -- that's correct. And not -- not to interrupt. But that's why I like to use the -- I like to use a long period of history with lots of rate cases and look at these numbers relative to rates. So that's -- that's one thing, because it sort of takes out the effect of any individual case.

But -- but, on the other hand, there are partially stipulated amounts. We don't know what those stipulations may have related to. I agree with you on that.

Q Okay. I have a couple of questions on Exhibit 531, which is that estimate. It's also ROA but --

A Yes. I have that.

Q On the -- on the back page of that, the major rate case decisions from July 2012 to settlement 2012, you had mentioned -- I want to make sure I understood because

you had mentioned like, for example, PacifiCorp And it has a 9.8.

Is there any -- and this is from Utah. Is there anything unusual in Utah that we ought to consider in that 9.8 that might be different from Missouri?

A I -- I just don't know enough about Utah to be able to say.

Q What about Entergy Texas?

A In the -- excuse me. The only thing I would say about Texas is that it is considered by RRA and by Standard & Poor's to be among the least credit supportive jurisdictions.

Q Now, you had talked a little bit, I think, the -- what was it? There was one that was 9.25. It may not even be on this. I think it's on the other one.

A Yeah. There were -- there were -- there was two. There was a 9.25 for Northern States Power in South Dakota. And -- and then there is, although this was a distribution case, the Patomic Electric Power Maryland of 9.31 percent.

Q Okay. Well, there was one there was a difference of -- I think it was -- it was a difference because you said they were -- it was a punitive action because of the storm issues.

A That was the Pepco, the Patomic Electric case, 9.31. And you can see that it's exactly 50 basis points different than the -- the sister company, Delmarva Power & Light.

Q Now, is that -- is that what the order said?

A Yes.

Q That the ROE is 9.8, but we're going to penalize you 50 basis points?

A To that effect, yes. And the only thing I would say is that both of those reflect a 50 basis points reduction for the company's revenue decoupling mechanism.

Q Okay.

A So the top line number would have been 10.31.

Q Okay. Thank you. Going back to -- to 531, the back page, look that the charts on major rate case decisions.

COMMISSIONER JARRETT: No. I think I've asked all the questions I need, and I don't have any further questions.

JUDGE WOODRUFF: Thank you. Commissioner Kenney.

CROSS-EXAMINATION

BY COMMISSIONER KENNEY:

Q Good morning.

A Good morning, sir.

Q Can you pronounce your last name?

A It's Hevert, but I'm willing to go with whatever.

Q I will call you Mr. Hevert. Thank you. I have some questions. I want to start with some follow-up on some of the other questions that some of the other attorneys asked. And I want to start with your hourly rate, which you indicated was about $450 an hour?

A Well --

Q Is it a flat rate contract and you're computing what it would turn out to be per hour?

A It's the -- again, I -- I'm subcontracting on this agreement through Concentric. And I don't recall exactly what the hourly rate is. That's -- that's what it is through Concentric.

My rate with my new firm is lower than that. But on Concentric, that's what it is.

Q And are you paid the same to prepare your testimony to appear here in Missouri?

A Yes, sir.

Q And you were deposed in this case?

A Not -- not in this case, no, sir.

Q Okay. And would your rate have been the same had you been deposed?

A Yes, sir.

Q Okay. And then I looked at your direct

testimony, and it's got your -- your CV and it's got about nine pages of cases in which you've testified at FERC and various other State regulatory bodies. Is that list exhaustive?

A It's exhausting, but --

Q I didn't say that. But it was good reading. But I'm weird.

A Yeah. As of -- as of that time, yes.

Q Have you ever testified for a non-utility, so, for instance, on behalf of a ratepayer advocate or Office of Public Counsel?

A Not for those agencies, no, sir.

Q Any non-utility industrial consumers?

A No. Not that I can recall.

Q Okay. And you said you worked at a utility, too, right?

A Yes, I did.

Q So that makes -- that's fair enough then. Let me go back to some of the questions -- you were in the room when Mr. Martin was testifying about the credit reporting agencies and credit metrics and all that?

A Yes, sir, I was.

Q So you heard some of the questions that I asked?

A Yes, sir.

Q And would you agree with the assertion that in

assessing whether a particular regulatory body is credit supportive, Moody's, S&P and Fitch are only concerned with the mechanism by which the utility is able to recover its costs and expenses?

A Well, I think what they're -- what the rating agencies are focused on broadly is the utility's ability to meet its debt service obligations. And to the extent that there are mechanisms in place that improve that likelihood, improve that probability, then, yes, I agree that's a focus.

Q And you would agree that they are not -- by they, I mean Moody's and S&P and Fitch, they're not making assessments or judgments as to the prudence and reasonableness of the company's expenditures as that term is used in regulatory parlance?

A I -- I think that's generally true, although I could not speak to how they look at specific circumstances.

Q Okay. All right. And I just want to follow up on another question that you were asked -- Mr. Thompson was asking you about Mr. Murray and Mr. Gorman's qualifications. And you guys are all MBAs and CFAs, right?

A Yes, sir.

Q And he asked you whether you recognized

Mr. Murray and Mr. Gorman as experts. And you know responded that you recognized their credentials, which I think is slightly a nuance -- it's a nuance answer that I don't know was directly responsive to Mr. Thompson's question. Do you recognize Mr. Murray and Mr. Gorman as experts?

A I believe that they have experience and knowledge well in excess of a lay person. So yes, in that regard, I agree with that.

Q That they are experts?

A Yes, sir.

Q Okay. And then you were asked about whether an ROE below 9 -- or 10.25, which I think was the low end of your range --

A Yes.

Q -- whether anything lower than that would be confiscatory, and I think you indicated you're not a lawyer?

A Right.

Q You cited Hope and Bluefield in your testimony. And so you have some familiarity with the legal terminology that's used in rate cases and some of the legal standards, right?

A Yes, sir.

Q Would it be fair to say, however, that you don't

feel that you're legally qualified to offer an opinion as to whether Mr. Murray's ROE recommendations are confiscatory?

A From a legal point of view, I don't -- do not consider myself qualified.

Q And then many of the other questions that I was going to ask have already been answered and asked. And Mr. -- there is some testimony, and I don't remember where read it, but there's the distinction between cost of equity and return on equity. Are those two distinct terms that are -- terms of art that have distinct meanings?

A Well, what I would say is that I use them as the same. And, in fact -- in fact, on -- right in the front of my direct testimony I actually have a little footnote there saying that I use the two terms interchangeably. In my view, they're the same thing.

Q And Mr. Murray, you read his testimony, I'm sure?

A Yes.

Q He distinguishes between cost of equity and return on equity.

A He does.

Q And do you take issue with his distinction?

A I think for -- for this purpose what we're trying to do, which is understand the return required by investors, that the cost of equity is, in fact, the return on equity.

When you look at the methods that we use, which is that -- we look at data from thousands of investors in the process that they use to form prices. And we infer from that the return that they require. And that required return on equity, in my judgment, is the same thing as the cost of equity. So I do not see them as separate issues.

Q I want to talk a little bit about the construction of a proxy group. And the whole idea of constructing this proxy group is to try to put together a group of enterprises that are of similar risk, correct?

A Correct.

Q And that similar risk refers to the risk to the investor's capital. Is that -- is that the risk that we're trying to identify?

A Yeah. I think that's fair to say. We're trying to -- and I'll just back up one -- one quick step, which is to say that a lot of this cost of equity information is based upon the notion of opportunity cost, meaning the return you would get on one investment is the term that you forgo by not investing somewhere else as a similar risk. So in that perspective, yes, I agree with you.

Q So it's -- it's a term of economic art or charter financial analyst art and a legal term of art,

correct?

A I would agree with that.

Q And the enterprise's risk is a measure of its financial health as well?

A An enterprise's --

Q The measure -- the measure of an enterprise's risk can help you determine its financial health?

A I -- I think they're highly related. The company's financial health, both current and expected, would be a consideration in determining risk, so I think the two are moved together. Right.

Q And here I think a few days ago, we had a discussion -- and I don't -- I don't remember what context, but we were talking about the possibility that with constructing a proxy group comprised of solely electric utilities that you can get into an echo chamber of sorts where your ROEs are self-perpetuating, self-justified because you're looking at electric utilities.

Is it possible in constructing a proxy group for purposes of assessing ROE to identify enterprises of similar business risks that are not electric utilities?

A The -- I have seen people do that. I have seen people look at companies in sectors beyond utilities. And in order to do that, they'll look at parameters such as value lines -- safety ranking, value lines, financial safety rating, beta coefficients, credit ratings. And they'll use the expected return on equity of the proxy for utilities. That does happen, but not often.

Q You anticipated my question. My next question was going to be what are the mechanisms one would use to construct another proxy group not composed of electric utilities? And you said value line, beta coefficients and other mechanisms are other criteria that one could use?

A They are. They are metrics that people would consider, measures of investment risks.

Q Have you ever constructed a proxy group for an electric utility not comprised of utilities?

A No, I have not.

Q But you've seen it done?

A I've seen it done.

Q And would you say that to construct such a proxy group is consistent with your profession and would yield appropriate ROE?

A I'm sorry. Do you mean a proxy group beyond -- it -- it could. But the reason I don't do it is because, in practice, investors actually do look at separate sectors. And utilities tend to be a separate sector. And even within utilities, electric utilities tend to be a separate sector.

So what I try to do is look at the market the way investors would. And since investors do distinguish among various sectors in the economy, that's why I tend to focus on the utility sector.

Q For purposes of what we're doing here, though, do you think there would be value in doing that, not maybe as to supplant a utility, electric utility proxy group, but perhaps to supplement it?

A And I should say in the -- the circumstances where I've seen that approach taken, it was for that purpose, not just to supplant, as a supplement.

Q Oh, not to -- not strictly for regulatory purposes?

A Well, in rate cases in this type of application, I have seen -- I have seen people do that.

Q So you've seen it done, and it's not outside the main?

A I've seen it done. I'll be honest. I don't know how frequently it's accepted by regulatory Commissions, but I certainly have seen it applied in cases.

Q Okay. In your direct testimony, you ran a constant growth DCF and then one multi-stage DCF with one terminal?

A That's correct.

Q Okay. And then in your rebuttal testimony, you ran a second multi-stage with a second terminal value for the --

A That's correct. Yes.

Q And then Mr. Gorman also includes in his analysis a sustainable growth DCF model. Why would you not have done also a sustainable growth DCF model?

A I -- in my view, the sustainable growth model is problematic now for electric utilities because it -- it makes some assumptions that I don't think necessarily hold.

If you -- it assumes that when -- that the -- that the primary driver of growth is the amount of earnings retained and your expected return on equity. And there's another term, which has to do with the extent of shares that you receive and the book values of those shares.

But when you look at electric utilities, especially now, you have to, in my view, break apart that component, that retention, times the expected return on equity and see whether or not you think those are likely to remain stable over the coming period.

And as we talked about, I think payout ratios, which is sort of the inverse of -- of retention rate, are changing over time. And so you can't really assume that they're going to be stable over the next few years.

And when you look at the return on equity piece, the expected return, I think you see, also, that as utilities are in the middle of a capital spending cycle, the expected return is somewhat diluted by some of the investments that they make, for example.

So when you put those two things together, I think they become -- there's a lot of moving parts that result -- result in an expected growth rate that's low. And so, too -- and I think Mr. Gorman, you know, to his credit, he understood that and accepted that and did not give that result much weight.

Q So of all of the different methodologies by which one can calculate ROE, you also ran a CAPM and risk premium analysis. The DC -- putting aside what we've said in prior rate orders, because I know all of you guys comment on the fact that we've accepted it in prior rate orders. Putting that aside, independently of whatever any Commission has said, is it your opinion that -- that the DCF is -- well, let me state that differently -- that the multi-stage DCF methodology is the most accurate and reliable measure of ROE?

A I -- in my view, the multistage DCF allows you to really think about what's driving the numbers and allows you to make assumptions that are reasonable within that context. And so for that reason, these days, I -- my view is that that's a model that I -- I do tend to prefer.

Q So then if we -- I mean, the Commission was reaching its determination, the fight, so to speak, is in valuing the credibility of the inputs. Would that be fair?

A The -- I would agree with that. Yes.

Q All right. Let me ask a couple more questions about the regulatory environment. Now, you said in your direct testimony that you didn't make explicit adjustments for the regulatory environment, but you did take it into consideration?

A Yes, sir.

Q So can you -- can your consideration be quantified?

A I would be reluctant to quantify it. I think --

Q You marked this down for not being as credit supportive as maybe somebody else in another state.

A I -- I think so. But the -- when I look at the -- where the recommendation wound up, both in my direct testimony and subsequently in the rebuttal testimony, it's at the mid-point of the range and then toward the lower end of the range.

And so I do think it's a consideration. And I do think that when you look at, for example, what some of the rating agencies have said, that is something to be taken into account.

Again, though, I think it's fair and appropriate to recognize that over time the Commission has instituted some policies and designs that have been helpful to the company. And I think that, likewise, needs to be taken into consideration.

Q And -- and so -- and you mentioned the credit rating agencies. When you use the phrase credit supportive, you're using it in the same fashion, with the same meaning as the credit reporting agencies would use as well?

A Yes, sir.

Q And so, again, I think we already established when assessing credit supportiveness, they're only looking at cost recovery mechanisms and the utility's ability to recover their costs, not just necessary or reasonableness or prudence of expenditures, right?

A Well, I think -- right. Yeah. From the perspective of Moody's, you look at mechanisms that are in place. And I think in large measure -- well, two things happen. One is you're able to get a sense to which those mechanisms may improve the specific metrics.

They've talked about this morning the cash flow coverage metrics, and then there's the more qualitative assessment that Moody's would make that also factors in to the assignment of the eventual credit rating. So there's, I think, really those two parts.

Q They're not looking at just prudence of the expenditures as we use the term, as regulators would look at the prudence of the expenditures?

A Yeah. I think the -- generally, not perhaps, on a case specific basis, they might.

Q And then I think you heard Mr. Martin testify that Moody's is the most transparent in putting forth the criteria that they use and their credit metrics?

A Yes.

Q Would you agree with that?

A I would.

Q So another expert, another financial analyst, could take their ROE recommendation and plug it into Moody's formula and see if their ROE recommendation would still lead to a particular credit rating?

A Yeah. The -- the only issue there is that --

Q I mean, they can do that, right?

A They could. But it's -- because the metrics themselves cover -- I don't want to say a wide range, but there's a range over which the metrics will fall and still relate to a specific ratings category.

And as you -- as you go through the calculation to see what would happen on a proforma basis, you can have fairly wide ranges of assumed cost equity ROEs that would satisfy those criteria.

And I think, in large measure, that's partly why rating agencies such as Moody's explicitly recognize that there's a qualitative aspect to assigning the ratings.

Q So you wouldn't necessarily be able to produce the exact result that a Moody's analyst would produce, but could you get a general idea?

A I -- I think that's fair.

COMMISSIONER KENNEY: I don't have any other questions. Thank you.

A Thank you.

JUDGE WOODRUFF: Commissioner Stoll?

COMMISSIONER STOLL: I have no questions, your Honor. But I do want to thank Mr. Hevert for his testimony.

A Thank you.

JUDGE WOODRUFF: Commissioner Jarrett? You had something else?

COMMISSIONER JARRETT: Yeah. I'm sorry. Just real quick, a couple quick questions.

RECROSS EXAMINATION

BY COMMISSIONER JARRETT:

Q Your range is from 10.25 to 11?

A Correct.

Q If we ultimately decide anywhere within your range, would you consider that to be reasonable?

A Yes, sir.

Q Okay. The second thing, I wanted to flesh out just a little bit from Commissioner Kenney's questions and your answers about using companies and proxy groups that are not electric utilities. And you indicated you had seen that in a few cases. Can you tell us which Commissions have done that in your experience and when they did it?

A Well, I -- I guess that's the thing. I've seen witnesses use it, but I'm not sure that I've seen Commissions necessarily embrace that approach.

Q Okay. So you're not aware of any Commission that has actually embraced that and used it in making a decision?

A I am not aware of that. Correct.

COMMISSIONER JARRETT: Okay. Thank you.

JUDGE WOODRUFF: Commissioner Kenney?

RECROSS EXAMINATION

BY COMMISSIONER KENNEY:

Q Are you aware of any Commission that has explicitly rejected it?

A I can't think of that offhand. No.

COMMISSIONER KENNEY: All right.

JUDGE WOODRUFF: All right. And then we will break for lunch now, and we'll come back at -- let's say at 1:30.

MR. BYRNE: I have something, Judge.

JUDGE WOODRUFF: Okay. We're on the record.

MR. BYRNE: We had committed to take Ms. Ferguson out of -- out of order, and we talked about taking her after lunch. I think given the fact that we've got to go to calculate things and read things, it might be a good use of the Commission's time to take Ms. Ferguson immediately after lunch.

Obviously, I'm going to miss the baseball game no matter what happens, but --

COMMISSIONER GUNN: Not necessarily.

MR. BYRNE: But anyway, that's what I would suggest, that after lunch we take Ms. Ferguson and go back.

JUDGE WOODRUFF: Anybody have a problem with doing that? That's what we'll do, then, and then we'll have Mr. Hevert -- Hevert back after we're done with Ms. Ferguson.

MR. THOMPSON: Thank you, Judge.

JUDGE WOODRUFF: All right. We are on break now till 1:30.

(Break in proceedings.)

JUDGE WOODRUFF: Let's come to order, please. We're back from lunch, and I believe there's been some changes in the plans. Mr. Byrne, do you want to explain what's going on?

MR. BYRNE: Yes. We had talked about before the lunch break taking Ms. Ferguson, but Mr. Hevert has a flight that he might miss if we do that. So the parties have generously agreed to let us finish up with Mr. Hevert, and then we would take Ms. Ferguson after that.

COMMISSIONER KENNEY: You don't want to stay here with us?

A I would love to, but my wife would be angry.

COMMISSIONER GUNN: Fair enough.

JUDGE WOODRUFF: Okay. Well, we are at the moment on questions from the Bench for Mr. Hevert. And, Mr. Chairman, you had some documents you wanted to offer?

COMMISSIONER GUNN: Did the parties get a chance to review -- review these documents?

MR. BYRNE: Yes.

CHAIRMAN GUNN: Was it a fair representation what I said? Does anybody have any comments about what I said or any corrections or --

MR. BYRNE: We believe it was a fair

representation of what you said.

CHAIRMAN GUNN: Does anybody object -- anybody object to these being marked as Commission's A and B and entered into the record?

MR. BYRNE: No. No objection.

MS. BAKER: No.

CHAIRMAN GUNN: Judge, I'd like to offer these two documents, Quarter 1, 2012 Financial Update from EEI as A, and Quarter 2, 2012 Financial Update Rate Case Summary as Commission Exhibit B.

JUDGE WOODRUFF: All right. Commission Exhibits A and B have been offered. Any objections to their receipt? Hearing none, they will be received.

(Commission Exhibits A and B were offered and received into evidence.)

JUDGE WOODRUFF: And I believe there was a question you had pending before the break as well that the witness was going to try to answer.

RECROSS EXAMINATION

BY CHAIRMAN GUNN:

Q The witness was going to try to do a calculation. I asked about what effect the inclusion of the Empire District Electric Company had on his calculations.

A It turns out that I had done that calculation in

-- in the testimony. It is actually on page 93 of my rebuttal testimony. And including Empire in the group is -- 14 to 15 basis points is the effect. And that's based on the multi-stage approach, which, as we talked about, is the approach that we primarily focused on.

Q Can you point to the line? It's on page 93 in your rebuttal testimony. Is that 6 through 9? No?

A No. I'm sorry. There's a table. Table 15. And it would be -- and it would be the difference between Step 3 and Step 2. So 9.56 less 9.42.

Q Got it. And that starts on Line 4 on page 93?

A Yes. Correct.

CHAIRMAN GUNN: All right. Thank you very much.

JUDGE WOODRUFF: Anything else?

CHAIRMAN GUNN: No. I don't have anything else

JUDGE WOODRUFF: Okay. Then we'll move to questions -- recross based on questions from the Bench, beginning with MIEC.

RECROSS EXAMINATION

BY MS. ILES:

Q Mr. Hevert, in response to Chairman Gunn's question just now, you pointed to page 93 of your rebuttal testimony where you made that adjustment -- made adjustments to Mr. Gorman's multi-stage DCF model, correct?

A That's correct.

Q And you also make the same adjustments to his constant growth DCF model, and I believe that's -- those calculations are shown on page 79 of your rebuttal testimony?

A Yes. That's correct.

Q And the -- the effect of including Empire Electric -- Empire District Electric Company in the proxy group would be the difference between Step 2 and Step 3 on that chart, correct?

A That's right.

Q Which is 32 basis points, right?

A It is for the constant growth. But, of course, again, we talked about -- we could have done the calculation for all of the methods. But because we focused on the multi-stage, that was the basis of my response.

Q Okay. I understand. I just wanted to make clear it's different depending on the methodology.

A I agree with that.

Q Okay. Then another question in response to Commissioner Jarrett's questions, he pointed out, I believe, and you may recall, that in Exhibit 4 -- or 530, the RRA from -- showing the major case -- major rate case decisions from January through June of 2012.

But according to the footnotes on page 5, which relate to the numbers shown on page 4, the Footnote B shows that some of those ROEs were set in cases that involved settlement, correct? Do you recall that --

A Yes, I do.

Q -- those questions? So in your experience in working on rate cases, isn't it true that rate cases frequently are either partially or fully resolved through a stipulation?

A As a -- as a general proposition?

Q Yes.

A Is your question are certain aspects of any given case settled rather than fully litigated?

Q Right. They -- they are, aren't they? I mean, they're -- it's not unusual -- I mean, obviously, just looking at this chart, that B footnote shows up on a lot of those decisions?

A Yeah. And I think we talked about that this morning.

Q Right.

A So I would agree with that.

Q Right. I didn't think that was controversial. Also in your experience, I mean, in trying to figure out, well, what does that tell us about the ROE, we know that if a company has entered into a stipulation that involves

the ROE, wouldn't it be reasonable to assume that they consider whatever settlement they're entering into as a fair -- a fair return for them?

A Well, I -- I think the company would take into consideration the -- the give and take involved in -- in settlement. And so there would be aspects of the case that, that they perhaps trade off for something else. But on balance, the company would consider the totality of the outcome to be reasonable.

Q Right. But there wouldn't be any reason necessarily to assume that because there was a partial or full stipulation that those ROEs are unusually low or lower than they would have been had the Commission issued a decision?

A You know, I can't answer that because, as we said, the stipulation, settlements typically involve some give and take. And as to what the ROE would have been absent that give and take, I think it's hard to say.

MS. ILES: All right. That's all.

JUDGE WOODRUFF: And from Public Counsel?

MS. BAKER: No questions. Thank you, Mr. Hevert.

JUDGE WOODRUFF: Okay. For Staff?

MR. THOMPSON: Thank you.

RECROSS EXAMINATION

BY MR. THOMPSON:

Q Mr. Hevert, you'll recall that Commissioner Jarrett was asking you about the numbers in the RRA report, and you agreed with him that with respect to 2011, the average, the 10.2 is a good number, I think was what you used, the words you used? Do you recall that?

A Yes. I recall that.

Q Okay. Do you recall the RRA regulatory focus there, Exhibit 530?

A I'm sorry. You said that 2010 -- I'm sorry. Could you repeat your question?

Q I thought that you told Commissioner Jarrett that 10.2 was a good number for 2011.

A See, I -- I thought that question had to do with the 12 months ended June 30th, 2012.

Q Well, there was a question about that as well.

A Okay.

Q What I wanted to direct your attention to is that paragraph that you were asked to read by Ms. Baker on the first page of Exhibit 530 where it talks about excluding the Virginia surcharge rider generation cases.

A Yes. I recall that.

Q And it says that with those excluded, the average authorized electric ROE was 10.05. Did I read that right?

A Which exhibit was this?

Q Exhibit 530, the Regulatory Focus for July 6th, 2012.

A Right. And this would be the first paragraph?

Q First paragraph on the first page. And I have a copy of it if you need it.

A Oh, no. I've got it right here. Thank you, though. Yes. I'm sorry. Yes, there is.

Q Okay. And don't you agree that 10.05 is a better number, at least for the period under consideration there?

A Well, I think the 10.05 does -- as I said earlier, what I have done, which is to exclude for the purpose of -- for the limited purpose of looking at the average authorized return, the generation cases in Virginia. So it's -- which is not to say there's not information in those cases. But for the purpose of this calculation, I do exclude that and I agree with that.

Q Okay. Then to follow up on a question that Commissioner Kenney asked you, whether or not cost of equity and return on equity are the same thing, do you recall that question?

A I do.

Q And you indicated that you thought, for the purpose of what we're doing here, they were the same thing

since you're attempting to calculate the return required by investors.

A Yes.

Q Okay. But there's another way to look at that cost of equity, isn't there? Just -- in other words, in the same way that with return on equity, there is, in fact, the company's objective earned return on equity that can be deduced from its operations, the results of its operations, isn't there an objective return -- or cost of equity that can be deduced?

A I'm sorry. Are you suggesting that the accounting return on book equity is the same thing as the market required return on common equity?

Q I'm suggesting it's a different way of looking at return on equity. Don't you agree?

A I think that what you're suggesting has been often referred to as the comparable earnings approach, which is an approach that really has not been given much traction recently. I don't think comparable earnings is a -- a way of estimating the -- the return for two reasons.

One is it's historical. It's backward looking. We're looking forward. And we're trying to understand what the return will be and what the required return on the market is going forward.

And in so doing, we use market-based data as opposed to accounting-based data. So I think those two distinctions, the use of market versus accounting based data and using forward versus backward looking data are two reasons why I don't think using historical earned return on book equity is an appropriate method.

MR. THOMPSON: Thank you. No further questions.

JUDGE WOODRUFF: All right. Redirect?

REDIRECT EXAMINATION

BY MR. BYRNE:

Q Mr. Hevert, just real quickly, Chairman Gunn asked you some questions about those EEI reports that had been marked as exhibits. Did you get a chance to look at those over the lunch hour?

A Yes, I did.

Q And, you know, was what Chairman Gunn represented about those reports basically a fair representation?

A Yes. I think it's a fair representation. It's fact-based. There's some commentary, as we discussed, but on balance, it's generally fact-based analysis.

Q Okay. You -- earlier this morning, you were given some exhibits by Ms. Iles, and I'd like to go through them if I might.

The first exhibit she gave you was 529, which says Cost of Capital Analyses, Changes Since Ameren

Missouri's -- Last Ameren Missouri Rate Case. Can you see that one?

A Yes, I do.

Q Okay. And -- and as I understand this exhibit, at the top, it shows the results of your constant growth DCF from the last rate case and it compares it to your position on -- in your direct testimony and your position in your rebuttal testimony, and then it calculates the difference; is that correct?

A Yes. That's correct.

Q Let me ask you, first of all, are you primarily relying on your constant growth DCF analysis?

A No. As we discussed this morning, most of the witnesses in this case -- I think we all give considerable weight to the multi-stage and not so much the constant growth model.

Q And, I mean, what's wrong with the constant growth model?

A As we said, the constant growth model is really subject to a number of limiting assumptions. And to the extent those assumptions do not hold, in reality, they can give you biased and unreliable results.

And in my view, when the market is this volatile, when you see results change that much over a short period of time, you have to wonder the extent to which those assumptions play into that change. And -- and I think that's in large measure, again, why we tend to give more weight to other forms of the model, the multi-stage form of the model instead of this one.

Q I mean, to the extent that that -- I guess, basically, it shows from your last rate case recommendation on the constant growth DCF model until your rebuttal, there's a -- looks like a 91 basis point difference; is that correct?

A That's correct.

Q Does that suggest that Ameren Missouri's cost of equity is 91 base points lower than it was last time?

A No. As I said this morning, I don't disagree that the cost of equity has fallen somewhat, but, certainly, not 91 basis points worth.

Q Okay. I guess the same -- I guess the lower part of the exhibit shows declines in A rated utility bond yields and BAA rated utility bond yields. And it looks to me like -- well, this doesn't tie to your testimony, but it looks to me like what they're trying to show is during the period when the rates were set in the last rate case until, I guess this last summer, there's been a decline in bond yields; is that true?

A That's what this shows. Yes.

Q Okay. And, I mean, does that suggest to you

that there's a comparable reduction in Ameren Missouri's cost of equity?

A No. Again, for two reasons. One is, as I mentioned earlier this morning, when you look at the composition of that return, Treasury yields and the credit spread, you'll see that, in fact, when you're looking at BAA bonds, for example, the credit spread has increased over the past year.

So while the -- the Treasury rates has fallen, the credit spread, the increment required by investors to be compensated for the risk, has actually gone up. And in my view, it's important to look at both of those things.

I recognize the Treasury yields have fallen. But it's also important to understand that the incremental return required spread over Treasuries has somewhat gone up. That of course, extends to the cost of equity as well, the equity risk premium having gone up even as -- especially as Treasury yields have gone down.

Q So does Exhibit 529 tell you anything about the magnitude in any change on return on equity between the last case and now?

A I don't believe so. No.

Q Regulatory Focus, which is Exhibit 530, Ms. Iles marked and put in the record. That's the major rate case decisions from RRA from January the -- through June of

2012; is that correct?

A Yes.

Q I wanted to ask you a couple of questions. First of all, there's been some discussion about how the actual results for the first six months of 2012 were 10.36 percent. But then that was adjusted down to 10.22 percent to take out these Virginia decisions; is that right?

A Yes. That's correct.

Q And my understanding is all of your analyses takes out the Virginia decisions; is that right?

A It does. Yes.

Q And that chart, for example, that we have up on the easel, that excludes the Virginia decisions, doesn't it?

A Yes, it does.

Q Okay. And my question is, is there any -- is there any value -- is there any value to looking at the Virginia decisions in addition to the other decisions?

A Well, I think the -- the Virginia decisions -- well, I'd say for the sake of consistency, I did take them out of all of my analyses. And I think it's appropriate to do that.

But when you look at the Virginia decisions and you recognize that what the Commission has done is to provide an incentive for in-state generation. So the

Commission essentially identified a -- a public objective and developed incentives in order to meet that public objective, which is in the form of the premium allowed on the rate of return.

Q And -- and are those some of the same issues we're struggling with in Missouri?

A Yes.

Q Okay. I notice -- if you look on page 4 of the exhibit that has the electric utility decisions, the -- I guess it's the first and second quarter both. And I -- Chairman Gunn asked you about the whole -- a question about Hawaii, and I think there is a 20-month -- you know, there was a 20-month period of time for the rate case. Do you recall that question?

A Yes, I do.

Q But I noticed that the decision on Hawaii has an I by it. Do you know what I means?

A The -- the footnote -- the I indicates that interim rates were implemented prior to the issuance of the final order.

Q And -- and does -- would interim -- is there any relationship between interim rates and the length of the regulatory process?

A Well, the longer the process, the -- the more detrimental it would be not to have interim rates put in.

The lag would be extraordinary. The interim rates, of course, is a way of mitigating that.

Q Do you know about any other -- any other things about Hawaiian regulation or any aspects that are relevant to that in Hawaiian regulation?

A Well, Hawaii Electric -- and I believe Maui as well have, for example, decoupling mechanisms which decouple the revenue from usage. And in addition, they have a -- a revenue adjustment mechanism and a combination of those two things are, in some sense, the functional equivalent of a formula rate plan such that revenues are meant to be separated from volumes and, at the same time, expenses are subject to an increase, a formula increase outside of the context of a full rate case proceeding.

Q Okay. I noticed, you know, one of the footnotes -- by some of these footnotes is D. can you tell me what D is?

A D means that it applies to electric delivery only, so these are companies that do not have generating access.

Q When you do your averages, do you include or exclude the D companies?

A We're focused on vertically generated companies that own generation as well as distribution. I tend to exclude the distribution only companies.

Q And why is that?

A Well, because the Commissions that have jurisdiction over those companies typically view them as being less risky than vertically integrated companies because they don't have generation and the operating regulatory financial risk associated with generating assets.

Q I believe Commissioner Jarrett asked you about the 2011 returns. Do you recall that?

A Yes.

MR. BYRNE: I'd like to mark an exhibit if I could.

JUDGE WOODRUFF: All right. Your next number is 69.

Q (By Mr. Byrne) Can you identify that exhibit, Mr. Hevert?

A This, again, is a Regulatory Research Associates report, and it's major rate case decisions for calendar year 2011.

Q And the first page, what does it show for the average return for electric utilities?

A On the first page, it says the average return on equity authorized electric utilities was 10.22 percent.

MR. BYRNE: Okay. Your Honor, I'd offer that exhibit.

JUDGE WOODRUFF: Exhibit 69 has been offered. Any objections to its receipt? Hearing none, it will be received.

(Exhibit 69 was offered and received into evidence.)

Q (By Mr. Byrne) Okay. I'd like to talk to you about Exhibit 531, which was S&L RRA data for the third -- I guess it's for the third quarter. It's the single page document. And do you have that?

A Yes, I do.

Q Okay. And I think there's -- there's a list of all the companies. I think it's electric and gas companies, distribution and non-distribution. And I think there were only a handful of companies that you identified that were electric, fully integrated. Can you tell me what those are?

A Those were PacifiCorp, Entergy Texas, PacifiCorp again and Oklahoma Gas & Electric.

Q Okay. And I think you said Entergy Texas -- well, what was the -- Entergy Texas got a 9.8 percent return on equity. Do you have any explanation for that?

A Well, the one observation I would have, again, is that Texas typically is considered to be among the least credit supportive jurisdictions.

Q How -- how about the PacifiCorp Utah decision?

Do you have any knowledge about that?

A Well, I think as we were talking about just a bit earlier, the PacifiCorp decision was a settlement, and it's my understanding it was -- involved a multi-year settlement. It involved the deferral of some substantial investments.

And so there were elements of the case that, again, would be beneficial to the company as part of the entire settlement and as part of the -- of the overall case.

Q I -- I think -- well, do you remember -- or maybe could you -- could you tell me if you don't remember what the average of integrated electric utility returns on equity for the quarter was? I think it was 9.9 percent; is that right?

A It was 9.9. Correct.

Q All right. And do you have any -- I mean, is there any issue with relying on a single quarter of data with a handful of data points in it?

A Well, I think any analysis where you're trying to understand some measure of central tendency is -- relies on more data than less. And I think in a circumstance where you have four observations, I think it's hard to draw conclusions from that regarding the level of returns, the level of required returns overall for the electric utility industry.

Q I mean, do you know if this Commission has typically relied on a single quarter's worth of data, or have they looked at longer periods of time?

A My -- my recollection is the Commission has looked at six and 12-month periods.

Q Okay. Commissioner Kenney asked you some questions about the idea of having a proxy group composed of non-utility companies. Do you remember that question?

A Yes, I do.

Q And I think that ties in with an issue that's come up before, which is the idea that if you use utility companies in the proxy group, you're -- you're sort of engaged in a circular exercise. Do you -- do you know what I'm talking about?

A I do.

Q And -- and could you address that? Is there a problem with circularity when you use utility companies in proxy groups?

A Well, it -- it is not an issue that concerns me for this purpose, really, for a couple of reasons. One is that, just as a factual matter as we've been noticing today, the numbers have been drifting downward.

And if there were sort of a self-perpetuating cycle, you would imagine that there would be no such drift over time. But we have seen the numbers come down. And as I've said, even based on my analyses, I've suggested somewhat of a downward drift. And I think those two things are consistent.

But when I look at the way Commissions typically arrive at authorized returns, they are market based, use the same methods that we use here. So Commissions will look to the same types of models, the same types of data.

By necessity, you have to use proxy groups because you cannot rely -- for the reasons we talked about a minute ago, you can't rely on a single company. There could be all sorts of the anomalies that would be in the data that could significantly skew your result.

And you also have the issue of opportunity cost and comparable risk, comparable return standards. So it's important to use proxy groups in developing the cost of equity. But the methodologies are market-based.

And I think the other important consideration is that it is an observable data point that is of value to the financial community. Investors notice it. It's the reason that Regulatory Research Associates publish this data.

So it's information that's noted, relied upon by the financial community. But at their core, these decisions really are market-based decisions.

Q If you look -- and I know you're saying currently there's a -- there's a drift downward that's being reflected. But if you look back in history, have utility commissions increased and decreased authorized returns on equity as market conditions change?

A They do.

Q And -- and so, for example, what were returns on equities back in the late '70s and early '80s, if you know?

A Well, certainly much higher during periods of higher inflation. Higher long-term interest rates, for example, they were higher then.

Q How about in the '90s, if you know?

A Same thing. The returns in the '90s were in the mid 11, close to 12 percent range.

Q Okay. You -- you talked a little bit to some of the Commissioners about the impact of having or not having regulatory mechanisms in your rate, return on equity analysis. And I think you said, you know, since maybe there are fewer of them in Missouri, you took that into consideration, but it wasn't -- you couldn't particularly quantify it. Do you remember the -- that discussion?

A Yes, I do.

Q And I guess what I wanted to ask is about a particular mechanism and whether you took it into account

when you estimated your return on equity. And that is what Ameren Missouri's requesting in this case, which is plant in service accounting. Is that taken into account in your return on equity estimate or not?

A It is. And, again, going back to the notion that estimating the cost of equity is a comparative analysis, when you look at the type of mechanisms that are in place, the ability for some companies to include construction work in progress in rate base and earn a current return on it or to use a forecasted -- fully or partially forecast test year for the purpose of developing the rate base, those are elements that serve the purpose of trying to have companies address the dilutive effect of making substantial capital investments between rate cases.

And so when you look to the fact that a lot of these companies have that ability or have such mechanisms, by comparison, in my view, the plant in service accounting structure is not incrementally risk mitigating. It does not bring the cost of equity down.

Q So how many basis points of adjustment should the return on equity be adjusted downward if -- if Ameren Missouri gets plant in service accounting?

A None. Again, because the other -- the proxy companies have the ability in large measure to -- to have those types of mechanisms available to them.

Q I think in response to one of the Commissioners' questions, you were talking about using Value Line, Zack's, First Call growth rates for your constant growth analysis, and you -- and you mentioned using the mean or the median. Do you recall that?

A Yes.

Q When would you use the mean, and when would you use the median?

A Well, the -- the median, of course, is a number that takes into account the effect of outlying observations, numbers that are very high, very low relative to the average.

And so to the extent that there's significant outliers, you would use the median as opposed to the mean.

Q And if there are not significantly outliers?

A Typically, the mean.

Q Mr. Thompson asked you -- well, I'm not even sure if it was Mr. Thompson addressed it in his opening statement. Someone asked but, you know, at what points rates become confiscatory. Do you recall those questions?

A I do.

Q And I guess my question to you is -- I know you're not a lawyer, but do you think this Commission should set Ameren's Missouri's return on equity at the edge of legal confiscation?

A I think that would be -- I think a rate that's so low to be considered, as you describe it, at the edge of confiscation would be -- would put the company in a difficult financial position.

Again, we have to remember that the return on equity is important, not only for the purpose of providing a compensatory return to shareholders, but also for the purpose of maintaining the company's financial integrity and, therefore, enabling its access to the capital markets. So I think for those reasons we have to be very careful along those lines.

MR. BYRNE: Okay. Thank you, Mr. Hevert.

JUDGE WOODRUFF: Mr. Hevert, you can step down and get on your plane.

MR. HEVERT: Thank you so much.

CHAIRMAN GUNN: Thank you

JUDGE WOODRUFF: All right. It's my understanding, then, we're going to move on to Ms. Ferguson on severance cost.

MR. THOMPSON: That's my understanding, Judge.

JUDGE WOODRUFF: Are we going to do openings on that issue now or wait Tuesday to do that?

MR. LOWERY: I'm not going to do one because I'm not prepared to do one.

JUDGE WOODRUFF: Okay. That's fine by me. Go ahead and bring Ms. Ferguson up, then. Good afternoon.

MS. FERGUSON: Good afternoon.

JUDGE WOODRUFF: Raise your right hand, and I'll swear you in.

LISA FERGUSON,

being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified as follows:

DIRECT EXAMINATION

BY MR. THOMPSON:

JUDGE WOODRUFF: Thank you. You may inquire.

MR. THOMPSON: Thank you, Judge.

Q (By Mr. Thompson) State your name, please.

A Lisa Ferguson.

Q And are you the same Lisa Ferguson that contributed to the Staff revenue requirement cost of service report and also prepared or caused to be prepared surrebuttal testimony designated as Exhibit 232-HC?

A Yes.

Q Is that all your testimony, or did I miss a piece?

JUDGE WOODRUFF: 232NP.

Q (By Mr. Thompson) 232NP?

A I'm sorry. I believe that's all.

Q Okay. Do you have any corrections to any of that testimony?

A I do not.

Q And if I asked you those questions today, would your answers be the same?

A Yes.

Q And is the information contained in those pieces of testimony true and correct to the best of your knowledge and belief?

A Yes.

MR. THOMPSON: At this time, your Honor, I will offer Exhibits 232 and 233 and tender Ms. Ferguson for cross-examination.

JUDGE WOODRUFF: 232 and 233 have been offered. Any objections to their receipt? Hearing none, they will be received.

(Exhibits 232 and 233 were offered and received into evidence.)

JUDGE WOODRUFF: Cross-examination, we begin with MIEC.

CROSS-EXAMINATION

BY MR. DOWNEY:

Q Good afternoon, Ms. Ferguson.

A Good afternoon.

Q I'm Ed Downey. I represent the MIEC. Since we did not have opening statements, could you just briefly tell us what the issue is that we're addressing this

afternoon?

A Sure. We're addressing VS11 severance costs. These were severance costs that were incurred by the company in the end of 2011. The severance costs -- the Staff considers them to be non-recurring costs. And we consider them non-recurring because we -- we can't tell or predict them in the future. They're irregular costs that don't happen on a regular basis.

That being said, there's usually two occurrences where Staff would allow a non-recurring cost. And one of those would be where there is an act of God and the company can recover those costs through an AAO.

The other is -- is if a company incurs a large amount of costs upfront in order to have future costs, which is what's happening in this case.

If they -- what we usually do is we allow the company to have a chance to recover those costs. If they do not recover those costs, we give them an ability to recover those costs as long as they have an added cost recovery through amortization?

In this case, the company has recovered their costs by the effective date of rates, and I believe anything that we would consider giving them in future rates would be considered double recovery.

Q Okay. What is the amount of these voluntary

separation 2011 costs?

A They're $25.8 million.

Q Okay. And have you calculated the resultant cost savings through the operation of law date, which would be January 2nd of 2013?

A Yes, I have.

Q And let me ask you a question. Is this a highly confidential number?

A I'm under the understanding that the total amount is not, but the individual numbers might be; is that correct?

MR. LOWERY: The total number is not.

Q (By Mr. Downey) Okay. would you tell the Commission what the cost savings were or what they're expected to be by that date?

A What I have calculated --

Q Yes.

A -- as cost savings? Yes. I have calculated approximate cost savings of $26 million.

Q And is that a conservative number?

A Yes, it is.

Q Would you explain what you mean?

A This number includes only the amount of payroll, the payroll taxes, and the benefits that are comprised by the employees that left. And I -- I originally had a -- a more general calculation. I have since then refined my calculation. And these salary savings are based off of the actual dates that these employees left employment at Ameren Missouri. That is the same for the benefits and the payroll taxes. I have since in my refined calculation added a calculation for the capitalized piece in addition to the O&M piece.

Q Did you consider any kind of incentive compensation savings?

A No, I did not. And that's -- that's usually a very large number. I also did not consider any future pension and OPEB savings. There's -- other things that we could consider, such as future payroll increases. I didn't include any of that, and any training cost, any equipment cost, anything that would be in relation to these employees leaving.

Q Okay. To state the obvious, then, your calculated cost savings exceeds the actual VS11 costs that Ameren incurred; is that correct?

A Yes, it does.

Q Did you review MIEC witness Steve Carver's testimony?

A Yes, I did.

Q And did he estimate a VS11 savings as well?

A Yes, he did.

Q Is his the same or different than yours?

A His is slightly different than mine.

Q Do you know why?

A I believe it's because he didn't do -- he didn't calculate the exact times that these employees left Ameren. So I believe his salary is just slightly different.

Q Okay. Do you know if the company agrees that the cost savings and the amount of the VS11 cost that Ameren incurred are roughly equal?

A I'm sorry. Can you say that again?

Q Do you know if the company agrees that the cost savings resulting from VS11 is roughly equal to the cost of implementing VS11?

A Roughly. Yes.

MR. DOWNEY: Okay. Thank you. Nothing further.

JUDGE WOODRUFF: Public Counsel?

MR. MILLS: Those were most of my questions, but I do have one more.

CROSS-EXAMINATION

BY MR. MILLS:

Q The savings that you and Mr. Downey talked about, are those persistent savings that will last beyond calendar year 2012?

A In reference to anything --

Q The savings from the employees leaving that you've calculated. You've calculated an annual amount roughly for calendar year 2012, correct?

A Yes.

Q And will those savings persist beyond the effective date of rates in this case?

A They will persist.

MR. MILLS: Okay. That's all I had. Thank you.

JUDGE WOODRUFF: All right. For Ameren?

CROSS-EXAMINATION

BY MR. LOWERY:

Q Good afternoon, Ms. Ferguson.

A Good afternoon.

Q Do you have a copy of your testimony, both the part of the direct case, the direct report and your surrebuttal? You have that with you; is that true?

A I do. Yes.

Q And do you have a copy of your deposition with you?

A I do.

Q Mr. Downey took some of my questions away as well, so I won't have nearly as many for you. I think in response to Mr. Mills' question, you indicated -- well, let me back up.

The -- the revised calculation that you talked

about with Mr. Downey, it's a calculation you actually -- I don't know whether you completed it, but you provided it to the parties yesterday afternoon; isn't that right?

A Yes, I did.

Q And that revised calculation is not exactly an annual number, right, because you have -- you took in account payroll and benefit savings and associated taxes for employees who left in the latter part of 2011 pursuant to this program, correct?

A Yes. It's from when each employee left to the effective date.

Q Right. And so -- since a relatively small number of employees relative to the total left before January 1, 2012, and also since you picked up two days in 2013, your number is not exactly an annual number, right?

A I guess you would not consider it an annual number.

Q Well, here's what I'm trying to get at. Your number is -- is payroll and benefit savings and associated taxes covering a period of more than 12 months, right, for some of these employees?

A Yes. But I don't understand how an annual number -- I don't understand the importance of that.

Q That's not my question. My question is, is it an annual number or not?

A No.

Q The annual number, though, the annual payroll and benefits savings and associated taxes would be a little bit less than that total; is that fair to say?

A Probably, yes.

Q But not significantly less; is that fair to say?

A Yes.

Q Okay. So the -- the O&M that will be reflected in the revenue requirement used to set rates in this case, and that would be through 7/31/12, right, through the true-up period?

A Yes.

Q The O&M that's going to be reflected is going to be lower by almost as much as the number that you came up with. It's going to be lower by almost that much because all of these roughly 340 employees left as a result of this program, right?

A I believe the capital and O&M would both be lower.

Q Okay. I'm just talking about O&M at this point, just so we're clear.

A Okay.

Q I think your calculation is that -- we'll just look at the O&M piece. I think your calculation is that the total savings, capital and O&M, again, this -- this

number that isn't exactly an annual number was around $26 million, right?

A Yes.

Q The O&M piece of that is roughly $25 million, correct?

A Yes. Uh-huh.

Q So the operations and maintenance expenses reflected in the revenue requirement upon which rates will be based in this case are going to be lower by probably not 25 million, but something close to 25 million as a result of these roughly 340 employees leaving pursuant to this program, right?

A Yes.

Q Okay. And -- and that's why, you know, a program like this, and this program in particular, can provide substantial benefits to ratepayers because we end up with that reduced test year or trued up test year level of cost; isn't that right?

A That's true. But there's also benefits to the company.

Q But there are -- that 24 plus million dollars benefit is going to be baked into rates, right?

A Yes.

Q And -- and that -- that benefit -- putting aside whatever benefit you say the company may get, that

benefit, customers are going to get it next year, and if there's not another rate case the next year unless these employees were hired back; isn't that true?

A These cost savings, you will have recovered your cost by cost savings. On a going forward basis, we will have annualized your payroll levels to met what is needed.

Q But you didn't answer my question, Ms. Ferguson. The rates set in this case are using a revenue requirement that is, can we agree, approximately 24 million plus lower on the O&M side than it otherwise would have been if these roughly 340 people had not left as a result of the program? True or false?

A True.

Q And so -- and then we'll calculate rates based on a revenue requirement that's 24 million lower, right?

A True.

Q And if there are no new rates before 12/31/13, then customers will pay rates reflected that lower revenue requirement through all of '13, correct?

A Yes.

Q And if there are no new rates before 12/31/14, customers will pay rates that are also based on that lower revenue requirement throughout all of '14, correct?

A Yes.

Q So for those two years, customer rates in total,

if you assume normalized sales and the sales don't vary, will have in total then $48 million lower roughly than they would have been had these 340 employees not left as a result of this program. Isn't that true?

A Yes.

Q It's not Staff's position that the VS11 program is imprudent, is it?

A No, it's not.

Q And as we just discussed, it's obviously not the Staff's position that the program won't benefit ratepayers; isn't that true?

A That is true.

Q It's also true that the company did not have to offer this program at all; isn't that right?

A That is true.

Q In other words, the company could have chosen to continue to employ these 340 people or roughly 340 people and continue to pay them, right?

A That's true.

Q And had the company done that, then the trued up test year O&M used to set rates in this case would have been approximately 24 plus million higher than it's going to be; isn't that right?

A That's true.

Q So in '13 and '14 in my hypothetical when

there's no new rates, customers would have paid about 48 million plus more in rates than they're going to pay; isn't that right?

A That's true.

Q Because of the company's decision to engage in this program; isn't that right?

A That's true.

Q All else being equal, if the company cannot obtain a financial benefit as a result of a severance program, then even you would agree that perhaps that would provide a disincentive for the company to offer such a program in the future, right?

A I don't believe it does provide a disincentive.

Q Well, you said at your deposition -- would you turn to page 73, please?

A 73.

Q Line No. 16 and confirm that I'm reading the question and answer correctly. Question -- and this wasn't my question, but I'm going to read it anyway.

Question: I don't want to beat this to death either, but if the company can't, for whatever reason, obtain a financial benefit as a result of a severance program, do you think that provides a disincentive for that company to offer that or a similar severance program in the future?

Answer: I don't know. There could be benefits other than financial.

Question: Managerial efficiencies, things of that nature?

Answer: Right. There could be other possibilities.

Question: What if I am talking just purely about financial benefits?

Answer: All else being equal, perhaps yes.

Did I read that accurately?

A Yes.

Q Now, I want to talk about your revised calculation is a little bit that you sent us yesterday. And I think your point is that in addition to O&M savings in the form of lower payroll benefits and the taxes associated with that -- and I'm putting aside your theories or your contention or your belief about pension and OPEB. I'm putting that aside. Do you follow me?

A Okay.

Q But in addition to O&M savings, you claim that there's about an additional million dollars of savings for the company associated with the portion of these 340 employees' salaries that historically had been allocated to capital, right?

A Yes.

Q And when I say allocated to capital, what that means is you have employees paid $60,000 a year. Perhaps 25 percent of that employee's salary gets capitalized on the company's books because it's deemed under the accounting rules that they're working on a capital project or something of that nature, right?

A Yes.

Q That's the capital portion we're talking about here, right?

A Yes.

Q Okay. Now, let me -- let me ask you this. It's my understanding that the company and the Staff have agreed or they very nearly agree on both plant in service and the depreciation reserve balances that will be used to set rates in this case as of 7/31/12?

A Yes.

Q Okay. Now, when the company allocates some part of an employee's salary, benefits and taxes, the associated taxes to capital as opposed to O&M, that part would be booked in construction work in progress while the capital project is being built and before it goes into service; is that true?

A Yes.

Q And then after the plant goes into service, effectively, that amount of money shifts to plant in

service, right? Shift is my word.

A Correct.

Q When the roughly 340 employees that took the severance left, did the company's CWIP balance go down by an amount equal to the cumulative salary, benefits and taxes for those employees that had previously been booked for CWIP but not been moved to plant in service?

A That, I don't know.

Q You don't know?

A No.

Q Well, let's -- let's explore that for a minute. If I had an employee who will be working and, let's say, from the beginning of their employment until now there had been X percent of their salary and benefits allocated to capital, and let's say that that was $50,000. And that -- it just so happens that that $50,000 was all on projects that were still in CWIP. Are you with me so far?

A Okay.

Q Let's say they got fired on that day. All right? Or they left. It doesn't really matter. They left. So they left. They went somewhere else. Did $50,000 come out of CWIP on that day?

A I would assume if they're not working anymore on the capital project it would not be included in CWIP any longer.

Q No. I think you're changing my hypothetical. $50,000 of their salary and benefits has already been booked for CWIP. It was booked to CWIP already before they left. Okay?

A Okay.

Q So it's sitting in CWIP. They're working on a -- they're working on an electrostatic precipitator at the Labadie plant, and $50,000 of their work has been booked to that project and that precipitator is not yet in service so it's still sitting in CWIP, right?

A Okay.

Q And they left, right?

A Yes.

Q Was the $50,000 of work, was it already done or not?

A I would assume not.

Q Their $50,000 of work? When they left, did the $50,000 worth of the contribution to the project suddenly -- if they installed four valves and a pump, did the pump and the four valves get removed from the electrostatic precipitator the day they left?

A I would assume not.

Q Okay. I'm sorry. I must have misunderstood you. The $50,000 of their salary that had already been booked to CWIP, it stayed in CWIP when they left, didn't

it?

A Okay.

Q I need you to answer yes or no.

A Yes.

Q So when they left, the CWIP balance didn't go down by that $50,000, did it?

A From the scenario we're talking about, I would agree.

Q And that's true of the other -- all the other cumulative amount of payroll, benefits and taxes booked to CWIP associated with the work of these roughly 340 employees, that -- that cumulative number, whether it's half a million dollars, ten million dollars, I have no idea what it is, that number also didn't get removed from CWIP when those people separated from the company, right?

A That may be true. But regardless to that, there are other savings outside of the capital piece. So if you would like to remove the capital piece, there are other savings that we could consider.

Q You said that may be true. Is it true or not?

A Yes.

Q Okay. Now, when those -- now let's take another scenario. Let's say that we had these 340 employees or so, and, cumulatively, they had -- had $5 million of their time and benefits and taxes allocated to projects that had

already gone into service at the -- at the time they left. Are you with me?

A Okay.

Q In that case, plant in service didn't go down by that $5 million when they left either, did it?

A No.

Q Okay. Now, your theory is that because these roughly 340 employees left that there would be less plant to put into service than if they had still been there; isn't that right?

A Salaries as a part of plant? Is that what you're --

Q Your theory is that because they left that there's going to be less plant put into service prospectively than had they stayed around, right?

A The capitalized piece of salary. Not just in plant.

Q Plant in service can be expressed in dollars, right?

A Yes.

Q Okay. So your theory is that the dollars that will be capitalized into plant and service is going to be less because these -- prospectively because these 340 -- roughly 340 people left because your theory is that the other resources of the company, other employees are not

going to fully take up the slack, and the company's not going to be putting as much plant in service as if these employees had stayed around; isn't that true?

A I didn't say that.

Q Well, then what's the basis for your calculation that you sent us yesterday? You've done a calculation that took the amount of the capitalized portion of these 340 employees salary, right?

A Uh-huh.

Q That's what you did. And then you applied composite depreciation rate to it, right?

A Uh-huh.

Q And you said the company's going to save roughly $125,000 annually in depreciation expense on the theory that the plant in service balance is going to be less by that seven million dollars, right?

A By the salaries that are being capitalized. These salaries wouldn't be there any longer if these employees are gone.

Q That's right. That's right. So you're assuming --

A That doesn't mean a piece of plant, and that doesn't mean --

Q So you're assuming -- so you're assuming that the capitalized portion of these folks' salaries and --

well, let's look at the number.

JUDGE WOODRUFF: Ms. Ferguson, while there's a break, you need to get closer to the microphone. Thank you.

Q (By Mr. Lowery) Do you have your work paper with you?

A Not the full work paper, no.

Q Does -- for 2012, does about 7.4 million, 7.5 million, does that sound about like the number we're talking about?

A For the capital piece, yes.

Q For 2011, it was about 300,000. Does that sound about right?

A I believe so.

Q What you did was you made an assumption that plant in service in 2012, when we get to the end of the 2012 that the dollars in plant and service were going to be less by about seven and a half million dollars because these employees are gone, right?

A Yes.

Q And what that has to mean is you're assuming that the other employees of the company aren't going to do that seven million dollars of work -- or aren't going to do work that -- that ends up being allocated -- seven and a half million dollars is being allocated to plant in

service, right?
A Yes.
Q So if -- if other employees take up the slack, then your number would be too high, wouldn't it?
A I don't think so.
Q Well --
A Because those salaries would already be included in capital.
Q The employees that left at the end of 2012 --
A No. Employees that are picking up the slack are already in the capital piece.
Q That's true. That's absolutely true.
A So on a forward -- on a forward going basis, that would be less for those who left.
Q But you're assuming, are you not, that the plant in service balance at the end of 2012 is going to be seven and a half million dollars less because you're assuming that the employees who left, had they been there, they would have had seven and a half million dollars of their salaries and benefits put into plant in service during 2012, right?
A Yes.
Q But because they're gone, that won't happen, right?
A Yes.

Q But if other employees -- if other employees did all of the work that they would have done had they been there, then that seven and a half million dollar figure would go away, right?

A Perhaps. But the effect is not seven million dollars.

Q Okay.

A And irregardless as to if you remove the capital piece, there is still sufficient savings.

Q So your -- but the bottom line is even with your calculation, you're attributing an additional $130,000 or so of ongoing depreciation expense savings?

A Yes.

Q Now, the rest of your roughly million dollars of capital-related savings that you came up with relates to return, right?

A Yes.

Q Okay. I'd like for you to explain to me and to the Commission how the reduction in a company's return constitutes a savings to the company from a severance program.

A The capitalized piece of the salaries has, as Mr. Lowery said, a depreciation piece and also a return that's earned on it because it's -- as a part of rate base.

If the amount of capital is removed for rate base, then they would not earn a return on that piece. So the savings of these salaries that -- that affect rate base would not earn that return.

Q Ms. Ferguson, is the return that a company receives on its rate base a cost of the company or a benefit to the company?

A I don't know as it could be a cost, but -- but you would not have received it without this piece.

Q If the company doesn't receive a return, is that a savings that the company gets to -- gets the benefit of?

A No. If you want to look at it like that, no.

Q Isn't that the only way you can look at it?

A I suppose. But --

Q Well --

A -- yet again, irregardless, with this approximate 900,000 and 130,000, the company will have received cost savings.

Q Let's start over. I will give you, theoretically, that if the company's plant in service balance is $7.5 million lower at the end of the 2012 because these employees are no longer around and the company doesn't put as much plant in service, I will give you, theoretically, that the company's depreciation expense will go down, assuming your composite depreciation

expense is right by $130,000 a year. I'll concede that point to you. But it makes no sense to me that you could claim that the company is getting a benefit of $900,000 a year because it is going to earn on a smaller rate base because it has a lower plant in service balance.

Now, is it still your contention that that $900,000 is a benefit, it is a savings generated by the VS11?

A I believe so.

MR. LOWERY: Well, I guess we'll leave it at that.

JUDGE WOODRUFF: Anything else?

MR. LOWERY: No.

JUDGE WOODRUFF: Okay. We'll come up for questions from the Bench then. Chairman Gunn?

CHAIRMAN GUNN: I don't have any questions.

JUDGE WOODRUFF: Commissioner Jarrett?

COMMISSIONER JARRETT: I have no questions.

JUDGE WOODRUFF: Commissioner Kenney?

COMMISSIONER KENNEY: No questions. Thank you.

JUDGE WOODRUFF: Commissioner Stoll?

COMMISSIONER STOLL: I have no questions. Thank you.

JUDGE WOODRUFF: No questions from the Bench, so no recross. Any redirect?

MR. THOMPSON: Thank you, Judge.

JUDGE WOODRUFF: All right. Ms. Ferguson, you can step down. All right. And then we'll go back to the ROE issues. We'll take a break before we do that. And we'll come back at 2:45.

(Break in proceedings.)

JUDGE WOODRUFF: All right. Let's come back to order. We're back on the record.

MR. LOWERY: Your Honor, I have a -- I guess a process comment or question, and then -- and then I don't know if it's a request or a proposal.

But on the process comment, Mr. Gorman had policy testimony and was actually scheduled as a policy witness and wasn't able to be here, and we agreed to take that up today.

I'm actually going to do the cross-examination on the policy issue, and I was wondering if it might make sense to do that as a sort of a separate mini issue. But, you know, you could do that in an ROE cross by Mr. Byrne and go through the whole thing. It's completely up to you. Mr. Byrne is handling the ROE portion, and I'm just questioning on another narrow issue.

JUDGE WOODRUFF: How do the parties feel about that?

MS. ILES: We have the same issue.

MR. DOWNEY: Judge, we have the same issue. I'm here for the -- for the earnings attrition part, and Carole is handling ROE.

JUDGE WOODRUFF: Well, let's -- let's go ahead and do the policy portion first, and -- and then we'll do it all over again for the ROE.

MR. LOWERY: And then I guess I would throw this out and would certainly understand if this doesn't work, but we are -- we have an open day -- or almost a nearly open day on Tuesday that we didn't have before.

I think it's going to be a real challenge to probably even get completely done with this issue today. I would suggest we might consider if the Commissioners are Cardinal baseball fans that we adjourn early enough that we might be able to see that game today and we just start first thing Tuesday morning and finish this issue up.

JUDGE WOODRUFF: I think that would be acceptable. We want -- maybe just to do the first, the policy issue today and then worry about ROE on Tuesday?

MR. LOWERY: That would be acceptable to the company.

JUDGE WOODRUFF: Is that acceptable to the other parties?

MS. VUYLSTEKE: Your Honor, I think that it would be possible to have Mr. Gorman available to come in on Tuesday. If that's the Commission's preference, we're certainly happy to do that. If it's possible to finish Mr. Gorman on ROE and then take the other witnesses on ROE on Tuesday.

We know all Commissioners are able to be here today, and so we certainly would like to present Mr. Gorman this afternoon if -- if the Commission doesn't mind and then maybe move on to the rest of ROE on Tuesday.

JUDGE WOODRUFF: That would be -- Mr. Murray is the only other ROE witness. But I think that's likely --

MR. THOMPSON: I'm advised that Mr. Murray is not available on Tuesday.

JUDGE WOODRUFF: He's not available on Tuesday.

MR. LOWERY: Oh.

JUDGE WOODRUFF: Okay. I guess that means --

MR. LOWERY: There went that idea.

JUDGE WOODRUFF: All right. We'll be slogging on, and I guess we can watch the Cardinals game on tape. Okay. At this point, then, we're going to be doing -- well, I need to swear him in first.

MICHAEL GORMAN,

being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified as follows:

DIRECT EXAMINATION

BY MS. ILES:

JUDGE WOODRUFF: Thank you. We're going to do the policy issue separately first. And so direct.

MS. ILES: Well, it's all -- he only has one set of testimony.

JUDGE WOODRUFF: You can go ahead and offer it all at this time then.

MS. ILES: That's all I'm going to do.

Q (By Ms. Iles) Would you state your name and address for the record, please?

A My names is Michael Gorman. My address is 16690 Swingley Rich Road, Chesterfield, Missouri.

Q Ad are you the same Michael Gorman who caused to be prepared and filed in this case direct and surrebuttal testimony on behalf of MIEC, which is marked as Exhibits 507, 508 and 509, and that's Direct Highly Confidential Direct NP and the surrebuttal testimony?

A Yes.

Q Do you have any corrections to your testimony?

A I do. In my direct testimony, my Schedule MPG-21, the rate of returns were -- are incorrect on that schedule. The common equity balance was -- the incorrect total common equity balance of the utility was used in developing those returns on equity. So I've corrected that schedule using the total reported common equity balance for Ameren Missouri.

Q And did you prepare a substitute schedule?

A I did. A revised Schedule MPG-21.

MS. ILES: Your Honor, should we have this marked as an exhibit, or how do we do that?

JUDGE WOODRUFF: Yeah. Let's mark it as a separate exhibit. It will be 532.

MS. ILES: Thank you.

MR. DOWNEY: Judge, what was the number?

JUDGE WOODRUFF: 532.

MR. DOWNEY: Thank you.

Q (By Ms. Iles) The exhibit has been marked as 532. Is that your substitute schedule?

A Yes.

Q Is there anything else you wanted to tell the Commission about that?

A The -- the error in the original schedule is I did not include a component of common equity capital, the line item referred to as Paid In Capital. And that had the effect of understating total common equity from the balance sheet and overstating a return on equity. So the revised schedule includes that correction.

MS. ILES: I guess I need to move for the --

Q (By Ms. Iles) Or do you have any other corrections to your testimony?

A I do not.

MS. ILES: I'd like to move for the admission of Exhibits 507, 508, 509 and 532 and tender the witness for cross.

JUDGE WOODRUFF: All right. 507, 508, 509 and 532 have been offered. Any objections to their receipt? Hearing none, they will be received.

(Exhibit Nos. 507, 508, 509 and 532 were offered and received into evidence.)

JUDGE WOODRUFF: For cross-examination, we'll begin with Public Counsel.

MS. BAKER: No questions on this issue. Thank you.

JUDGE WOODRUFF: All right. Staff?

CROSS-EXAMINATION

BY MR. THOMPSON:

Q I only have one policy question for you. During the policy portion of this hearing last week, there was talk about whether or not it would be appropriate to make an ROE adjustment if the Commission granted plant in service accounting to the company as a device to ameliorate earnings attrition. Do you have an opinion as to whether or not such an adjustment would be appropriate?

A I do. The -- my recommended return on equity is based on the company's current investment risk. If regulatory mechanisms are implemented which reduce that risk, then it would be appropriate to consider a reduction to the authorized return on equity to reflect a risk that is lower than the risk of the company that currently stands without those enhanced regulatory mechanisms.

I do recommend, however, staying within my recommended return on equity range. The ability to accurately estimate the -- the increments for -- for implementing mechanisms that reduces the existing operating risk of the company would be difficult to gauge. But staying within my recommended range, I think, would be appropriate.

Q So when you say staying within your recommended range, would you mean a reduction from 9.3 to 9.2?

A In this case, yes.

MR. THOMPSON: Thank you. No further questions.

JUDGE WOODRUFF: All right. For Ameren?

CROSS-EXAMINATION

BY MR. LOWERY:

MR. LOWERY: You took away 95 percent of my cross-examination, which everybody's probably going to be happy about. I do have an exhibit I'd like to get marked, your Honor

JUDGE WOODRUFF: All right.

MR. LOWERY: -- to speed things up.

JUDGE WOODRUFF: You're up to No. 70.

Q (By Mr. Lowery) Mr. Gorman, I've handed you what's been marked for identification as Exhibit No. 70. Would you agree that the graph on the first page of Exhibit 70 is either remarkably similar to or identical to the revised Schedule MPG-1 that was just put into the record?

A Yes.

Q And the only reason I'm going through this is I'd like to ask you to verify, if you would, whether or not the calculations shown on all of the other pages of Exhibit 70 -- which you recognize to be your work paper as revised, do you not?

A Yes.

Q Would you verify that the calculations of the ROE to comment on those pages of Exhibit No. 70 are accurate and -- and I guess I'll ask you a compound question to speed this up, and that the additional equity that has been added to your original work paper is also accurate?

A I believe it to be accurate. Yes.

MR. LOWERY: With that, your Honor, I move for the admission of Exhibit 70.

JUDGE WOODRUFF: Exhibit 70 has been offered. Any objections to its receipt? Hearing none, it will be received.

(Exhibit 70 was offered and received into evidence.)

MR. LOWERY: And if you'll bear with me just a second, your Honor, I might not have any more questions.

JUDGE WOODRUFF: Okay.

MR. LOWERY: Those are all my questions, your Honor.

JUDGE WOODRUFF: We'll come up for questions from the Bench on policy questions. Chairman Gunn?

CHAIRMAN GUNN: No questions.

COMMISSIONER JARRETT: No questions on policy.

COMMISSIONER KENNEY: No, thank you.

COMMISSIONER STOLL: No questions, your Honor.

JUDGE WOODRUFF: All right. No need for recross. Any redirect?

MR. DOWNEY: I think just one question.

JUDGE WOODRUFF: Okay.

REDIRECT EXAMINATION

BY MR. DOWNEY:

Q Okay. Mr. Gorman, the calculations shown on the spreadsheet that is a part of Exhibit 70, are those the same calculations that you used to create MIEC Exhibit 532?

A They are effectively the same calculations. I revised the way I developed the total common equity capital in my revised schedule. But the effective -- the effect of including the premium on capital stock as shown on Schedule 70 is the same correction that I included in my revised Schedule 21.

Q All right. And does -- does this revised schedule in any way change any of the opinions you gave in your testimony?

A No.

MR. DOWNEY: Thank you. Nothing further. I guess those were two questions.

JUDGE WOODRUFF: Okay. We'll let you slide this time. All right. Then we'll start the process over again on the ROE issue. We can begin with Public Counsel.

MS. BAKER: Thank you.

CROSS-EXAMINATION

BY MS. BAKER:

Q Good afternoon, Mr. Gorman.

A Good afternoon.

Q You were here whenever questions were asked of Mr. -- Mr. Hevert. In your -- in your experience, has the cost of capital gone down in the past few years?

A It -- it has been on a declining trend over the last few years. I think more recently in the last six months or so, it has -- has had a very noticeable drop and declined quite a bit throughout 2012.

Q All right. And in your experience, has the overall yield also gone down?

A The bond yields have also decreased in a very significant way, yes.

Q And do you know among the economic community, is there an expectation that the economy will rebound substantially within the next couple of years?

A Well, I think there's a great debate on how long it will take the economy to recover from this recession. But I do think there is an optimism that the -- the economy has made a turn in the road. And it does appear as though it will start strengthening throughout 2013 and forward.

Q All right. And fluctuations in the economy are a normal part of business, aren't they?

A Yes.

Q Okay. Let's see. There were questions that were asked earlier about a DCF analysis using a non-electric company proxy group. Do you remember that questioning?

A I do. Yes.

Q Okay. Have you ever performed a DCF analysis using a non-electric company proxy group?

A You know, I -- specifically, I think the question was a non-regulated proxy group.

Q A non-regulated proxy group. Right.

A And I have not. And I have argued against the use of a non-regulated proxy group for reliably estimating a utility market return. So I -- I would continue to do that here.

Q All right. Whenever you are looking at non-regulated business entities such as Fortune 500 companies and the like, do you see that their returns have lowered significantly in the economy lately?

A Well, I have a schedule on my testimony that that shows both corporate and utility bonds as well as Treasury bonds. And it shows that -- that investment grade utilities -- or securities cost have decreased recently.

That is shown on my Schedule 13. Under Column 6 and 7, I show AAA and BAA corporate bond yields that are -- Columns 2 and 3, I show the single A and BAA utility bond yields. And as you can see, the corporate and utilities as well as the Treasury bond yields which are shown under Column 1 have all decreased over the last few years.

Q And for a non-regulated business entity, they have more risk than a regulated monopoly such as Ameren. Would you agree with that statement?

A Generally speaking, yes.

Q Okay. So it would be logical to expect that in the economy today, given a regulated monopoly with much lower risk that it would have returns that are somewhat lower than a Fortune 500 company would have?

A I would agree with that. And the difficulty, again, if you would look at my Schedule MPG-13 is that a non-regulated company or a regulated company, even if they had the same risk characteristics such as a BAA bond rating as an example, the market price is a non-regulated security differently than the price of a regulated security.

And that's evidenced by simply tracking difference in bond yields. For a utility bond yield with a BAA rating versus a non-regulated corporate bond with a BAA rating, the BAA rating indicate they're comparable in risk, but the market simply values them differently, and the cost of capital for a non-regulated company is distinct and separate from the cost of capital of a utility company.

You make the same analogy with a AAA rated bond rating of a corporate relative to the U.S. Treasury securities whereas a piece -- it says they're rated AAA, where Moody's and Fitch does.

While the AAA rating would indicate a Treasury security has the same investment risk as a AAA corporation, you look at the yield difference between a Treasury and a AAA corporate, and they're just not the same. So the risk measures would indicate comparable risk, but the market valuation and pricing security is just very different.

So I question whether or not you can reliably estimate utility's cost of capital for a regulated company using non-regulated securities.

Q Okay. You also heard testimony about the art in choosing the inputs to -- to basically reflect what one is seeking from the model results to be. Did you hear testimony like that this morning?

A I don't remember specifically the -- the use of the word art. But I do recall Mr. Hevert describing the -- the -- the type of data used in these bonds.

Q Okay. Does it surprise you that given the inputs that Ameren chose for its study that their results show the highest ROE reasonable range?

A It -- I -- it does not surprise me. And I did respond to Mr. Hevert's ROE studies, and I believe that he has overstated fair return on equity for Ameren Missouri in this case.

And I outlined those criticisms and offered some modifications to the studies to produce what I believe to be a more reasonable or more accurate estimate of what

Ameren Missouri's cost of equity is in this case.

Q And one of the other things that -- that was discussed was the -- the credit -- or the environment of the regulatory system in Missouri and the fact that Mr. Hevert gave a little bit of a bump to his ROE because of the regulatory climate in Missouri; is that correct?

A That's my understanding, yes.

Q Okay. But states do go about their regulatory rate setting a little bit differently, such as don't states like Illinois, for example, use an average year rate -- rate base?

A Well, for a future test year, they do. Historical test year, often, they will use end of year.

Q And does --

A And, you know, more recently, Illinois has adopted a formula rate methodology for electric utilities. So the -- within that formula rate process, it was a very -- very disputed issue. But I believe the Commission ultimately adopted the recommendation for use of an average rate base in that formulary process.

Q Are there other states that -- that also use this average rate base mechanism?

A I think it's -- it's fairly common for use of future test years. So I --

Q Okay. And in Missouri, generally, aren't we in

this case specifically using the actual rate base as the true-up cutoff date?

A Yes. Well, the true-up date rate base.

Q Right.

A Which would be at the end of the true-up period rate base.

Q Yes. So isn't that a part of the process in Missouri that's favorable to utilities? They get their rate base actually stated as of the true-up date rather than averaged or forecast?

A Generally speaking, the rate base at the very end of the true-up period would be higher than the average rate base over the entire 12-month period leading up into the true-up period.

So it is more favorable to the utility to use a higher rate base because it produces a higher revenue requirement. So I would agree with that.

Q So you would agree that that is at least one example of -- I'm sure there are several -- where Missouri has a better or a more favorable environment for the utility in its rate-making?

A I'd say that's one element of the rate making calculus that is favorable for the utility. Yes.

Q All right. In your testimony, you calculate that a reasonable range for ROE is between two -- 9.2 and

9.4. And your recommended ROE is 9.3; is that correct?

A Correct.

Q And I assume that you agree with the statements earlier that a reasonable ROE for Ameren is one that is, one, adequate to attract capital at reasonable terms thereby enabling Ameren Missouri to provide safe and reliable electric service that is sufficient to ensure Ameren Missouri's financial integrity and is commensurate with returns on investments in enterprises having corresponding risks?

A Yes.

Q So, therefore, in your opinion, at a return on equity range of anywhere between 9.2 and 9.4, Ameren is adequately able to attract capital at reasonable terms enabling it to provide safe and reliable electric service?

A Yes.

Q And anywhere within that range, Ameren's financial integrity is ensured?

A I believe so. Yes.

Q And last, and given your research, a return on equity anywhere between 9.2 and 9.4 is commensurate with the returns of other similar enterprise like Ameren who have similar risks?

A Well, it's similar measure of what the cost of capital is for those companies based on today's marketplace.

Q Okay. So you -- you do believe that your -- that your recommendation meets that -- meets that requirement?

A Yeah. My -- my studies are specifically designed to accomplish measuring a return on equity that meets that standard.

Q All right. And so Ameren would receive a reasonable return on equity anywhere between 9.2 and 9.4. That's your recommendation? Or that is your -- your opinion?

A Correct.

MS. BAKER: Okay. No further questions.

JUDGE WOODRUFF: All right. For Staff?

MR. THOMPSON: Thank you, Judge.

CROSS-EXAMINATION

BY MR. THOMPSON:

Q Good afternoon, Mr. Gorman.

A Good afternoon.

Q Are you familiar with the zone of reasonableness analytical method that has been used by this Commission in the past?

A Generally, yes.

Q And do you understand that to essentially encompass a range of 100 basis points above and 100 basis

points below the average of awarded ROEs as reported by Regulatory Research Associates?

A That's my understanding.

Q Do you believe that that method is flawed by a circularity of reasoning?

A I believe if you use it by itself, it would certainly be flawed. I believe considering what other Commissions are awarding is -- is appropriate information to consider in estimating what a fair return on equity is.

But the trend in those authorized returns, I think, are important, particularly when they are considered along with reasonable estimates of what the current market cost of equity is.

Q And I know you're not an attorney, right?

A Correct.

Q But you are familiar with the parameters that are set by the Hope and the Bluefield decisions insofar as you have to work with them in creating your testimony?

A Yes.

Q Do you have an opinion as to what the points of confiscation would be with respect to awarding an ROE to Ameren Missouri?

A Well, I -- based on my studies, I think a fair estimate of the current market return on equity is within my range of 9.2 to 9.4. So I wouldn't be comfortable in this market recommending return on equity lower than 9.2.

Q Okay. And you were here, were you not, for the testimony by Mr. Hevert?

A Yes.

Q And did you understand him to testify that he used growth rates based on earnings per share projections drawn from Zack's, First Call and --

COMMISSIONER KENNEY: Value Line.

Q (By Mr. Thompson) -- Value Line?

A Yes. For his constant growth DCF model. That's correct.

Q And, also, I believe, for the initial stage of his two multi-stage DCF models?

A Correct.

Q And the number that he used was 5.07.

A For the group average growth rate, I believe -- yeah. I have to check the number, but that sounds correct.

Q Okay. If I told you that's what his testimony was, would you have any reason to disagree?

A I would not.

Q Okay. And do you consider that an appropriate growth rate figure to use?

A I think over the next three to five years, I think it's probably a pretty reasonable estimate to expect the growth rate through those companies.

Whether or not it can be sustained indefinitely, I think is a separate issue, and it's an important issue of the constant growth DCF model. 5.07 is not significantly higher than the consensus analysts projection of future GEP growth which is 4.9 percent. So I think it's higher than what I would be comfortable concluding is a reasonable estimate of long-term sustainable growth. But I think it's close.

Q What is the figure that you would be comfortable with?

A That would not be reasonable or that --

Q I think you said that 5.07 is higher than what you would be comfortable with for long-term sustainable growth. So my follow-up question is, well, what -- what is the figure you would be comfortable for long-term sustainable growth?

A In my testimony, I used a growth rate of 4.9 percent.

MR. THOMPSON: Okay. That's all I have. Thank you.

JUDGE WOODRUFF: For Ameren?

CROSS-EXAMINATION

BY MR. BYRNE:

Q Good afternoon, Mr. Gorman.

A Good afternoon.

Q Do you have a calculator with you?

A Yes, I do.

Q Do you have your deposition that I took last -- September 18th with you, by chance?

A I did not bring that, no.

Q Okay. I've got -- fortunately, I've got an extra copy for you.

A I was hoping you would.

MR. BYRNE: May I approach, your Honor?

JUDGE WOODRUFF: You may.

Q (By Mr. Byrne) Here's your deposition. I think I have one for your attorney, too.

MR. BYRNE: Ms. Iles, do you need a copy of the deposition?

MS. ILES: No. I brought mine.

MR. THOMPSON: I could use one.

MR. BYRNE: Sure.

Q (By Mr. Byrne) Mr. Gorman, I was going to start by asking you a follow-up to a couple of the questions that Mrs. Baker asked you. And one was you -- you had a discussion with her about -- and I think you basically said you didn't think it was appropriate to use non-regulated companies in a proxy group to determine a return on equity for a regulated company. Do you remember

that?

A Well, let me clear that up if that's what I said. What I intended to say is I don't think you can reliably estimate --

Q Okay.

A -- a regulated company's return on equity with a non-regulated proxy group because of the differences in the market valuation and pricing of securities for non-regulated companies versus the regulated companies.

Q Okay. And so -- and I guess I -- I guess, therefore, you don't see a problem with circularity in using regulated companies in a proxy group?

A Well, I do not. As long as you use market -- observable market data and you're trying to capture how investors value securities and their return requirements for making investments in utility companies, I -- I don't think there's a -- I do not believe that there's a circularity in using those models to estimate fair compensation, particularly when you can -- can also look at the results of the regulatory decisions.

If authorized returns on equity were consistently too low, you would hear credit rating agencies being critical of regulatory Commissions' authorized returns. We're not seeing that.

Credit rating agencies are rating utility industry stable. That's an indication that regulatory treatment is supportive of credit standing, which includes fair compensation and the ability to maintain adequate access to capital.

So there is market evidence that suggests that the way things are being done is accomplishing the objective.

Q Okay. Ms. Baker also asked you a question about updating rate base to the end of the true-up period, and I think you -- I think you said that was a positive thing about the regulatory frame work in Missouri. Is that a fair summary of what you said? Or what exactly did you say about that?

A I think she asked me whether or not the use of an end of true-up period rate base was more beneficial to investors than the use of an average rate base within the true-up period.

And my comment was it is more beneficial because it results in a higher rate base normally, which results in a higher revenue requirement and earnings entitlement for the companies.

Q I mean, is it less beneficial than having projected rate base?

A It's not necessarily less beneficial. I mean, you need to consider how the future test year would be developed in forecasting what a rate base would be and whether or not there's restrictions to properly reflect what sales growth might be with growth in customers, growth in unit sales per customer, changes in operating costs throughout that same time period and changes in cost of capital.

So that -- that's a pretty complicated issue. I don't know if you can necessarily generalize it. But there are forms of future test years, which I don't think more accurately reflect the utility's cost of service when the rates are actually in effect than Missouri's procedure of the true-up mechanism is able to -- to put rates into effect, which provides a -- a reasonable opportunity to earn their cost of capital.

Q Okay. I'd like to ask you some questions about Staff Witness Murray's position on return on equity. Have you read Mr. Murray's testimony?

A It was a while ago, but, yes, I have.

Q And are you aware that Mr. Murray is -- is asserting that cost of capital witnesses such as you and Ameren Missouri witness Mr. Hevert and -- and other -- this Commission and other Commissions are not properly estimating the cost of equity when they set return?

A Generally, I -- I do recall some language to that effect. I don't know exactly that he said it that way, but --

Q And he believes that the actual cost of equity is much lower than anyone is recommending in this case. Are you aware of that?

A I do understand that to be his position.

Q Do you agree with him?

A I do not. I -- I -- my clients hire me to estimate the cost of capital in a way that provides fair compensation but not excessive compensation to AmerenUE that will -- will allow them to maintain the financial integrity and provide high quality and reliable service. It's important to my client.

They want competitive rates, but they also want high quality, reliable service. So they asked me to do my best job of estimating what the fair compensation is for a utility to accomplish all the objectives we just described, and I think I've done that.

Q Well, maybe you just said this. What would happen if the Commission sets an ROE that's too low? What are the negative consequences to your clients and, I guess, to my client?

A Well, if you take it to the extreme, if the return is too low, then there could be a couple negative consequences. One is the utility's cash flow metrics may not be adequate to support its bond rating.

The second consideration is that the utility may because it has a fiduciary responsibility to manage its investors' capital prudently may limit capital investments in utility plant and equipment, and that could have an effect on service quality and reliability. And those two factors may result in the service area incurring greater costs because certain companies business and homes that operate with the assumption that they're going to get high quality, reliable service.

Q Mr. Murray argues in his testimony that instead of -- or -- or perhaps in addition to using the traditional analyses like, you know, DCF analyses we've talked about and CAPM and risk premium analyses, that cost of capital experts should look at what investment analysts are using to estimate the value of the utility stocks and even when investment analysts use to value stocks or assets outside of the regulated arena. Are you aware of that testimony of his?

A I'm aware that he considers projected returns by some money managers, yes.

Q I mean, why don't you use information like that in estimating the cost of equity?

A Well, I am concerned about the reliability of the accuracy of the projections. My analysis is based to the greatest extent possible on information that is available to investors, that investors may rely on to value the prices of the securities, including the companies in my proxy group.

Because I'm trying get a sense of what investors' expectations are in reaching the values of those prices in my proxy based on DCF studies. Because if -- the available market information concerning those companies, specifically being a proxy for what investors are likely expecting from those companies, is the best information I think that's available to estimate what investors' return requirements are to assume the investment risk of the utility companies included in my proxy groups.

So I believe that starting the analysis with observable utility stock prices for a proxy group that is measured to be reasonable and consistent with the investment risk of the underlying company or observable utility bond yields, measured beta estimates which is tied to stock price variations relative to the market. Ties the entire analysis to the focus of the proxy group, or at least focus of the industry, which I believe is -- is the best estimate for capturing what investor current return requirements are.

Q Mr. Murray did a multi-stage DCF analysis that had three stages; is that correct?

A Again, I looked at his testimony a while ago, but I believe that's correct.

Q Well, and -- and my understanding is that when you do a multi-stage DCF analysis, the growth rate you use in Stage 3 is a pretty important input to that; is that fair to say?

A I think all the data is pretty important to input into that model. But, yeah, the long-term sustainable growth rate is driving the growth and the longest period of dividend within that cash flow projections.

Q Would it be fair to say that growth rate in Stage 3 has a big impact on the result that's produced by the multi-stage model?

A Yes.

Q Okay. And Mr. Murray used a 3 to 4 percent growth rate from his Stage 3. Do you -- do you recall that other --

A I would have to verify that.

Q Okay. Assume with me that he did use a 3 to 4 percent growth rate for Stage 3. Do you think that's an appropriate growth rate for Stage 3 of a multi-stage DCF model?

A If I thought that was the appropriate third state growths rates, I would have used that in my model.

For the reasons outlined in my testimony, I did not use a growth rate of 3 or 4 percent. I used one of 4.9.

Q Okay. Let's discuss your recommendation. As you testified before, you're recommending a 9.2 percent to a 9.4 percent range, right?

A Yes.

Q And my understanding from your deposition is that you agree that any -- any point within that range would be reasonable; is that true?

A Yes.

Q Okay. Mr. Gorman, would you agree with me that estimating the appropriate return for regulated electric utility is not an exact science?

A Yes.

Q And is that why experts like you and Mr. Hevert typically provide a range for your recommended ROE and Mr. Murray, too, has a range for his recommended ROE as well as a specific point recommendation?

A Well, yes. I think that's why all of us use more than one methodology to try and estimate the current market rate of cost of equity.

Q Would you agree with me that a basic tenant of finance is the risk return trade-off?

A I do.

Q So that investors require a higher return more

for more risky investments?

A Yes.

Q And would you also agree that an important consideration on setting return on equity for an electric utility is the risk that the utility faces?

A Yes.

Q All else being equal, would it be fair to say that a utility facing a higher risk should get a higher return and a utility facing a lower risk should get a lower return?

A Well, I don't know what you mean by all else equal. By if a utility is facing higher risk because of imprudence or unreasonable management, then I wouldn't agree with that.

Q Okay.

A But if the management and prudence and management-induced problems were not a factor, then higher risk companies should get a higher risk return.

Q Fair enough. And I think you would agree with me, would you not, that Ameren Missouri competes for capital with other electric utilities?

A Yes.

Q Okay. And I -- we've had a lot of discussion about RRA data. And I assume you would agree that RRA is a -- a reputable firm and provides reliable data?

A I do.

Q And I think on Schedule MPG-11, which is one of the schedules in the risk premium analysis, you have a list of returns for integrated electric utilities or maybe electric utilities?

A Yeah. This is an electric utility industry average return. I do not agree with Mr. Hevert that it's appropriate to separate integrated electrics from wires or distribution only companies because I think that's too simplistic of a consideration of risk differentials.

Q So these numbers would include both wires only and integrated electric utilities?

A Correct.

Q Do you have your calculator? Do you -- could you tell me what the average authorized return on equity for electric utilities for the past five years was?

A Based on my Schedule MPG-11, which goes through the end of 2011 for that five-year period --

Q Okay.

A -- 10.37 percent for the period 2007 through 2011.

Q Could you do the same calculation for the last ten years?

A 10.56.

Q Okay. Now, as I understand it, you and

Mr. Hevert used the same proxy group of companies at least in your direct testimony; is that correct?

A In our direct testimony, that is correct.

Q But then he added Empire, and you did not; is that correct?

A Correct.

Q Okay. We had a couple of documents --

MR. BYRNE: May I approach the witness?

JUDGE WOODRUFF: You may.

Q (By Mr. Byrne) We had a couple of documents that were entered into the record as exhibits, and they were the RRA -- the RRA information from calendar year 2011, which Exhibit 69, and the RRA data for the first six months of 2012, which was Exhibit No. 530.

And so I'm going to give you a copy of those. And what I tried to do, Mr. Gorman, was to mark within that document the proxy group companies that had reported authorized ROEs. And I'd like to walk through the document, if you would, the two documents and let me know if I did it right. Maybe we could start with the calendar year 2011 document.

A All right.

Q And I show on -- on the -- I guess starting on page 5 of that document, it's the list of all the decisions, and I show Public Service Company of Oklahoma

the first company on the list being an AEP subsidiary; is that correct?

A It's noted as that. I believe that's correct. Yes.

Q Okay. And they -- and then they got a 10.15 percent ROE; is that correct?

A Yes.

Q And the next one I had is Wisconsin Public Service. Is that one of the companies in one of the proxy group companies, if you know?

A In my proxy group companies?

Q Yeah. In the common group of proxy companies that you and Mr. Hevert had in direct testimony.

A Yes.

Q Okay. And that shows an ROE of 10.3 percent; is that correct?

A Yes.

Q And the next one I have is Appalachian Power/Wheeling Power, and that's shown as a subsidiary of AEP; is that correct?

A Yes.

Q And that shows 10 percent; is that correct?

A It is.

Q And then the next one is Kansas City Power & Light Company?

A Yes.

Q And that shows 10 percent; is that correct?

A It does.

Q And then Ottertail Power, and that's in your group; is that not right?

A It is.

Q And it shows 10.74 percent; is that correct?

A Yes.

Q And then the next two are KCPL Greater Missouri Operations, and those are in your proxy group, too, right?

A Yes.

Q And there's 10 percent, 10 percent for two decisions for that company; is that correct?

A Yes.

Q And then Empire is marked, but it's really not in your proxy group. And at any rate, there's no authorized return specified, correct?

A It is.

Q And if you turn the page, there is another -- there is an Appalachian Power decision and Appalachian Power is in your proxy group; is that correct?

A Yes.

Q And that's 10.9 percent; is that correct?

A AEP is in my proxy group. Appalachian Power is the subsidiary, yes.

Q And that shows 10.9 percent for Appalachian Power?

A Yes.

Q And Columbus Southern Power is also a subsidiary of AEP; is that correct?

A It is.

Q And it shows 10 percent for them?

A Yes.

Q And Ohio Power is also a subsidiary of AEP?

A Yes.

Q And it shows 10.3 percent for them?

A Yes.

Q And Upper Peninsula Power is also in your proxy group; is that true?

A Yes, it is.

Q And that's 10.2 percent?

A Yes.

Q And that's all the reported returns on that document; is that correct?

A Well, there's one for Georgia Power. No. I'm sorry. Yes. That is correct.

Q Okay. And can you take a look and see if I've missed any? Are those all the -- are those all the companies within your proxy group that are on that document?

A I believe it is.

Q Okay. And then on the next document, which is Exhibit 530, which should be a lot shorter, I'm looking at page 4 where they start listing the company and the company's authorized returns. The first one I marked was Indiana Michigan Power, which I believe is a subsidiary of AEP; is that correct?

A Yes.

Q You have it at 10.2 percent return on equity, correct?

A Yes.

Q And then Idaho Power, that's in your proxy group, correct?

A Yes.

Q And that is a 9.9 percent ROE?

A Yes.

Q And then Gulf Power, which is a Southern Company subsidiary?

A Correct.

Q And that's in your proxy group, correct?

A Yes.

Q And 10.05 percent ROE?

A Yes.

Q And Arizona Public Service, that's in your proxy group; is that correct?

A Yes.

Q And at 10 percent ROE. And that's the last one on that list. Can you take a look at that list to make sure I didn't miss any?

A It appears to be.

Q And isn't it true that of all those data points we just went over, only one, Idaho Power, got below a 10 percent return on equity, and they got 9.9 percent; is that correct?

A Yeah. For the time period these rate cases took place, that is correct.

Q Okay. I -- okay. I -- I'd like to take a look at your analyses. My understanding is you did three types of analyses models in your testimony, discounted cash flow analyses, and I know you did a couple different -- several different kinds of those, and risk premium analyses and a capital asset pricing model analysis; is that correct?

A It is.

Q Okay. And my understanding is the upper bound of your range, which is 9.4 percent, was based on results of your DCF analyses; is that correct?

A Yes, sir.

Q And the lower bounds you have in your range was based upon your risk premium analyses; is that correct?

A Yes.

Q Okay. So let's talk about the one that didn't figure into the range, which is the capital asset pricing model or CAPM. Can you briefly explain how a CAPM analysis works?

A CAPM analysis estimates a firm specific risk factor above a risk free rate. The firm specific risk factor is calculated by developing what is referred to a company specific beta estimate and multiplying that beta estimate by the market risk premium.

The product of multiplying the beta times the market risk premium produces a very specific risk factor. And you add that to what is the risk free rate, which I use a proxy for as the 30-year Treasury bond rate, and the sum of those two components, the firm specific risk component and the Treasury bond yield produces the CAPM return estimate for the company.

Q And what were -- what was the result of the CAPM analysis? What return -- return on equity did it produce?

A Shown on page 36, it produced a return of 8.7 percent.

Q And can you explain why you didn't use that result in your -- in developing your recommendation?

A Well, I was a little concerned about the reliability of that result because, essentially, the market risk premium I'd used reflected more normal risk premium levels where the risk free rate, the Treasury bond rate was at a very low level.

So I was concerned that it was a bit of a mismatch between firm specific risk component, which doesn't reflect the -- the general belief, including myself, that market risk premiums are a little high for risky securities and -- and applying that with a risk free rate.

So based on those parameters and my assessment in consideration of the results of the other models, I thought CAPM return estimate was too low in this case.

Q Isn't it true that you were also using a projected Treasury bond rate in your capitalization?

A I always do that. Yes.

Q Okay. And what -- what was the projected rate that you were using?

A Three point -- 3.7 percent.

Q And for what period was that projected?

A It would have been two years out at the time of the forecast. It would have been out through about June of 2014.

Q And do you know what the actual 30-year Treasury bond rate was at the time you filed your direct testimony?

A It was 3 percent.

Q And I'm assuming if you would have used -- if

you would have used the 3 percent as the Treasury bond component, then your result would be an even 70 points lower; is that true?

A Yes.

Q Okay. And do you know, by the way, what the 30-year Treasury bond rate is right now?

A I believe it's fallen under 3. I can't tell you exactly what it is, but I'm fairly certain it's less than 3 percent now.

Q And the CAPM model reflects point for point a reduction in the -- in the Treasury bond rate; is that correct?

A Well, the way I employ it, it does because I don't measure the market risk premium with my risk free rate estimate. But if you did, the market risk premium would adjust with changes in the risk free rate.

Q And didn't you also testify that Treasury bond yields are really higher than a true risk free rate?

A yes.

Q So -- so if you use a really true risk free rate, the result would have been even -- even lower than it was; is that correct?

A Well, that's -- that's true every time I file testimony, including this time.

Q Okay. And I think you testified that we're in a

market that does not reflect normal valuations of Treasury; is that true?

A I think there's a very, very profound flight to quality in the existing marketplace and low risk securities like Treasuries and like utility securities are being sold at a premium.

Q And, I mean, what -- okay. And is it -- are you saying that the -- that the rate of return on Treasury bonds is lower than normal? Is that your point?

A The price of Treasury bonds is higher than normal and the yield is lower.

Q Okay. Okay. And is the only reason for that the flight to quality, or does Government monetary policy affect that as well?

A Well, on the short end of the curve, Government monetary policy impacts Treasury bill yields and possibly Treasury notes. It's debatable whether or not the Federal Reserve can actually impact the long end of the yield curve. I believe they have limited inputs on it.

Under monetary policy, what's going on at the Fed now with them buying corporate securities, it's having an impact I think on bond yields. But that's because of the extraordinary economic conditions we're in right now.

Q And my understanding is when you calculated your market risk premium, you may have said this already, but

when you calculated your market risk premium group, your CAPM, you looked at the achieved return in stock investments versus Treasury bond investments with a data set that started in 1926 and up till the present; is that correct?

A Yes.

Q Okay. And isn't it true that you use historical information like this because, over the long run, the expectation is that the market will revert to what it has done in the past?

A Well, that is the -- the assumption for use of long historical time periods and then the way I've done it for measuring the market risk premium. So that is the assumption I'm making --

Q Okay.

A -- in this case. But --

Q No. That's -- let me -- let me ask you a little about your risk premium analysis. And I think we talked about this a bit in your deposition. Can -- well, first of all, can you briefly explain how the risk premium method works?

A Well, risk premium, like the CAPM, relies on observable bond yields as a starting point for estimating your required return for common equity securities. A risk premium that I use starts with the Treasury bond yield and estimates an appropriate equity risk premium to add to that bond yield estimated with the market required return on common equities for utility companies.

That equity risk premium will change over time based on the investment risk perceptions of the marketplace that equity securities is relative to debt securities.

So I attempt to gauge what an appropriate equity risk premium over Treasury bond yields is by looking at a relative spread of Treasuries and utility securities to get a sense of how the market perceives the utility industry at that time and whether or not they're pricing utility securities to produce a premium return, an average return or maybe a below average return.

In this instance, I thought market was pricing utility securities for an above average equity risk premium, so I incorporated that in my first risk premium study over Treasury bonds.

The second risk premium study was over observable utility bond yields. And again, it required measuring what the contemporary equity risk premium would be for utility bond yields, estimate the return on equity. And, again, it required gauging what the market's risk assessment is for equity securities versus debt securities, which is approximated by comparisons at utility valuations relative to Treasury securities and then estimating what appropriate equity risk premium is over utility bond yields in this marketplace.

Q Just so I understand, I mean, what you need in order to do a risk premium is you need a risk free rate, and then you need a market premium to go on top of it? Is that true? And you add those two things together, and that's the number that is produced?

A Well, you need an observable utility bond yield --

Q Okay.

A -- and an equity risk premium.

Q Okay.

A The risk free rate was from the CAPM study.

Q Okay. But you've also -- you've done two separate CAPM studies, one using Treasury bond rates, correct?

A Yes. And I do characterize that as risk free rate in my CAPM. But I -- it's a fair characterization, but I don't call it risk free rate in this bond.

Q I think what you did is you have two premium risk analyses, and then you averaged your results, and that average is what constituted the lower boundary of your range; is that correct?

A Well, I developed a range based on my risk premium study and then developed a point estimate using the risk premium model which is how I also interpreted the results of my DCF study and ultimately my CAPM study.

Q Okay. Let's take a look at your two risk premium analyses. And my understanding is for your risk premium analyses, you used data from 1986 to 2011 to calculate the risk premium in both of those studies; is that correct?

A Yes.

Q Okay. And -- and the first one used Treasury bonds, right?

A Yes.

Q And my understanding is the results of your two separate risk premium analyses are set out on Schedule MPG-11 and MPG-12 attached to your direct testimony, correct?

A Yes.

Q Okay. Well, let's take them individually. I went ahead and made a blow-up of -- this is unfortunately where we start to get down to the weeds, but there's no -- there's no avoiding it.

I went ahead and blew up MPG-11. And I'm hoping you can tell me -- well, let me -- let me walk through how I think it works, and you can tell me if I'm right or wrong.

Okay. On MPG-11, you've got all the years from 1986 to 2011. That's the first column that just lists the years, right?

A Yes.

Q And the second column, Authorized Electric Return, that's the electric utility return based on RRA data or average electric utility return for each of those years based on RRA, correct?

A Industry average, yes.

Q So like, for example, the 10.22 is here for 2011. That's a number we've been talking about today, correct?

A Yes.

Q Okay. The next column has Treasury bond yields. And as I understand it, that is 20-year Treasury yields, the average for each of those years; is that correct?

A It's the long-term bond. Yes.

Q Okay. They just didn't have a 30-year bond or -- it could be 30 years once they had them?

A No. It was 20 years because there was a period during the '90s when the U.S. Government went to surplus budgets that they stopped selling 20-year Treasury bonds and the data wasn't available for part of the analysis.

Q Okay. And this last column is indicated risk premium, and that's each year you subtract the Treasury

bond yields from the authorized electric return for that year, and then you get an indicated risk premium for that year, right?

A Yes.

Q And there's 26 different years with 26 different indicated risk premiums, right?

A Yes.

Q Okay. So then, as I understand it, to figure out a risk premium, the first thing you did with this data set is you threw out the three highest results and the three lowest results; is that correct?

A Yes.

Q Okay. And the three highest results, I'm going to mark them with a plus. And let's see. I think they were -- no. Let me catch up with my notes here. Okay. It looks like the three highest results were 6.41 from 2009; is that correct? I'm going to put a little plus here, so hope I don't get it wrong.

A Yes.

Q That's the highest result. And so you threw it out. And the next highest result was 6.31 from 2011, so you threw out that result; is that correct?

A Yes.

Q And then the next highest result is 6.18 from 2008, so you threw out that result; is that correct?

A Yes.

Q So for the -- for the high results that you threw out, you threw out the results for three out of the last four years; isn't that correct?

A Yes.

Q Okay. Then you threw out the lowest results, too. And I think the low -- the lowest result was 3.83 way back in 1988. So I'm going to put a minus sign by that one. You threw that out because it was too low, right?

A Yes.

Q And then the next lowest was 1994 at 3.97, right?

A Yes.

Q Put a minus sign by that. And then the next lowest one was 4.09 from 1990. So I put a minus sign by that, right?

A Yes.

Q Is that -- am I doing all right so far?

A Yeah.

Q And then my understanding is after you threw the three highest and the three lowest out, you established your range with the highest remaining risk premium and lowest remaining risk premium; is that correct?

A Yes.

Q And in this instance, the highest remaining risk premium was the one from 1986, right? I'm going to circle that if that was one of the bounds of your range. Is that true?

A Yes.

Q And the lowest risk premium, coincidentally enough, was the next year, 4.41 percent in 1987, right?

A Yes.

Q Okay. And so -- and then -- well, and then, as I understand it, once you had this range established -- well, in order to -- for these risk premiums to be turned into a return on equity, you've got to add back in the Treasury bond yield; is that right?

A Yes.

Q And so as I understand it, you took these two numbers and you added the 3.7 percent, which is what you're using as a Treasury bond yield. I understand it's not current. It was a projected two years into the future, but that's what you're using, right?

A It is.

Q Okay. So you would add 3.7 to 6.13, and that would be the top of your range. Do you know what that ended up being? Can you -- can you add those two numbers together?

A That's at page 30 of my testimony. And the high end of the rage was 9.83 percent. It's on page 30, line 10. And the low end of the range was 8.11 percent shown on line 9.

Q Okay. And then my understanding is that you weighted the high end of the range, which was 9.83?

A Yes.

Q You weighted that two to one -- or weighted it two-thirds, and you rated the low end of your range, which is 8.11 percent, up one-third; is that correct?

A It is.

Q And so then for this, it gave you a result of 9.3 percent, right?

A 9.26, and I rounded it to 9.3.

Q Okay. And so -- I mean, what obviously struck me about this is, you know, throughout the -- you threw out three out of the last four years for being too high, and the ones that you threw out for being too low were in 1998 and 1990 and 1994. That's correct, isn't it?

A That's how it turned out in this case, yes.

Q Sure. And then what you -- but what you ended up doing is you're using risk premium from 1986 and 1987 to figure out what our return on equity should be here in 2000 -- I guess it's 2013 by the time the rate come into effect; isn't that correct?

A That's a -- that's a fair -- I mean, that's not how the analysis --

Q Just please answer --

A -- is structured, but that's the result of the analysis.

Q Okay. And wouldn't you agree with me that the financial conditions prevailing back in 1986 and 1987 were completely different from the financial conditions that are prevailing now?

A Not completely different. The reason I selected --

Q No. No. I'm not -- I'm not asking you the reason that you did it. I'm asking you if the financial conditions are completely different. Yes or no?

A The financial conditions are the reason I selected this time period.

Q Well, isn't it true -- just look at your chart. My gosh. Isn't it true authorized electric returns were 14 percent and 13 percent in -- you know, almost 14 percent, almost 13 percent in '86 and '87; isn't that true?

A It is.

Q Isn't it true that Treasury bond yields were 7.8 and 8.5 percent back in those years? Isn't that true?

A Yes.

Q Do you know what the Dow Jones industrial

average was in 1986?

A It was less than it is now.

Q Would you believe it was less than 2,000?

A Subject to check.

Q Okay.

MR. BYRNE: All right. Your Honor, I've got copies of this chart that I would like to mark and offer as an exhibit.

JUDGE WOODRUFF: All right. Your next number is 71.

MR. THOMPSON: I'm sorry, Judge. What did you say the next number is?

JUDGE WOODRUFF: 71.

MR. THOMPSON: Thank you.

COMMISSIONER KENNEY: Thank you.

CHAIRMAN GUNN: Premarked. Nicely done.

Q (By Mr. Byrne) Okay. Well, let's look at the next chart, which I think is MPG-12. And this, I believe, was your second risk premium analysis; is that correct?

A Yes.

Q And I think --

MR. BYRNE: Oh, your Honor, I'd like to offer Exhibit 71, if that's what it was.

JUDGE WOODRUFF: All right. 71 has been offered. Any objections to its receipt? Hearing none, it will be received.

(Exhibit 71 was offered and received into evidence.)

Q (By Mr. Byrne) You know, before I leave the other one, I think I'll ask you, wouldn't it -- wouldn't it have been possible to use more recent data to do your analysis, Mr. Gorman?

A If you're attempting to increase the return on equity estimate by manipulating the date, you could, yes.

Q So, for example, if I wanted to use the most recent five years of data and do the same analysis that you did, what -- what result would it produce?

Let me see if I can walk you through it. If you only used the last five years data, one, two, three, four, five, the high end of your return would be 6.41 percent, correct?

A Are we throwing out the high and the low or --

Q No. This is -- this is instead of the data set after the high and low have been thrown out. If you use the last five years --

A So excluding them --

Q The last five years as the whole data set. That's what I'm asking.

A Throwing out the high and low is a way of trying to capture the central tendency of all the data.

Q sure. I'm not doing that here. I'm asking if you used the last years of data, what would it be?

A You're asking me if I used the last five years of data and I didn't try to capture the central tendency of the data net end, then yes.

Q Okay.

A The high end of the data would be 6.41 percent.

Q 6.41 percent, plus you have to add 3.7 percent, don't you?

A Yes.

Q What would that be?

A 10.1 percent.

Q Okay. And what -- and the low end would be 5.53 percent plus 3.7 percent. What would that be?

A 9.2.

Q And what if you weighted the high end two-thirds like you did in your analysis and the low end one-third? What would that result be?

A 9.8.

Q And what if you just used the simple average of the last five years of risk premium? What would that simple average be?

A The risk premium would be 6.1 percent. And with the bond yield of 3.7, it would be 9.8 percent.

Q So that would also be 9.8 percent?

A Yes.
Q What about ten years of data? If you used ten years of data, the highest ROE -- or the highest risk premium would still be 6.41 percent; is that correct? And so if you add 3.7, that, again, would be -- the high end of your range would be ten 10.1 percent, correct?
A Yes.
Q But the low end would move that to 5.37 percent from 2007. And so if you add 3.7 to that, that would be 9.07 would be the low end; is that correct?
A It is.
Q And if you weighted the high end two-thirds and the low end one-third, it would produce 9.75 percent; is that correct?
A 9.76. Yes.
Q Okay. And what if, again, you just used a simple average of the last ten years of risk premium? I calculate a 5.9 percent risk premium; is that correct?
A I'm sorry. You got what?
Q I got 5.9 percent.
A Yes.
Q And then if you add 3.7, that yields 9.6 percent; is that correct?
A It is.
Q Okay. Now we'll get into the other one. Sorry,

this is the part where it gets boring.

MR. THOMPSON: Oh.

Q (By Mr. Byrne) Okay. So that I've reproduced MPG-12, which, again, I think is your second risk premium analysis. And this one uses A rated utility bond yields in the place of the Treasuries from the last chart; is that correct?

A Yes.

Q And it's the same 26 years' worth of data?

A Correct.

Q Okay. And so -- so, again, you threw out the three highest and the three lowest. The highest one looks to me like it's 5.18 percent in 2011; is that correct?

A Yes.

Q The most recent year of data. And then the next highest is 4.89 in 2009; is that right? Wait.

A 4.88.89.

Q 4.88. Is that the highest?

A 2010. Oh, I'm sorry. Yeah. 2006.

Q Yeah. You're right. Thanks. I'm sorry. 2006, 4.89?

A Yes.

Q Okay. And then I must have mistyped. And then what's the third highest, if you know?

A And I think it's the 4.88.

Q Then it goes to 4.88. Okay. So the three highest this time were in 2001, 2010 and 2006. How about the three lowest? I think 2.30 in 1988 is the lowest. Does that sound right to you?

A Yes.

Q Minus --

A 2.89 in '87.

Q 2.89 is the second lowest?

A Well, 2.84 in '91 -- or '90.

Q Okay. So these are the three lowest are 1987, 1988 and 1990, right?

A Yes.

Q And so then, again, you pick the lowest and the highest of the remaining, which it looks like -- I think those were in, I think, 1994. The 3.03 is the lowest; is that correct?

A I will my doublecheck my testimony.

Q Okay. I show 3.03 as being the lowest and 4.62 in '98 being the highest?

A Yes.

Q So at least these -- you know these are '95 and '98. No. '94 and '98.

A Yes.

Q So at least they're a little more current. But still Clinton era.

MR. BYRNE: Okay. Your Honor, I also have copies of this I'd like to mark as an exhibit if I could.

JUDGE WOODRUFF: Okay. Your next number is 72.

Q (By Mr. Byrne) I'm going to ask you to do the same thing again with this chart. Mr. Gorman, if you pick out the last five years worth of data, if you set your -- the high end of your range at the high point in the last five years, it would be 5.18, correct?

A Yes.

Q And if you added -- and what risk premium are you adding to those for the -- for the bond yield?

A To this, I'm adding the bond yield that's appropriate for AmerenUE, which is a BAA bond yield of 5.01 percent.

Q Okay. So if you add the 5.18 plus the 5.01 percent, that would be a 10.2 percent ROE on the high end; is that correct?

A 10.19 , yes.

Q Okay. And then the low end of the range would be the risk premium of 3.93 percent from 2008; is that correct?

A Yes.

Q And if you add 5.01 to that, that would yield 8.94 percent; is that correct?

A Yes.

Q And if you weighted the high end two-thirds and the low end one-third, what would that result be?

A 9.77.

Q Okay. And, again, could you calculate it averaging the last five years of risk premiums?

A Five-year average of 4.54 gets a return on equity estimate of 9.55.

Q Okay. And if you did the same thing over ten years, my understanding is that 5.18 would still be the highest risk premium; is that correct?

A Yes.

Q So it would still be 10.2 percent on the high end of your range, but the low would now be 3.79 percent, correct?

A Yes.

Q And that would -- so that would yield a return of 8.8 percent; is that correct?

A Yes.

Q And if you weight the highest end two-thirds and the lowest end one-third, that would be 9.73 percent; is that correct?

A 9.73.

Q Yeah.

A Yes.

Q And then, finally, if you averaged the risk

premiums of the last ten years, what result would that produce?

A It's 4.47. That would be 9.48.

MR. BYRNE: Okay. Judge, I'd like to offer Exhibit 72 into the record.

JUDGE WOODRUFF: Exhibit 72 has been offered. Any objections to its receipt?

MR. THOMPSON: I'm going to object, Judge, because while entertaining, this lengthy cross has shown that it's possible to manipulate the data set used by Mr. Gorman to achieve different results than the results he did achieve. But it's not his testimony. And I think it's -- it's, frankly, irrelevant.

JUDGE WOODRUFF: I'm going to overrule the objection, and it will be admitted.

(Exhibit 72 was offered and received into evidence.)

MR. THOMPSON: Thank you.

Q (By Mr. Byrne) Let's talk a little bit about your DCF analysis, Mr. Gorman. It's my understanding the high end of your range, 9.4 percent, is based on your discounted cash flow or DCF analysis; is that correct?

A Yes.

Q And my understanding is you did three separate DCF analyses; is that correct?

A Yes.
Q You did a constant growth DCF analysis; is that correct?
A Using an analyst's growth rates, yes.
Q And you also did a constant growth sustainable growth version of the model; is that correct?
A It is.
Q And then you did a multi-stage version of the model; is that correct?
A Yes.
Q Okay. And with regard to the sustainable growth version of the model, it's my understanding that it produced an ROE estimate of 8.63 percent; is that correct?
A Yes.
Q And that result was even lower than your CAPM result; is that correct?
A It is.
Q Which you testified that you didn't use because it was too low; is that correct?
A I testified I didn't use it because it was too low for the concerns I had with the level of Treasury bond yields and the way the market risk premium was measured in my model.
Q Okay. Fair enough. But in any event, it's my understanding that your sustainable growth model results

do not play a part in your ROE recommendation in this case; is that correct?

A That is true, but not for the reasons I decided not to rely on the CAPM results.

Q But, nonetheless, it didn't play a role in your -- in your recommendation; is that true?

A Well --

Q Do you have your deposition? Because I think we talked about this in your deposition.

A Well, but I didn't use it in developing my range, but --

Q That's answers my question.

A Well, no.

Q That answers my question. Okay. Then the remaining DCF analyses that you conducted produced ROEs of 9.3 percent for the constant growth, correct?

A Yes.

Q And 9.38 percent for the multi-stage growth; is that correct?

A I -- yeah. I rounded that up to 9.40 percent. But --

Q Okay.

A But for purposes of summarizing the results of the DCF studies.

Q And then, as I understand it, from reading your

testimony to be conservative, you picked 9.4 percent, which was the highest -- or the higher of the two for your -- for the top end of your range; is that correct?

A That is correct.

Q Okay. I -- Mr. Gorman, I'd like to show you a copy of your testimony from Case No. ER-2010-06.

MR. BYRNE: Your Honor, may I approach the witness?

JUDGE WOODRUFF: You may.

Q (By Mr. Byrne) Okay. And do you recognize that document?

A Yes.

Q And in that case, I don't know if you recall, but you had two separate proxy groups. And do you -- do you recall that? Maybe you can take a look at it and see if you recall that.

A Yes. There is two proxy groups here.

Q Okay. And what were the names of the proxy groups?

A One was Integrated Electric Utilities, and the other one was S&P Electric Utilities.

Q Okay. And my understanding is you did six separate DCF analyses in that case -- three separate DCF analyses, but using two proxy groups in each analysis; is that correct?

A Yeah. The later description is correct.

Q Okay. So I'd like to walk you through the results of your analyses in that case. And I have another chart that has these results. And I want to -- I want you to verify that I've accurately produced the results. So the first thing -- the first result was the constant growth DCF for Integrated Electric Utilities, okay? And I think that is shown -- you have a schedule for that?

A MPG-6.

Q MPG-6. And on MPG-6, that has an average of 12.02 and a median of 11.03, which are on this chart; is that correct?

A Do you have a copy I could --

Q Oh, sure. Actually, I do. I hate that I have to acknowledge that I'm getting old.

MR. BYRNE: In fact, as long as I'm doing it, I'll have it marked as an exhibit.

JUDGE WOODRUFF: It will be 73.

Q (By Mr. Byrne) And so it shows -- my chart -- or actually, Exhibit 73 shows 12.2 for the mean and 11.03 for the median for your constant growth DCF Integrated Electric Utilities proxy group; is that correct?

A Yes.

Q Okay. And then how about the constant growth result for the S&P Electric Utilities? I show a mean of

11.99 percent and a median of 11.01 percent. Is that correct?

A Yes.

Q And for the next one, I show the constant growth sustainable growth for the Integrated Electric Utilities with a mean of 10.68 and a median of 10.2; is that correct?

A Yes.

Q And then for the next one, I show the sustainable growth for the S&P Electric Utilities, the mean of 11.59 percent and the median of 11.5 percent; is that correct?

A Yes.

Q And then for the multi-stage DCF for the Integrated Electric Utilities proxy group, I show a mean of 10.73 and a median of 10.25 percent; is that correct?

A Yes.

Q And for the multi-stage DCF S&P Electric Utilities proxy group, mean is 10.51 and the median is 10.06 percent; is that correct?

A It is.

Q And isn't it true that in that case, when you chose to use the median, which I -- you chose to use the median, which in every case was lower than the mean in that -- in that case; is that true?

A Well, based on the analysis at that time that's the reason you would choose --

Q Well, I mean, I just want to know if it's true or not. Maybe on redirect you can explain why.

A Trying to save a little time. It's true for the constant growth. It's true for the constant growth with sustainable growth. And it's true for the multi-stage growth.

Q Okay. I'll hand you your testimony from the last rate case, which was Case No. ER-2011-0028. Do you recognize that testimony, Mr. Gorman?

A Yes.

Q And, again, I think in this case, you only had one proxy group; is that correct?

A Yes.

Q And you did three -- you did three DCF studies; is that correct?

A Yes.

Q And, again -- well, maybe I can get you a -- I guess you already have that. And, again, the -- can you confirm that I've correctly put on Exhibit 73 and on this chart the -- the results of your studies?

I show for the constant growth a mean result of 10.31 and a median of 10.17; is that correct?

A Yes.

Q And for the sustainable growth, I show a mean of 10.26 and a median of 9.67; is that correct?

A Yes.

Q And for the multi-stage DCF, I show a 9.65 percent for the mean and a 9.86 percent for the median; is that correct?

A It is.

Q And then my understanding is, in this case, you -- your -- your recommendation or your -- your DCF result resulted from averaging the three results; is that correct?

A Pardon me?

Q Your -- your -- the summary of your DCF -- the DCF result that you used was an average of those three results; is that correct? And I'm -- specifically, I'm looking on page 24 of your testimony.

A No. My -- I used the highest estimate of the model, multi-stage model of 9.4 in this case. In the other cases, I considered -- gave some weight to the other models.

Q Okay. You didn't -- you didn't -- look on page 24 of your testimony.

A One six?

MR. LOWERY: Tom, he's confused. He's looking at his current testimony.

Q (By Mr. Byrne) Oh, I'm sorry. I'm looking at. Your 2011-0028 testimony.
A I'm sorry.
Q I apologize for the confusion. And all your DCF results are on a table, Table 2 on page 24. Do you see that?
A Yes.
Q And it looks to me like you used the average of all of the medians of the three studies; is that correct?
A It is.
Q And isn't it true that the average of the medians produces a lower result than the average of the means would have for those studies? I mean, I haven't done the math, but the constant growth, 10.31 is higher than 10.17. 10.26 is a lot higher than 9.67. And --
A I would suspect it would be higher. Yes.
Q Okay. But then along comes the current case. And, again, you did -- I don't have to hand you anything because this is all in the record. But, again, you did three DCF studies. You did a constant growth. You did a sustainable growth. And you did a multi-stage growth.
But this time, instead of picking the median to use for your result, you picked the mean; isn't that correct?
A Yes.

Q And if you would have picked the -- the mean result, your constant growth was 9.3 percent. But if you would have picked the median, it would have been 9.9 percent; is that right?

A Yes.

Q And the mean for your multi-stage was 9.38 percent. But if you would have picked the median, it would have been 9.7 percent; isn't that right?

A Yes. And the sustainable growth would have been 8.47 percent instead of 8.63.

Q That's true. Mr. Gorman, isn't it true that you told me in your deposition that the reason that you use a median rather than a mean is to account for outliers?

A Well, generally, yes. But, I mean, the --

Q Okay.

A Well, what you're trying to describe is what the central --

Q I think that answers my question. I just asked if that's what you told me during your deposition, and you said yes. So -- yeah.

MR. BYRNE: I guess, your Honor, I'd like to offer Exhibit 73.

JUDGE WOODRUFF: 73 has been offered. Any objections to its receipt? Hearing none, it will be received.

(Exhibit 73 was offered and received into evidence.)

Q (By Mr. Byrne) I tried to do a scattered plot graph. And I'll -- I know it's a little bit hard to see on the chart, so I'll give it to you.

JUDGE WOODRUFF: Will this be 74?

MR. BYRNE: Yes.

Q (By Mr. Byrne) And the scattered plot graph that I just gave you that is on the board tries to show a comparison of the results of your proxy group for your constant growth DCF model in this case, which is on the bottom with the results from your constant growth DCF model from the last case, Case No. ER-2011-0028, which is on top.

Let me ask you this: Can you confirm for me that those scatter plots reflects the data in your constant growth DCF schedules for those two cases?

A Well, I would need the data used to produce this graph. But --

Q Well, the data is on the schedules in your testimony that you have that -- for the -- for the constant growth.

A I would need to confirm that that data used to produce this graph is consistent with the data on my schedules.

Q Okay. Well, then we'll just -- I guess we can walk through it. Let's start with ER-2011-0028. And do you have -- still have your testimony from that case?
A Yes.
Q Okay. And I believe your constant growth DCF model is shown on -- I believe it's shown on Schedule MPG-4; is that correct?
A Yes.
Q So looking at the scatter plot graph, the first result is from American Electric Power Company; is that correct?
A It is.
Q 9.05. Do you see it on the scatter plot graph?
A It appears to be there.
Q Okay. The next one is Cleco Corporation, 7.71. Do you see it as the next dot on the scatter plot graph?
A Yes.
Q The next one is DPL, 11.05. Do you see it as the next dot on the scatter plot graph?
A I do.
Q Then the next one doesn't have an ROE. Then the next one is Idacorp, which is 8.18. See it as the next point on the scatter plot graph?
A It appears to be.
Q And the next one is 10.7. Do you see that as

the next point on the scatter plot graph?
A Appears to be.
Q The next one is 12.81. That's the next point, correct?
A Appears to be.
Q 10.31 is the next one, correct?
A Appears to be.
Q And 9.97 is the next one --
A Appears to be.
Q -- correct? 10.03 is the next one?
A Appears to be.
Q And 13.28 is the next one?
A Appears to be.
Q Okay. And then same with your testimony in this case. Well, perhaps you could just do the same thing on your own with the testimony in this case. Or would you like me to walk through it plot by plot?
A It appears to reflect this data.
Q And I guess the point of me making these scatter plot graphs is -- is to show the -- the relative outliers in ER-2011-0028 where you used the median and this case, ER-2012-0166, where you used the mean. Isn't the most outlying point on either of these graphs the 5 point -- I guess it's just a little over 5 percent result that's on -- that's in this case? Isn't that the most outlying

point on either of those graphs?

A In terms of being the furthest away from the average?

Q Yes.

A Probably is, yes.

Q I mean, aren't there about as many outliers on the ER-2012-0166 scatter plot graph as there are on the ER-2011-0028 scatter plot graph?

A Well --

Q It's a yes or no question.

A Could you repeat the question?

Q Aren't there about as many outliers in this case as there were in the last case? If anything, it appears to be there's more outliers in this case; isn't that correct?

A Are you asking how I interpreted the results of the data or --

Q No. I'm asking you, isn't it true there's as many or more outliers on the scatter plot graph for this case as there are on the scatter plot graph for that case? Yes or no?

A In this case, they are six points above the average. In this case, they were four -- in this case, it's four points below. In the last case, there was one, two, three, four right on the average and median with three above and three below.

Q Okay. Let's try it for your multi-stage growth. And I tell you what, your -- let's try it for the multi-stage growth. Again, I've put together a scatter plot graphs, and I can walk you through them, or could you just check to see if --

A I'll agree to it subject to check.

Q Okay. And, again, doesn't -- doesn't this show about the same amount of outliers in both this case and the last case?

A I probably will need a copy of that to check it.

Q I'm sorry. Yeah. Let me --

JUDGE WOODRUFF: It will be 75, then.

A Well, there are outliers. But, again, in the last case, there were more observations kind of scattered on the median and means than there was in this case. There's more of a dispersion of the results in this case than there was in the last case.

MR. BYRNE: Your Honor, I'd offer Exhibits 74 and 75 for the record.

JUDGE WOODRUFF: 74 and 75 have been offered. Any objections to their receipt? Hearing none, they will be received.

(Exhibits 74 and 75 were offered and admitted into evidence.)

MS. ILES: What was the number? I'm sorry.
MR. LOWERY: 75 was the last one, Carole.
MR. BYRNE: If I can have just a minute, your Honor. I'm disorganized.
Q (By Mr. Byrne) Mr. Gorman, I'd like to ask you a couple of questions about the growth rate in Stage 3 of your multi-stage analysis. I think we talked a little bit about it earlier.
My recollection is you used a 4.8 percent growth rate for Stage 3; is that correct?
A It is.
Q And can you tell me where you got that 4.9 percent?
A 4.9 percent is an average of the consensus of economists projections of GEP growth rate over the next five and ten-year periods.
Q Okay. And doesn't that create some degree of a problem for an analyst because what you're really trying to do is project growth that doesn't begin until year '11 in Stage 3 of the multi-stage growth model? Isn't there a disconnect between using five-year and ten-year data to -- to project growth that's to occur beginning in year '11 and continuing to infinity?
A There -- there is a problem with identifying publicly available forecasts by independent economists of

GEP growth rates longer than ten years. And the growth rate used in the model covers a period longer than ten years.

Q I mean, I guess the problem is there really isn't market-based information available; is that fair to say?

A Well, there are some individual analysts that project long-term growth rates. And I think I identified some of those in my testimony. But it's the only source of consensus economist projections, which is my preferred source because I think it better captures what the likely expectations of investors are.

MR. BYRNE: Okay. Thank you. That's all the questions I have.

JUDGE WOODRUFF: Okay. Then we'll come up for question from the Bench. Commissioner Kenney?

CROSS-EXAMINATION

BY COMMISSIONER KENNEY:

Q Hello.

A Good afternoon.

Q I just have a few questions. You were here when I was questioning Mr. Hevert about some of the things I asked him about. I was going to ask you about the whole notion of using non-regulated utility proxy groups, but I think you sufficiently answered that under questioning

from other counsel, so I'll skip all that.

A If I would be permitted, I've got --

Q Sure.

A Utilities compete with non-regulated companies for capital.

Q Right.

A So it's not my position that the investment returns for those companies utilities compete with for capitals are irrelevant. My point is that the -- the ability to accurately estimate a return for those companies which truly are valued by the marketplace in a comparable way that utility securities is valued and the cost of capitals are set is highly uncertain.

And some risk factors that suggest that they're comparable in risk and you would expect to get the same cost of capital, when there is observable evidence on that what cost of capital is, you can see that they're not the same, even though you would think they would be the same because they're comparable risk.

Q So you could construct a proxy group of comparable risk, but the value placed on their stock would be different?

A Well, I think the reliability of your cost estimate to identify what the investors required return for the utility securities are would be highly problematic.

Q So would you argue, then, that there would be no value in constructing such a proxy group as a supplement to the typical proxy group?

A I think all data points are worth giving some consideration, so I wouldn't say there's no value.

Q Okay.

A I would just caution the use of a non-regulated proxy group in estimating a fair return.

Q Okay. Fair enough. So let me just ask a few questions, and then I'll try to get us out of here. What -- what's your hourly rate?

A $215.

Q And is that the same for deposition and trial?

A It is.

Q Were you deposed?

A Yes.

Q Okay. And have you -- I looked at your CV, and I saw that there was a list of agencies for which you sponsored -- entities for which you had sponsored testimony in front of different regulatory bodies.

A Uh-huh.

Q Have you sponsored testimony for an Office of Public Counsel or residential ratepayer advocate entity?

A I have worked for Office of Public Counsel here in Missouri and Washington state.

Q That -- that was when you were employed by Office of Public Counsel, or you were employed as an expert by --

A No. My current employment.

Q Okay. And have you ever sponsored testimony for -- on behalf of a regulated utility?

A I've been hired as an advisor to the regulators to make decisions, but I've never offered testimony on their behalf.

Q For regulators?

A Yes.

Q In which states?

A Actually, I was in the providence of New Finland.

Q Okay. How about an investor-owned utility?

A I sponsored testimony once on behalf of a investor-owned utility.

Q Okay.

A I've been hired by utilities to do studies, but I've only sponsored testimony in their behalf once.

Q Okay. Now, Mr. Murray refers in his testimony to the terms cost of equity and return on equity as different and distinct concepts. What's your -- your opinion about defining those two terms distinctly?

A I'm not sure how Mr. Murray is drawing that distinction. I mean, the cost of equity is -- is the cost to the utility to be able to attract equity capital. A return on equity, I suppose, would be what investors receive after they -- they make an investment in a company.

Q And I think you heard my discussion earlier about the credit rating agencies and their notions in assessing risk has more do with the utility's ability to recover its costs and their assessment of the regulatory environment in which the utility is operating. Would you agree with me, though, that the credit rated -- credit rating agencies don't make any determination or pass any judgments upon the prudence of the utility's expenditures?

A Yes. It's my understanding credit rating agencies are -- are focused exclusively on the utility's ability to meets the debt service requirements of the bond holders.

Q Exclusively?

A Exclusively.

Q Okay. And I think -- we talked about Moody's and S&P and Fitch's and how Moody's credit metrics are more transparent. And I think in your testimony, you used your proposed ROE and ran it through whatever metrics Moody's utilized and came up with the conclusion that your

ROE wouldn't -- wouldn't cause any damage to their -- to Ameren's credit rating; is that correct?

A Well, I used S&P benchmark, not Moody's.

Q Okay.

A And the reason I used S&P's is because they are focused exclusively on investor capital.

Q Okay.

A Third party off balance sheet obligations. Moody's ratios, on the other hand, include zero cost capital components such as deferred taxes, which is relevant, but -- but it's also -- the way it's treated here in Missouri, those are rate-based offsets, so it just seemed more of a direct comparison of a return on equity and depreciation of rates and expense recoveries to rely on Standard & Poor's benchmarks.

And, also, Standard & Poor's has some published guidelines to help gauge whether or not they are within the range adequate to support an investment pre pondere.

Q Could you perform the same analysis with Moody's?

A I could. They would be slightly different ratios, and you could use Moody's medians as a way of judging the adequacy of their ratio. But Moody's does not publish a benchmark like S&P does.

Q Okay. And then would you offer an opinion one

way or the other on whether Mr. Murray's ROE recommendations are legally confiscatory?

A I can't. It's the legality of it.

Q Okay. And a similar question that I asked Mr. Hevert, do -- do you consider Mr. Hevert and Mr. Gorman -- I mean, Mr. Murray, rather, to be experts?

A Yes.

COMMISSIONER KENNEY: Okay. All right. That's all I have. Thank you.

JUDGE WOODRUFF: All right. Commissioner Stoll?

COMMISSIONER STOLL: One quick question.

CROSS-EXAMINATION

BY COMMISSIONER STOLL.

Q Earlier in your conversation with Mr. Byrne, you mentioned that you didn't use the results of the analysis of the capital asset pricing method.

A Correct.

Q Would you care to elaborate on that at this time?

A I performed the analysis, and I showed what the results were. But I was concerned with whether or not that model was producing a reliable result now because I think there is a -- a large risk premium in the marketplace today relative to risk free proxies, Treasury securities.

Treasury bond yields right now are very low and have been low as long as we've been in economic distress as a country. One would expect and we see this with utility securities and with corporate securities, that there is a -- an above average risk premium for -- for increasing levels of risk in the marketplace.

But my CAPM analysis had a market risk premium that was based more on average risk premiums over time rather than above average risk premium that I think exists in today's marketplace. So I think it produced a return that was too low.

Q So I -- I guess -- so, obviously, then, in -- if other economic conditions existed, then you may have used that analysis?

A This is -- only for about the last year or year and a half, I -- I either have not used the CAPM or I put some very, very strong cautions on use of the CAPM.

As the economy recovers and market turns to more normal conditions, I likely will start using the CAPM again as part of my estimates to support my return on equity recommendations.

COMMISSIONER STOLL: Okay. Thank you.

JUDGE WOODRUFF: All right. We'll go to recross based on questions from the Bench, beginning with Public Counsel.

MS. BAKER: No questions. Thank you.

JUDGE WOODRUFF: For staff?

MR. THOMPSON: Thank you.

RECROSS EXAMINATION

BY MR. THOMPSON:

Q You'll recall, Mr. Gorman, a series of questions -- I guess they were "what if" questions from Mr. Byrne relating to your Schedules MPG-11 and MPG-12.

MR. BYRNE: I'm going to object. This is not based on questions from the Bench.

JUDGE WOODRUFF: He just said it was questions from Mr. Byrne.

MR. THOMPSON: They were questions from Mr. Byrne.

JUDGE WOODRUFF: All right. I'll sustain the objection.

MR. THOMPSON: Okay.

Q (By Mr. Thompson) Well, let me ask one question, then, based on what Commissioner Kenney asked. You stated that you consider Mr. Murray and Mr. Hevert to be experts in financial analysis?

A I do.

Q Do you consider Mr. Byrne to be an expert in financial analysis?

A I do not.

MR. THOMPSON: Thank you. No further questions.
JUDGE WOODRUFF: Okay. Recross Ameren?
MR. BYRNE: No, thank you.
JUDGE WOODRUFF: Redirect?
MS. ILES: Thank you, your Honor.

RECROSS EXAMINATION

BY MS. ILES:

Q Mr. Gorman, Mr. Byrne asked you a number of questions about the results reported in the RRA documents that have been admitted into testimony -- into evidence from one -- which is Ameren 69 showing the rate decisions from calendar 2011 and then Exhibit 530, which is the major case decisions from January through June of 2012. Do you remember Mr. Byrne asking you about those?

A I do.

Q What conclusions do you draw from the information that he pointed out to you in his cross-examination of you?

A Well, the conclusions I draw is the findings are not that surprising because capital market costs a couple years ago were higher than they are today. AmerenUE's -- or Ameren Missouri's last authorized return on equity was 10.2 percent.

The focus of my testimony is to provide evidence of why its cost of equity is no longer that high. I suspect that if I would have offered testimony for all these other proxy companies in the regulatory Commissions addressing their authorized return on equity, I would have provided similar evidence.

So what's relevant in this case, I believe, or I submit to the Commission for your consideration is what the current market cost of equity is for Ameren Missouri and these other companies, not what was their last authorized return on equity.

I agree that it's relevant because the markets's looking at it. But nevertheless, the return which is fair to the company and fair to investors is what the current market cost of equity is.

And I say that because it's not always going to be a lower number. There will be instances where the return in a rate case may be higher than the last authorized return on equity.

And if the utility has a right to expect to increase on return on equity in a rate case, I think customers have the right to expect you to decrease the return on equity in a rate case if the return on equity suggests that's a fair thing to do.

Q Mr. Byrne also asked you some questions about your equity risk premium calculations, specifically, your Schedule MPG-12 and MGP -- or MGP -- MPG-11 and MPG-12,

which are Exhibits 61 and 62. Do you remember those questions?

A Yes.

Q And, specifically, he asked you about -- and he asked you a number of questions about the time period reflected on these schedules and the fact that they go back to 1986. Can you explain why you used the time period that you did?

A I can. And the time period was selected because this is a period over which the observable market evidence indicated utilities had access to equity capital. Go back to -- to some of the cross we had before.

The principles of a fair return on equity is fair compensation and the ability to go to the market for additional capital if you need it to fund infrastructure and investments.

Since 1986, electric utility stocks have, on average, traded at premiums to book value. What that means is the utility could sell additional shares of common stock without diluting the value of shares -- existing shares through existing shareholders.

So that's an indication that the valuations that were in part supported by these authorized returns on equity supported the utility's access to external additional equity capital.

Prior to 1986, market to book ratios were below one. And that argument didn't hold up for that time period. So this time period was collected specifically to reflect a period where authorized returns on equity contributed towards the valuation of utility securities which supported the utility's access to additional equity capital in the marketplace.

Q So I think Mr. Byrne specifically asked you whether the financial conditions in 1986 and 1987 were completely different from current conditions. And I don't think he really gave you a chance to answer that. So would you like to explain?

A Well --

Q Are there any similarities?

A -- there -- the circumstances of the marketplace change constantly. so if -- if Mr. Byrne's point was that authorized returns on equity are lower today and bond -- observable bond yields are lower today, that's true.

But as can you see, this analysis is attempting to estimate the relationship between the cost of equity and the cost of bond. So that relationship also changes over time, but it's a relative measure that you need historical, observable evidence to get a sense of what that range of equity risk premiums are.

And the only way to get that range is to look at historical evidence. And -- and the time period I selected, again, was intentionallly selected because the authorized returns on equity must have equaled the investor required returns because the bond -- or the stock prices of the utility securities during that time were premiums to book value which insured the utility had access to external equity capital.

Q And then he -- Mr. Byrne led you through a series of recalculations of your risk premium analysis looking at, in each of these cases, five years of data and -- and in another ten case years of data. Do you recall those questions?

A I do.

Q And I wrote down most of them. I think I was keeping track of them. It seems to me that as you were going through all those, if you did the calculations the way Mr. Byrne wanted you to, all of the ROE calculations came out below 10 percent; isn't that correct?

A It is.

Q And why did you do the calculations that way?

A Well -- well, there were some point estimates that were right at 10 percent, 10.1, 10.2.

Q Right. But when you did the weighting and average, I think they all came out below?

A Correct. Right.

Q And why didn't you do the calculations the way Mr. Byrne had you do them?

A Because I think it's a, you know, self-serving data mining type exercise that Mr. Byrne was going through to try to find a way to find numbers that produced a higher return of equity. I would note that some of the risk premiums he was using were during one of the worst periods of Financial crisis this country has ever experienced.

The 2007 through 2009 time period reflected an instance where utility companies in some instances came close to defaulting on their financial obligations because short-term borrowing facilities were shut down. Their utility cost of borrowing for some companies sky-rocketed.

For example, Ameren Illinois, during the 2008/2009 time period, had the issue of mortgage bond at an interest rate of over 10 percent Because this was a very unique time period that created significant distress on utility companies in particular and the U.S. corporate securities in general.

So focusing on a time period largely impacted by one of the worst financial markets we've had in the last hundred years, I don't think is a very credible analysis. Going back ten years, he smoothed that out a little bit. But it's still largely focused on a relatively short time period that was captured to build up to the financial market collapse and then the very slow recovery from that collapse.

So I think Mr. Byrne simply found a way to add numbers together to produce a high return on equity without constructing analysis which really captured what my objective was, and that is to get a pretty good sense of what the range in market risk premiums were above Treasury bonds and then again above utility bonds, and then to explore based on current market information where this in that estimated range a reasonable estimate of the current market premium lies.

So I think my analysis was more biased, more direct in trying to get as legitimate an estimate of where the current cost of equity is. Mr. Byrne, on the other hand, is simply data mining to come up with a higher return on equity estimate.

Q Now, he also asked you about your sustainable growth DCF calculation, which was 8.63 percent. And you started to explain how you considered those results, and I think he cut you off. Was there something you wanted to add about the significance of the sustainable growth result that you came up with?

A Well, yeah. He kind of lumped it in with the results of my CAPM study, and I -- I took exception to that. My sustainable growth rate DCF analysis is developed ultimately on my Schedule MPG-7. It's developed onto -- the growth rate is actually produced on schedules before that.

But the sustainable -- the sustainable growth rate is 4.2 percent for the proxy group. That is not an unreasonable long-term growth rate estimate based on the parameters forecasted by Value Line.

It's lower than I think is sustainable in the long-term based on other considerations I see in the utility industry. But based on the sustainable growth rate model, it produces a number of about 4.2 percent.

So I'm uncomfortable recommending a return on equity that low in this environment because return on equity estimates have dropped so significantly in the last year, in particular, in the last couple years, and in general, because I think some -- some conservative or caution is necessary in awarding a return on equity for an electric utility company because dropping that authorized return on equity too fast can create financial trouble, even if the return on equity reflects fair compensation in the marketplace.

So I considered things like the authorized return on equity ability to support the current dividend payment or whether or not a sustained level of dropped cost of capital will persist. The utility can -- can modify its management of its dividend to reduce the cost of dividend so it can still support it in the sustainable cost capital market environment.

If return on equity estimates stay in this low area over indefinite period of time, I eventually will be recommending return on equities lower than I am now.

But my concern is that if the cost of capital drops and stays low, the utility needs time to modify its financial housekeeping in order to maintain its financial integrity while receiving a very low authorized return on equity, even if it is consistent with current market costs.

Again, the cost of dividends is an issue. The ability to refinance outstanding or imbedded debt -- debt securities takes time. So all of that was -- was in part of my judgment in recommending a return on equity which I thought reflected fair compensation but would also maintain the financial integrity of the utility.

Q Next, Mr. Byrne asked you a bunch of questions concerning your use of either a mean or median results in your recommendations. Do you recall those questions?

A I do. Yes.

Q Let me just ask you, do other expert -- you've testified in a number of cases. You've read testimony by

a number of other expert witnesses over the years. Do other experts only rely on mean or only rely on median, or do they, like you, sometimes use mean and sometimes use median?

A Well, I think we heard Mr. Hevert talk about this this morning. In one instance, you would use mean. In other instances, you would use median depending on the central tendency of the results of your proxy group. Which of those two factors best approximate the general tendency of the return on equity estimates within the proxy group?

In the last case, I thought the median was a better estimate of it because a lot of the estimates kind of clustered around the median. In this case, it was more of a dispersion above and below the -- the mean -- the median, so, on average, I thought better to describe those high and low estimates.

Q Didn't actually the charts that Mr. Byrne had us look at, the scatter charts, actually support what you're just saying?

A They absolutely do support it. Mr. Byrne wouldn't let me explain that. But that's precisely why I decided to use a median in the last case and an average in this case or a mean in this case.

And, importantly, in both the last case and in this case, even though I used either the mean or the -- the mean or the median, I showed both results to be as transparent as possible because I believe in this case the mean best summarizes the overall tendency of the proxy group. In the last couple cases, I thought the median did.

Q So just to be real clear, when you look at a chart like on page -- on Exhibit 74, at the top, there are a number of diamonds that are right in the middle. And in a case like that, you're saying that would have -- that would be the type of data set where you would use the median?

A Yes.

Q And on the bottom, the -- which is for this case, only one of the little diamonds is actually right on the line there. So you would -- you used the mean in this case. That's really what you're talking about, central tendencies?

A Yes, that is.

MS. ILES: Okay. I just wanted to make sure I understood that. No further questions.

JUDGE WOODRUFF: All right. Then Mr. Gorman, you can step down. Thank you. And before we go to Mr. Murray, I just want to ask the parties, it's now 5:00. And I know Mr. Murray is not going to be available next

Tuesday. Would he be available any other day next week, including Friday, which is --

MR. THOMPSON: Are you available another day? He says he would be.

JUDGE WOODRUFF: All right. I'll let parties decide amongst themselves when we want to bring him back, and I'll indicate that the Commission will be available on Friday. Mr. Byrne?

MR. BYRNE: I mean, there's -- I'm influenced by the Cardinal play-off games going on right now, so I would rather do it next week.

JUDGE WOODRUFF: Okay. All right. Well, then, that's what we'll do. And you can tell me on Tuesday when -- when you want to take him up, if it's on Friday or at some other time next week.

MR. THOMPSON: Thank you, Judge.

MR. MURRAY: I'd rather be gone, to be honest with you.

JUDGE WOODRUFF: I understand that. But you're probably the only one in the room who would.

MR. MURRAY: Doing surrebuttal and this case, it's been crazy lately.

JUDGE WOODRUFF: All right. With that, then, we will adjourn until 1 p.m. on Tuesday, correct?

MR. THOMPSON: That is correct, Judge. Thank you.

MR. LOWERY: Thank you.

(The proceedings were concluded at 5:10 p.m. on October 5.)

I N D E X

I N D E X (CONTINUED)

I N D E X (CONTINUED)

E X H I B I T S

AMEREN

EXHIBIT	DESCRIPTION	OFFERED	ADMITTED
20	Direct Testimony of Robert Hevert	1540	1540
21	Rebuttal Testimony of Robert Hevert	1540	1540
22-HC	Surrebuttal Testimony of Robert Hevert	1540	1540
22-NP	Surrebuttal Testimony of Robert Hevert	1540	1540
23	Direct Testimony of Ryan Martin	1507	1507
69	RRA Report	1652	1652
70	Graph	1693	1693
71	Chart	1738	1738
72	Chart	1746	1746
73	Chart	1755	1755
74	Chart	1760	1760
75	Chart	1760	1760

MIEC

EXHIBIT	DESCRIPTION	OFFERED	ADMITTED
507-HC	Direct Testimony of Michael Gorman	1691	1691
508-NP	Direct Testimony of Michael Gorman	1691	1691
509	Surrebuttal Testimony of Michael Gorman	1691	1691
528	Data Request & Response	1511	1511
529	Chart	1551	1551
530	RRA Summary of Major Rate Cases January Through June of 2012	1556	1556
531	5/13/12 S&L Report	1560	1560
532	Substitute Schedule MPG-21	1691	1691

COMMISSION

EXHIBIT	DESCRIPTION	OFFERED	ADMITTED
A	EEI Report	1637	1637
B	EEI Report	1637	1637

STAFF

EXHIBIT	DESCRIPTION	OFFERED	ADMITTED
232-HC	Testimony of Lisa Ferguson	1662	1662
232-NP	Testimony of Lisa Ferguson	1662	1662
233	Testimony of Lisa Ferguson	1662	1662

(Original exhibits were retained by PSC.)

REPORTER'S CERTIFICATE

STATE OF MISSOURI)
)ss.
COUNTY OF OSAGE)

I, Monnie S. Mealy, Certified Shorthand Reporter, Certified Court Reporter #0538, and Registered Professional Reporter, and Notary Public, within and for the State of Missouri, do hereby certify that I was personally present at the proceedings as set forth in the caption sheet hereof; that I then and there took down in stenotype the proceedings had at said time and was thereafter transcribed by me, and is fully and accurately set forth in the preceding pages.

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Monnie S. Mealy, CSR, CCR #0539
Registered Professional Reporter

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