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In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs To Increase Its Annual Revenues For Electric Service) File No. ER-2010-0036

MORRIS L. WOODRUFF, Presiding,
CHIEF REGULATORY LAW JUDGE.

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JEFF DAVIS,
KEVIN GUNN,
ROBERT S. KENNEY
COMMISSIONERS.

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P R O C E E D I N G S

JUDGE WOODRUFF: Good morning, everyone. Welcome to day four of the AmerenUE rate case hearing. Today we move on into a new issue, which would be return on equity, capital structure and flotation costs. We'll start off with mini openings on that.

Before we do that, I do note that there was a Partial Stipulation & Agreement filed last night on the class cost of service allocation and rate design issues. Mr. Mills, I note that you were a signatory on this.

MR. MILLS: Yes, I was.

JUDGE WOODRUFF: Do you anticipate opposition on this?

MR. MILLS: Judge, I don't know. There are one or perhaps two parties who may oppose, but I don't know that for sure. As far as I know, the rest of the parties that have been actively involved in talking about class cost of service and rate design issues are not going to oppose. And I will let you know, I realize it wasn't filed 'til shortly after midnight last night.

JUDGE WOODRUFF: Shortly before. It was 11:58.

MR. MILLS: Okay. My notice came a little later. The issue is scheduled to be tried next Thursday. I know that the parties that have been interested in class cost of service have been more or less kept abreast of developments, and so I don't think it would be unduly burdensome on them to shorten the seven days under the Commission's rules to perhaps five or six.

COMMISSIONER DAVIS: I guess a better question to ask, Mr. Mills, is are they still taking depositions?

MR. MILLS: That I don't know.

COMMISSIONER DAVIS: I guess to me that would be an indicator if they're --

MR. MILLS: It might, yes. I guess we can find that out.

JUDGE WOODRUFF: Okay.

MR. MILLS: Judge, if I may, a couple of brief housekeeping matters. With respect to the return on equity issue, my witness is flying in tonight, and I think everyone who's likely to be active in that case has agreed to take him first thing in the morning, even though that may be somewhat out of order from the witness list that we have filed. Hopefully that's not a problem with the Bench.

JUDGE WOODRUFF: That shouldn't be a problem.

MR. DEARMONT: I also have one preliminary matter. I believe that my name might have been omitted during Staff's entry of appearance on Monday, so I'd like to go ahead and make my formal entry.

JUDGE WOODRUFF: Please do so.

MR. DEARMONT: Eric Dearmont on behalf of Staff of the Missouri Public Service Commission, P.O. Box 360, Jefferson City, Missouri 65102.

JUDGE WOODRUFF: Thank you.

MR. BYRNE: Judge, one other housekeeping matter. I talked with Mr. Coffman. We have a -- he's filed a motion to take administrative notice of some testimony from our last case, and he -- two rate cases ago, and we opposed it, and he was -- asked if we would be willing to argue that motion Friday morning also. I don't have any opposition to that, but I just want to put that on your radar screen. Mr. Coffman's not here, but we might want to do that.

COMMISSIONER DAVIS: I'm sorry. What motion was that?

MR. BYRNE: Mr. Coffman's moved to introduce or take administrative notice of some testimony.

COMMISSIONER DAVIS: Got it.

JUDGE WOODRUFF: Okay. Well, let's go ahead and move on to the next issue of the ROE, capital structure and flotation costs. We'll begin with mini openings with AmerenUE.

MR. BYRNE: Thank you, your Honor. May it please the Commission?

We are here today to talk about the return on equity issue, but I would like to start by referring you to the chart that in my mind represents the heart of our case as a whole.

You've seen this chart before in the interim rate hearings that we held earlier -- well, last year, and it's been -- and the charts were presented in our prefiled testimony and during Mr. Lowery's opening statement. It's the chart that shows that our earned return on equity has been and continues to be consistently far below our authorized return on equity.

As AmerenUE's CEO Warner Baxter has testified, in spite of having an authorized return on equity of 10.76 percent, over the 12 months ending December 2009, we earned just over 7 percent, and that 7 percent number is adjusted to reflect our absorption of the Taum Sauk costs.

And the primary reason that we earned just 7 percent is that we've invested about $650 million into our system infrastructure since September of 2008, and there's simply no way for us to recover the cost of that investment until new rates from this case take effect next June. We can't include CWIP in rate base, we can't track our investment through a rider, and interim rates are not available to us. We just have to wait and permanently lose the return, taxes and depreciation on that investment for literally years and with this impact on our earnings.

I bring this chart up again not only because it is relevant to the overall decisions that you have to make on all the issues in this case, but it is particularly relevant to your determination of an appropriate return on equity for AmerenUE.

Investors are certainly interested in what this Commission orders for our authorized return on equity, but they are even more interested in how that authorized return on equity will impact the much lower return that we are able to earn.

If the Commission approves a low ROE, AmerenUE's opportunity to actually earn a fair return will very likely be nonexistent. AmerenUE's incentive to invest in infrastructure, which is already significantly diminished by the long delays in cost recovery, would be diminished even further.

I would ask that you view the recommendations of the return on equity experts in this case through that lens.

Now I'd like to turn more specifically to the details of the return on equity issue. As was the case with the depreciation issue, determination of an appropriate return on equity for a utility is a difficult exercise involving arcane and technical expert testimony and the use of numerous complicated models involving literally thousands of inputs. I've been working on return on equity issues for more than 25 years, and I certainly don't understand all the details of what the experts do.

But as Mr. Lowery said the other day when he was addressing depreciation, which is another complicated issue, it's critical that the Commission not miss the forest for the trees. And this chart, which again you've seen before, shows the forest. This specifically shows how each expert's recommendation in this case compares to the average return on equity authorized for integrated electric utilities over the past several years across the country.

The steady line in the middle of the chart is the national average, and as you can see, it's even gone up in recent months. The dark blue area shows the range between the 25th and the 75th percentile of decisions, and the light blue shows the range of the 10th to the 90th percentile of decisions, the light blue on the outside.

AmerenUE's recommendation for an ROE is a little bit above the national average at 10.8 percent. AmerenUE's recommendation is sponsored by Dr. Roger Morin, who is a nationally recognized expert in utility finance. He's a professor at Georgia State University, and he's the author of one of the most widely used textbooks in the field.

Dr. Morin's analyses have been relied on by many commissions, including the Missouri Commission. I urge you to take advantage of Dr. Morin's expertise while he is here because he is truly one of the leading experts in the country on utility finance.

In contrast, the Commission Staff witness, David Murray, has submitted a recommendation shown on this chart here, but it's so low that it's almost literally off this chart. Here's the 10th percentile. Here's Mr. Murray's recommendation.

Mr. Murray's recommendation of 9.35 percent is 124 basis points below the national average and 85 basis points below the lowest return on equity ordered for an integrated electric utility in 2009 according to the RRA data which has been filed in this case. And each 100 basis points impacts AmerenUE's pretax revenue by approximately $46 million per year.

Mr. Murray has reached his stunningly low recommendation by using arbitrary and unorthodox methods to estimate the cost of capital or cost of equity and to, quote, confirm the reasonableness of his recommendation.

In particular, the growth rates Mr. Murray uses for his DCF analyses are completely unsupported. In attempting to confirm his analyses, he ignores the returns authorized for other similarly situated electric utilities around the country with which AmerenUE must compete for capital, and instead he looks to sources such as the Missouri State Employees Retirement System and the application of a rule of thumb that he may have invented for returns to justify his own extremely low recommendation.

Mr. Murray's unorthodox recommendation is completely unreasonable, and it is entitled to absolutely no weight at all.

In some cases this Commission has employed a zone of reasonableness, which has been a 200 basis point area around the national average of applicable authorized ROEs, 100 basis points above and 100 basis points below. If any expert's testimony is outside the zone of reasonableness, in past cases that recommendation has been disregarded. In this case, Mr. Murray's 9.35 percent recommendation is materially outside the zone of reasonableness, and for that reason as well as the several deficiencies in his analysis, his recommendation should be completely disregarded.

The two other experts in this case, Mr. Gorman and Mr. Lawton, are competent cost of capital experts, and their recommendations are less damaging than Mr. Murray's. In particular, the high end of both of these experts' recommended ranges are in the vicinity of the national average, and they are in the vicinity of Dr. Morin's recommendation, but their midpoint recommendations are clearly still too low.

Mr. Gorman's 10 percent recommendation is 59 basis points below the national average, and Mr. Lawton's recommendation of 10.1 percent is in the same ballpark. Both recommendations are below the 10.2 percent ROE which was authorized by the Washington Commission on December 22nd, 2009, which was the lowest authorized ROE for an integrated electric utility in calendar year 2009. So 10.2 percent was the lowest in 2009.

In other words, if you accept Mr. Gorman or Mr. Lawton's recommendation, at least their midpoint recommendation, as opposed to their ranges, which are much more reasonable, you would be setting an ROE for AmerenUE lower than any that was authorized in 2009, the last calendar for which RRA data has been published.

In response to the question Commissioner Davis raised during the opening statement, in 2008 and

2009 there were no ROEs authorized for an integrated electric utility below 10 percent. So there were a couple in 2008 that were 10 percent. 10.2 was the lowest in 2009.

I would note that in a recent decision cited in Mr. Lawton's testimony, Florida Power & Light received an authorized return of 10 percent. That was in 2010. And Progress Energy at the same time from Florida got a 10.5 percent ROE but Florida Power & Light -- well, Florida Power & Light significantly cut its capital budget, but was nonetheless recently downgraded by Standard & Poor's since that decision was issued.

The bottom line with Mr. Lawton and Mr. Gorman's analyses is that if the high end of their recommended ranges is adopted or if relatively minor changes are made to the way their analyses are used to calculate their midpoint, then their analyses, too, will support a mainstream ROE near or above the national average and in the vicinity of Dr. Morin's recommendation.

The Commission has carefully considered national averages in reaching its decisions on the appropriate ROE in recent cases. Although the Commission has stated that it is inappropriate to unthinkingly mirror the national average, which AmerenUE agrees with, in cases where experts disagree and subjective judgments play such an important role, the national average provides a valuable point of reference that we believe the Commission must consider.

I would also note that AmerenUE has another ROE witness, Julie Cannell, who is an -- and she'll be here Friday, I believe. She is an expert with actual experience in providing utilities with capital from equity markets. Unlike the academic experts who are providing cost of capital analyses, Ms. Cannell brings real world experience to bear and can provide a perspective that this Commission rarely gets to consider in reaching an ROE decision.

Again, I would encourage you to make use of her expertise while she is here and ask her how equity markets would react to the various recommendations being presented in this case. This is important information that the Commission should consider in making its decision.

In closing, I would point out again how critical it is for AmerenUE to be authorized a reasonable mainstream return on equity that will permit us to compete for the limited pool of capital with other investor-owned utilities and to continue to invest in our system to provide the level of service and the level of reliability that our customers and this Commission have demanded.

Thank you.

JUDGE WOODRUFF: Thank you. Opening for Staff.

MR. DEARMONT: May it please the Commission?

A desired return is not a required return, and I ask that each of you consider this throughout my statement and throughout the testimony that you will hear presented on this issue.

Staff in this case is recommending that the Commission approve an authorized return on equity for AmerenUE in the range of 9 to 9.7 percent, with a point estimate of 9.35 percent. Staff currently recommends that the Commission apply this ROE to the AmerenUE test year capital structure comprised of approximately 47.4 percent common equity, 1.6 percent preferred stock and 51 percent total debt.

As reflected in the reconciliation filed by Staff on March 11th, the impact on the company's total revenue requirement associated with the difference between the Staff's recommended ROE of 9.35 percent and company's updated recommended ROE of 10.8 percent is approximately $66.5 million. Staff's recommended point estimate, if adopted by this Commission, would result in the ability of AmerenUE to attempt to earn an annual profit of over a quarter of a billion dollars.

Staff's recommendation as compared to those of the company, OPC and MIEC is currently being projected for the Commission's reference.

In reaching its recommendation in this case, Staff employed a number of traditional cost of capital methodologies, including a single stage or constant growth DCF, a multistage DCF and a capital asset pricing model.

As described in Staff's prefiled testimony and as depicted on the projection currently being displayed, in performing Staff's CAPM analysis, Staff multiplied the average beta of Staff's proxy group against the arithmetic and then the geometric averages of the long-term historical differences between the earned returns on stocks and the earned returns on bonds as reported by Ibbotson's 2009 Yearbook.

Staff then added these products, one based on an arithmetic average and one based on a geometric average, to a risk-free rate of 4.23 percent, representing a three-month average yield on 30-year T bonds. This calculation/methodology resulted in what I will call a geometric-based CAPM estimate of 6.1 percent and an arithmetic-based CAPM estimate of 7.94 percent.

Staff does not believe these results to be reliable indicators of the cost of equity for AmerenUE, and, therefore, chose to disregard these CAPM results in reaching Staff's recommendation.

Staff also performed a constant growth DCF analysis. In doing so, Staff added a dividend yield component of 5.2 percent to an estimated constant perpetual growth rate of 4 percent to 5 percent. This calculation resulted in a constant growth DCF result range of 9.2 to 10.2 percent.

To be clear, Staff inserted a generic perpetual growth rate of 4 to 5 percent based upon Staff's opinion regarding a sustainable perpetual growth rate. Although Staff's constant growth DCF results support the upper end of Staff's recommended range, Staff believes that the current building cycle associated with the electric utility industry, which in staff's opinion is causing near-term expected growth earnings per share to be higher than long-term sustainable growth, requires dividends to be evaluated in stages.

As this is the very premise of the multistage DCF, Staff's recommendation is driven primarily by the results of a multistage analysis, which in this case is based upon three distinct DCF stages.

Stage 1 comprised of years 1 through 5. In this stage Staff chose to rely on the average projected growth rate of each proxy group as contained in analyst estimates from Reuters and ValueLine. Staff chose to rely on these projections in its multistage analysis due to the fact that these analyst estimates are actually based on five-year projections and, in Staff's opinion, are therefore reasonable over that -- over that period.

To the contrary, Staff chose not to rely only on analyst grow projections in its constant perpetual growth DCF as, in Staff's opinion, these projections are not reasonable estimates of growth into perpetuity.

Stage 3 -- in Stage 3, representing years 11 through 200, Staff collected a long-term growth rate of 3.1 percent. Although many cost of capital witnesses use expected GDP growth as a long-term growth estimate, Staff chose to use an estimate based on projected electric consumption growth increased by an inflation factor.

Staff elected to utilize this approach as, in Staff's opinion, it is not reasonable to assume that electric growth will mirror that of the -- of the larger economy over this period.

For those of you scoring at home, Stage 2, representing years six through ten, represents a linear transition period from Stage 1 to Stage 3. For more information regarding the rates employed in Stage 2, please see Schedule 17 attached to the Staff Cost of

Service Report.

As has been discussed in the testimony filed in this case, in order to check the reasonableness of Staff's recommended return on equity, Staff has referenced a few sources that may be considered by some to be nontraditional in the context of a cost of capital determination for a regulated utility.

In specific, these sources include financial analyst research reports published on both Ameren and the electric utility industry in general by analysts at firms such as Goldman Sachs, J.P. Morgan and Edward Jones. In addition, these sources include information regarding expected returns for very asset classes provided by Missouri State Employees Retirement System and certain rules of thumb incorporated into the curriculum of the Chartered Financial Analyst program.

In Staff's opinion, these references demonstrate that Staff's recommendation is consistent with the expected returns used by those in the investment community, returns at or below Staff's recommendation in this case.

To be fair, Staff's recommendation is noticeably lower than the returns reflected in the data published by the Regulatory Research Associates. To the extent that the Commission has concerns about Staff's point estimate falling outside of a range based upon this data, Staff would recommend that the Commission authorize a return at the top end of Staff's recommended range as opposed to Staff's point estimate.

Although it is clearly within the authority of the Commission to consider this upward shift, it should be readily apparent reading Staff's testimony that Staff believes that its point estimate, 9.35 percent, approximates the cost of AmerenUE's equity capital and that, therefore, Staff has held steadfast to this position over the development of that testimony.

Right or wrong, high or low, conservative or not, Staff has provided a consistent methodology from the beginning of this case until today. Similarly, Staff strives to maintain its consistency from case to case unless disclosing up front the reasons for not doing so.

Unfortunately, the same cannot be said for a few of the other parties to this case. In fact, it was for this reason that Staff elected to retain the services of cost of capital witness Stephen Hill. Staff is optimistic that the Commission will acknowledge that Mr. Hill brings to the table an aspect that Staff simply could not alone. Mr. Hill is one of a relatively small group of experts who travel from state to state, commission to commission, providing his professional opinion on cost of equity capital.

Mr. Hill files testimony against experts such as Dr. Morin in states such as California, Washington, Hawaii, and here in the state of Missouri. As such, Mr. Hill has a unique and valuable insight into the consistent or perhaps inconsistent application of theory from case to case.

In conclusion, Staff is recommending that the Commission authorize -- approve an authorized return on equity for AmerenUE in the range of 9 to 9.7 percent, with a point estimate of 9.35 percent. Staff believes that this estimated range is consistent with the principles established in Hope and Bluefield.

In specific, Staff believes that such estimate if displayed in the context of the overall anticipated revenue increase, that the resulting rates will allow AmerenUE to maintain its financial integrity and to attract equity capital.

Staff has approached this case acting upon the premise that a utility's authorized return on equity should equal that utility's cost of equity capital. This is an important distinction. AmerenUE is entitled to a profit. Staff believes that AmerenUE is entitled to a profit that will allow the company the ability to meet the required returns of equity investors as those required returns are the cost of equity capital.

Thank you.

JUDGE WOODRUFF: Thank you. Opening for Public Counsel.

MR. MILLS: Good morning. May it please the Commission?

I'll be brief in my opening statement. First I want to address a couple of items that came up in the first two opening statements, and one is perhaps really not all that specific to return on equity, but I think it's sort of a general theme that you've heard from AmerenUE throughout this case, and that's the concept -- they won't put it this bluntly, but they -- I think if you look at all their statements and all their actions in this case and over the last year or two, and that's a sort of attack on the regulatory paradigm.

In this case the company has urged the Commission to raise rates without a thoughtful and measured consideration of all relevant factors. Recently the company, perhaps with some others, has been involved in efforts to sort of do away legislatively with the used and useful concept.

And certainly it's their right to try and change those things, but it strikes me that those are all part of a bigger picture, and the part of the picture is, you know, the utility gets a monopoly and it gets a guaranteed opportunity to try and earn a very reasonable rate of return, and I think to the extent that we start changing bits and pieces of that paradigm that has stood the test of time, you know, I think perhaps we need to look at the whole thing. Maybe it's time to end the monopoly status. Maybe UE needs some competition. If we're going to get rid of some of the other aspects that are unfavorable to them, perhaps we should get rid of some of the stuff that's favorable as well.

COMMISSIONER DAVIS: Do you want to draft a bill, Mr. Mills? Get it drafted and let's go.

MR. MILLS: I'm just saying, I think the rhetoric on that side of the issue is beginning to wear on me, and I think that it -- it came up in the opening statement this morning, and I think it's constantly attacking it from that side, the regulatory paradigm and things that have worked for 100 years just don't work anymore. We've got to change this. We've got to change that. We heard it this morning.

I don't believe that, and I don't believe that we need to end the monopoly status. I don't believe that we need to end the thoughtful and careful consideration of all relevant factors. I don't believe that we need to end the used and useful concept. But if we're going to talk about that stuff, I think we need to talk about some quid pro quo. That's my point. Not that we need to change things, but if we're going to talk about stuff in that manner, we can't talk about it in a one-sided manner.

The other thing I want to respond to is, and I'm not sure that this is a reasonable inference from Mr. Dearmont's opening statement, but with respect to the single small change that Mr. Lawton made, he simply averaged two numbers apparently in his head or on the back of the envelope and came up with a wrong number in his direct testimony.

He did not change his methodology. He did not change his approach. Did not really change any of his underlying data. He simply acknowledged that he had averaged two fairly simple numbers incorrectly and had come up with an average of 10.2 as opposed to 10.1 as the staff pointed out. And that, of course, is our current recommended ROE in this case.

Now, the consideration of return on equity in a utility rate increase case really boils down in the bottom instance to the credibility and the reasonableness of the witnesses. You heard testimony in the last case, and I wouldn't be surprised if you hear it in this case, that most of the witnesses in this case will acknowledge the expertise of the other witnesses, they will acknowledge that they all did the same general approach to the DCF, and they will acknowledge that calculating a return on equity through the DCF method is perhaps as much an art as a science, that there's a considerable amount of judgment that goes into picking the inputs to the DCF model.

There's very little -- there's some discretion in how you structure the model. Most of the witnesses will talk about a multistage or a two-stage DCF. And so there's some discretion in how you structure the model itself, and then there's some discretion in how you put the numbers in. Between the exercise of those two pieces of discretion is how you end up with rates that range from 9.35 to 11.5 in this case.

And so the only way that this Commission can decide which of those is the most accurate is to judge the reasonableness of the witnesses' use of discretion and the credibility of the witnesses. And I think you're in a good position in this case because you've got a couple of witnesses in this case that you found very credible in a number of cases.

In the recent MGE case, you had the, I believe the first opportunity to see Mr. Lawton, who is the Public Counsel witness in this case, and found him very credible and very persuasive. We're happy to bring him back and offer his testimony in this case.

You also have the testimony of MIEC witness Mike Gorman, whom the Commission has found credible over a number of years and reasonable and done a good job of exercising his discretion to come up with a reasonable return on equity.

Dr. Morin, certainly you have seen testimony of Dr. Morin in several cases in the last several years. In cases before that, you have cited to his textbook, and I think it's -- I don't think anybody in the case would not acknowledge that Dr. Morin is a recognized expert in this field.

But yet you've never really adopted Dr. Morin's testimony in any rate case in Missouri. You've never largely taken his testimony, maybe made a few changes to it as you've done with the testimony of Mr. Gorman and Mr. Lawton. And I think that's just because, frankly, his recommendations are too darn high. I mean, he came in here at 11.5. He's managed to knock that down to 10.8, but that's -- that's just too high. And I think you will through examination from the attorneys and through your own questioning, I think you will discover that it's still too high.

And finally, with respect to the role that the RRA data and the actions of other commissions play in your analysis, I would suggest to you that it should be fairly limited. When you look at the RRA data, what you're looking at is what your compatriots in other states have done in proceedings just like this, and some of those commissions in proceedings just like this are looking to see what you did. So everybody's looking in a mirror, and as a result, it's very, very slow to change.

You've heard testimony -- you heard -- you will hear testimony, you heard in the opening statement of Mr. Byrne that in 2009 the lowest return on equity was 10.2. Returns on equity are dropping for electric utilities and have been for the last several years. They're going to continue to drop farther.

I think it's important that this Commission not consider what happened in 2009, but what is the appropriate return on equity for AmerenUE in Missouri in the remainder of 2010 and 2011 when the rates set in this case will be in effect. I think the evidence here will show that it is considerably lower than the average from the RRA data for the last year.

Thank you.

JUDGE WOODRUFF: Thank you. Opening for MIEC.

MS. ILES: Since I'm not going to be using this, can I just set it aside?

JUDGE WOODRUFF: Certainly.

MS. ILES: Good morning. May it please the Commission? My name is Carol Iles, and I'm here on behalf of MIEC.

MIEC's recommended return on equity for this case for AmerenUE is 10.0 percent, and this recommendation is based on the testimony and analysis of Mike Gorman, whom you just heard described as a witness which has -- who has appeared before this Commission on numerous occasions and in the decisions of this Commission has been found to be credible and is considered to be a well-respected analyst in this field.

Now, as you've also heard in the openings that have gone before me, MIEC's recommendation in this case is not the lowest and it's not the highest. At 10.0 we're right in the middle there somewhere. You heard Mr. Byrne say that the recommendation of AmerenUE, which happens to be the highest in this case and now is at 10.8, is actually above the national average even though they're urging you to look at the national averages in making a determination this case.

And I would agree with Mr. Mills that that's not necessarily what you should be bound by or even extremely persuaded by in this case. But if you do want to look at those national averages and if you do want to look at what other commissions are doing, I would point out some interesting facts, one of which is that if you look at the first quarter of 2009 when this Commission's last decision was handed down for AmerenUE, the ROE of 10.76 was the highest that was awarded to an electric utility in that quarter of 2009.

And I would also agree with what Mr. Mills stated that ROEs awards are going down. Let's face it, you don't have to be an economic expert to recognize that the world has changed in the last year, that the financial markets, that the economic conditions of the world have changed, and that has a direct impact on what we're talking about today here with return on equity.

We're talking about what is reasonable for an investor to expect, which is exactly the issue we are talking about when we say -- when we talk about ROE, not how much money the company would like to make to make up for money they didn't make in past years. That's not the issue. The issue now is, what would a reasonable investor expect? What return is necessary to incentivize an investor to make that investment so that AmerenUE will have adequate capital to operate its business. That's, I think, very well accepted the standard that we're applying here.

And so it is important to look at where we are in the world, and where we are in the world is that every market-based security, whether you're talking about stocks or bonds or whatever, is lower. Every market-based security, we're at a lower level now than we were a year ago.

So I don't see how you can ever come to the conclusion that it is reasonable to increase AmerenUE's return on equity, which is what, of course, they are -- they are not coincidentally requesting in this case.

Their prior -- the prior return on equity that they were awarded was 10.76. Now they're asking for 10.8. They want it to go up. I understand that. Wouldn't we all? But that's not in the best interests of ratepayers, nor is it necessary to preserve the financial integrity of the company, and therefore it is not the return on equity that should be adopted by this Commission.

We'll point out today, I hope it will be clear by the end of the morning, that although we -- you know, although AmerenUE starting at 10.8, there are different ways to look at the analysis that Dr. Morin has offered that actually can bring the numbers that Dr. Morin is offering and the numbers of Mr. Gorman a lot closer together, and we're going to go into that.

Specifically if, for example, Dr. Morin we believe, although it's not entirely clear from his testimony, but we believe he included an adjustment to his estimates for the quarterly dividend compounding, which Mr. Gorman has explained in his testimony in extreme detail why that adjustment is not reasonable. If that's taken out, we believe -- and again, it's not entirely clear from Dr. Morin's testimony, but we believe that his numbers should be reduced by 20 basis points.

Then there's another very simple calculation that can be done, which we'll demonstrate again this morning, to actually take the numbers, the results that Dr. Morin came up with, and average them, which is the procedure as I understand it that I know this Commission followed in the last rate case, and it's certainly the procedure that Mr. Gorman has used.

So if we just follow what Mr. Gorman has done and do an average instead of picking a median, which is what Dr. Morin did, we come down to 10.47 percent. So, I mean, that's using his calculations is what I'm telling you with making these adjustments to them. That's without even taking out any of his upward adjustments for the quarterly dividend calculation or anything else.

So my point is that we're really not so far apart maybe as we may first appear, and I do not agree with the statement that Dr. Morin's testimony necessarily does support a return on equity above 10.5 percent in this case.

So just in conclusion, AmerenUE would like for its return on equity award to go up, and that is simply not supported by the current conditions of the economy and the financial markets. It's not in the best interests of ratepayers. The evidence in this case supports a return on equity of 10.0 percent as explained by our witness Mr. Gorman.

We thank you for your consideration.

JUDGE WOODRUFF: Thank you. I believe that's all the parties who would be offering openings, so we'll go with our first witness, which would be Dr. Morin.

(Witness sworn.)

JUDGE WOODRUFF: You may be seated. I do want to make a little statement that I've been giving to all the witnesses. You've testified many times before. I'm sure you're aware of this as well. We're concerned that witnesses only answer the questions that are asked and not go on to try and elaborate beyond what the questions are because that can waste a lot of time with the attorney trying to get back on track. So I just wanted to make that little statement.

THE WITNESS: No speeches.

JUDGE WOODRUFF: That's right. You may inquire.
MR. BYRNE: Thank you, your Honor.
ROGER MORIN testified as follows:
DIRECT EXAMINATION BY MR. BYRNE:
Q. Dr. Morin, can you please state your name for the record.
A. Roger A. Morin.
Q. And what is your title?
A. My title is emeritus professor of finance and distinguished professor of finance for regulated industry at the Robinson College of Business, Georgia State University, Atlanta, Georgia.
Q. And, Dr. Morin, are you the same Roger A. Morin who caused to be filed in this case direct testimony that has been marked as Exhibit No. 111, rebuttal testimony that's been marked as Exhibit 112, and surrebuttal testimony that's been marked as Exhibit 113?
A. Yes.
Q. And do you have any corrections to any of that testimony?
A. No corrections.
Q. Is the information provided in that testimony true and complete to the best of your knowledge and belief?

A. Yes, sir.
Q. And if I were to ask you the questions contained in that prefiled testimony here today when you're under oath, would your answers be the same?
A. Yes, sir.
MR. BYRNE: Your Honor, with that, I would offer Exhibits 111, 112 and 113 and tender Dr. Morin for cross-examination.
JUDGE WOODRUFF: 11, 12 and 13 have been offered. Any objection to their receipt?
(No response.)
JUDGE WOODRUFF: Hearing none, they will be received.
(EXHIBIT NOS. 111, 112 AND 113 WERE MARKED AND RECEIVED INTO EVIDENCE.)
JUDGE WOODRUFF: And for cross-examination, beginning with Public Counsel.
MR. MILLS: Thank you.
CROSS-EXAMINATION BY MR. MILLS:
Q. Good morning, Dr. Morin.
A. Good morning, sir.
Q. Let's start with your -- let's start with your direct testimony. You filed direct testimony on or about July 24th, 2009; is that correct?
A. Yes, sir.

Q. And in that testimony you recommended a return on equity of 11 and a half percent; is that correct?

A. That's correct.

Q. And do you know what the actual dollar amount of the increase that AmerenUE requested based in part upon that recommendation?

A. No, I do not.

Q. Now, in your rebuttal testimony, you have -- you changed that, the end result of your study has changed from 11.5 percent to 10.8 percent; is that correct?

A. Correct.

Q. Now, given that change, would it be accurate to state that you no longer support the 11.5 percent return on equity?

A. Correct.

Q. And is that -- is the change from 11.5 to 10.8 largely due to changes in the capital market since you filed direct testimony in July of 2009?

A. That is correct. When the initial testimony was filed, we were still on the edge of --

Q. That was a yes or no.

A. -- of the financial crisis, and we're not anymore.

Q. So really all of your calculations and market data in your direct testimony has been superseded by your rebuttal testimony; is that correct?
A. Yes, sir.
Q. Do you know whether the company has revised its rate request downward in part to reflect the fact that you have lowered your return on equity estimation?
A. Yes, it has.
Q. Do you know by how much?
A. No, I do not.
Q. Now, in your rebuttal testimony, at I believe it's page 2, line 14, you state that the average ROE allowed in 2009 was 10.59 percent; is that correct?
A. Yes, sir.
Q. Your original 11.5 percent ROE proposal was nearly 100 basis points above what regulators on average granted in 2009; is that correct?
A. That's correct.
Q. Have you reviewed the cash working capital calculation and amount in this case?
A. No.
Q. Now, Dr. Morin, you testified -- excuse me. You testified on behalf of AmerenUE in the last rate case in this state; is that correct?
A. Yes, sir.

Q. Now, let me just ask you sort of a general hypothetical about risk. If you're looking at two companies, let's call them Company A and Company B, if A is more risky than B, then A must have a higher return on equity than B if A expects to attract capital; is that correct?

A. That's correct.

Q. Now, in the last case, the Commission awarded a 10.76 return on equity for AmerenUE in early 2009; is that correct?

A. That is correct.

Q. Is it your opinion that the risk of AmerenUE has not increased appreciably since the last rate case?

A. That is correct.

Q. Now, are you familiar with the concept of a tracker mechanism as it's used in utility regulation?

A. Yes, sir.

Q. Can you explain how that concept works?

A. Whenever there are costs that are outside the control of the utility, for example fuel costs that are volatile and unpredictable, in order to streamline the regulatory process, these costs are automatically passed on to ratepayers in order to avoid rate cases and in order to reduce regulatory lag as well.

Q. Okay. Let me ask you a couple of questions. Is it your experience that trackers as you've described them are only used for costs that are volatile and unpredictable?

A. Yes, mostly.

Q. And is that the proper -- is that the only proper time to use them, in your opinion?

A. In my opinion, it is.

Q. Now, let me lay out a slightly different type of tracker mechanism and ask you if you're familiar with this. Say, for example, a utility has a category of costs that may or may not be volatile, unpredictable, but we'll leave that for another determination, but they have a category of costs for which they are awarded a particular amount in base rates, and that any changes above or below that base level are tracked and accumulated for recovery or return in the next rate case rather than as an automatic rate adjustment. Are you familiar with that type of tracker?

A. Yes.

Q. And for what types of expenses have you seen that type of tracker used?

A. Environmental compliance expenses for cold-related environmental issues.

Q. Anything else?

A. No. That's the first one that comes to mind.

Q. Have you ever seen a tracker like that used for storm restoration costs?

A. Rarely.

Q. But you have seen it?

A. Yes, particularly related to hurricanes in the southern part of the country, Mississippi.

Q. Have you ever seen it used for the cost of vegetation management for an electrical utility?

A. No.

Q. Have you ever seen it used for the cost of required infrastructure inspections for electric utilities?

A. For infrastructure investments per se, yes, but not for inspection.

Q. And I'm talking strictly about inspections and not investments.

A. No, I have not seen that.

Q. Now, if a utility were to get one or all three of those, storm, vegetation management or infrastructure inspection trackers of the type that we -- the second type that we talked about, would that reduce the utility's risk?

A. Imperceptibly. These are very, very small items in the grand scheme of things compared to, let's say, fuel. It would certainly reduce regulatory lag, and it would certainly improve the company's ability to earn its allowed rate of return, but it would not have a noteworthy or very, very direct impact on the bond rating, for example.

Q. And you can say that without knowing the magnitude of these costs for any particular utility?

A. I am familiar that, for example, the storm restoration costs are relatively small in the grand scheme of things.

Q. For AmerenUE?

A. Yes.

Q. And what is that level?

A. I don't know the numbers, but it's relatively minuscule compared to, let's say, fuel.

Q. What is AmerenUE's annual fuel expense?

A. I don't know. It's a significant portion of their costs, very significant.

Q. And do you know the -- the construct in Missouri under which utilities are required to manage vegetation around transmission and distribution lines?

A. No.

Q. Do you know the construct that requires them to do certain types of infrastructure inspections?

A. No. That was not within the scope of my testimony.

Q. If I were to represent to you that the utility is vigorously pursuing the award of all three of those trackers as a contested issue in this case, would that have any impact on your opinion that they are imperceptible and unimportant aspects of a company's overall revenue?

A. They are relatively unimportant compared to other things like fuel costs, and I think the company is doing everything it can to reduce regulatory lag in order to improve its ability to earn what is allowed by this Commission. Any gesture in that direction I think is perceived favorably by bond rating agencies and by investors.

Q. But nonetheless, it's your testimony that it will have only an imperceptible effect on ROE; is that true?

A. Compared to, let us say, fuel costs, yes, it's not a big deal. It's pretty low on the radar screen of bond rating agency reports.

Q. Let me see if I can get you to more accurately describe that. What do you mean by imperceptible?

A. A small percentage of total costs.

Something that would be significant to a bond rating agency. Something that would be on the radar screen of S&P or Moody's or Fitch; for example, fuel costs.

Q. So a tracker for any one of those three won't even register on the rating screen of investors or bond holders?

A. It will be at the fringe. Anything in the direction of enhancing the ability to earn your allowed return is perceived positively by investors. I'm not willing to say it will lower ROE or increase the bond rating immediately, no. There are other elements of risk that swamp these particular factors.

Q. And let me represent to you, and take this as a hypothetical if you want, that it is the -- it is likely that these types -- well, assume for the purpose of this question that these three trackers will on the whole increase the responsibility of ratepayers and decrease the responsibility of management to manage the risks of these three categories of expense. Can you make that assumption?

A. Yes.

Q. All else being equal, that's a detriment to ratepayers, is it not, if that assumption holds true?

A. If you don't consider the impact on the cost of money, yes, but anything that enhances the company's ability to earn its allowed return will be perceived as a positive in terms of risk. So the cost of equity could conceivably decrease very, very slightly as a result of implementing all of these trackers.

Q. Okay.

A. So that's the tradeoff, the quid pro quo.

Q. From your perspective as a return on equity expert, would you want to be able to quantify both the positive and the negative aspects of implementing such trackers before you were to recommend for or against their implementation?

A. It would be very, very difficult to quantify the impact on ROE of each one of those trackers, for example. It would be like splitting hairs in a sense because risk as perceived by bond rating agencies and investors is a multidimensional blend of a lot of factors, business risk, regulatory risk, financial risk, regulatory policy, regulatory risk mitigating mechanisms and so on.

So the impact of any one of those would be very, very difficult to measure, but it's a positive element in the right direction. It certainly would increase the probability of, let's say, being more creditworthy and an upgrade.

Q. But at a cost?

A. At a cost, yes.

Q. And as you sit there today, you have no way to tell me whether the costs exceed -- whether the benefits that you've just described exceed the costs, do you?
A. It would go in the direction of lowering the risk of the company.
Q. Lowering the risk or shifting it to ratepayers?
A. Both.
Q. And are you able to tell me as you sit there today that net/net that is a positive thing for ratepayers?
A. Is what a positive thing for ratepayers?
Q. Implementing these kinds of trackers and incrementally on the fringes, as you've said, lowering some business risk?
A. I think it would be in the interest of ratepayers to do anything that the Commission can do to increase the probability of earning your allowed rate of return and, therefore, decreasing the cost of capital.
Q. At any cost? At any cost to ratepayers?
A. It would reduce the cost of capital.
Q. Okay. You could reduce the cost of capital in a lot of ways, and some of them are very, very costly to ratepayers, are they not?

A. No. You're contradicting yourself. If you're reducing the cost of capital, you're reducing the revenue requirement and the cost of service and making ratepayers better off in the long run.

Q. In that aspect?

A. Right. The company has to raise billions of dollars in the next five years at a lower cost than otherwise would be the case because of those trackers.

Q. So you can quantify that?

A. It's difficult in the case of storm restoration costs, for example, because it's a small component of total costs.

Q. All I'm asking you is whether or not you can quantify that benefit to ratepayers from the lowering of the costs either to -- either in terms of equity or debt compared to the increase in costs based on the implementation of these trackers?

A. The best that I can do -- again, we're splitting hairs here -- is if you look at the yield spread between B double A and single A rated bonds --

Q. And, Dr. Morin, I'm not asking you to split hairs. I'm asking you to say, yes, I can quantify that and the ratepayers are better off, yes, I can quantify that and the ratepayers are not better off, or no, I can't quantify that accurately enough to give you a yes or no answer.

A. Yes, I can quantify it, and ratepayers are better off.

Q. Okay. Thank you. And you can do that without knowing the magnitude of these expenses?

A. That's correct. The presence or absence of such mechanisms is the factor that's taken into account by investors.

Q. But isn't the level of the expenses a factor that's taken into account by ratepayers?

A. Yes.

Q. Now, with respect to the DCF models used by Murray, Gorman and Lawton in this case, is there anything structurally unsound about the models that they used?

A. Well, read my rebuttal. Yes, there is something very wrong with Mr. Murray's implementation of the DCF model.

Q. Let's skip over him and talk about Gorman and Lawton.

A. Mr. Lawton I think did a pretty good job with his DCF analysis, and I agree with a lot of things that he's done.

Q. And all I'm asking about is the structure of the model. Not the inputs. Not any of the growth rates. Just the structure.

A. Then I would agree with you.
Q. Would you agree with me with respect to all three of the witnesses?
A. No, I do not agree.
Q. At least with respect to Gorman and Lawton, you agree that the structure is reasonable?
A. Yes, I do.
Q. And if you had to use their models and put in your own inputs, would you be able to come up with a reasonable ROE estimate?
A. Yes, I would. And our DCF estimates are fairly close to one another. Lawton and Gorman I'm talking about.
Q. So I think you were in the room when I made my openings statement.
A. Yes.
Q. Did you testify in the last case that -- and if you want to break out Murray or Mr. Hill, do so, but would you agree that in this case, that all the witnesses are expert witnesses?
A. No.
Q. Would you agree that Mr. Hill, Mr. Gorman and Mr. Lawton are expert witnesses?
A. Yes.
Q. And would you agree that the primary --

and, of course, you consider yourself to be an expert as well, do you not?

A. Of course.

Q. I just had to get that in the record in case nobody else did.

And so the primary difference among the witnesses that you recognize as experts in this case is their discretion and judgment on how they put things in the models and ran the models; is that correct?

A. Well, it's even narrower than that. I think the differences between Lawton, Gorman and myself is the choice of growth rate inputs in the DCF model.

Q. And so you're agreeing with my question and saying I could have made it even narrower, that really the biggest difference is the choice of the growth rate input in the model?

A. I would agree with that. We're pretty close on dividend yields.

MR. MILLS: That's all the questions I have. Thank you.

THE WITNESS: Thank you, sir.

JUDGE WOODRUFF: Cross-examination from the Staff is next.

CROSS-EXAMINATION BY MR. DEARMONT:

Q. Good morning, Dr. Morin.

A. Good morning, sir.
Q. You've obviously been retained by AmerenUE to provide testimony related to their cost of capital, correct?
A. Yes, sir.
Q. How much are you being compensated for your services in this case?
A. It all depends how long you keep me here. It coincides roughly with approximately $300 an hour.
Q. Prior to today, do you have an idea of how much this case has --
A. Well, the regulatory burden in Missouri is very, very heavy. These cases are very involved with surrebuttal and rejoinders. It's a very heavy process, so --
Q. More than $10,000?
MR. MILLS: Judge, can I ask you to again admonish the witness to answer the questions?
JUDGE WOODRUFF: Yes. If you would just answer his question.
THE WITNESS: I would guess anywhere from 40 to 50,000.
BY MR. DEARMONT:
Q. Do you own any stock in Ameren?
A. No, I do not.

Q. Have you ever?
A. No, never. As a matter of personal policy, I do not invest in utility stocks for obvious reasons.
Q. And I believe as you stated previously, you testified on behalf of AmerenUE in the company's last Missouri rate increase, correct?
A. Yes, sir.
Q. In your cost of capital testimony in that case, you included an upward adjustment of 30 basis points to account for flotation costs?
A. Yes, sir.
Q. And you did not include an upward adjustment in your DCF to account for quarterly compounding, correct?
A. Correct.
Q. Are you aware that the Commission in its Report and Order issued in the last case chose to eliminate your 30 basis point flotation cost adjustment?
A. The Commission decided to expense flotation costs rather than include them as a return adjustment. So yes, I am familiar with that.
Q. Do you also recall that in the last AmerenUE Order the Commission indicated that a quarterly compounding adjustment should be added to the DCF unless the parties could provide a more compelling argument as to

why this was inappropriate?

A. Yeah. I heeded the Commission's advice and incorporate that adjustment in my current recommendation.

Q. Not in your direct, though?

A. Correct.

Q. So when you filed your direct testimony in this case, you included an upward adjustment of 30 basis points to account for flotation costs, correct?

A. Yes, sir.

Q. And as I believe you stated previously, you did not include an adjustment for dividend compounding?

A. Correct.

Q. And your original equity -- return on equity recommendation in this proceeding was 11.5 percent, correct?

A. Correct.

Q. And that 11.5 is the mean of the results contained on page 56 of your direct testimony?

A. Correct.

Q. If you had excluded a 30 basis point flotation cost adjustment in your direct testimony at the time of your direct filing, the results shown, the average of the results shown on page 56 would have been 11.2 percent, correct?

A. Yes, sir.

Q. As we noted earlier, in your direct testimony you did not include any adjustment to the DCF for quarterly compounding, correct?

A. Correct.

Q. As we also noted, you did not make any adjustment for quarterly compounding in AmerenUE's last case either, correct?

A. Correct.

Q. In fact, you haven't made a quarterly dividend compounding adjustment in any cost of capital testimony filed in the last five years, correct?

A. Correct.

Q. And how many cases a year would you say you file cost of capital testimony? Eight or ten?

A. Approximately. I was going to say eight to ten.

Q. Can you tell us why in the last 40 or 50 cases in which you've filed cost of capital testimony, including the last AmerenUE case and your direct in this case, you did not make an upward adjustment to your DCF to account for quarterly compounding of dividends?

A. Yes. Three reasons. No. 1, to be conservative. No. 2, when you inflate the dividend yield component by 1 plus G, G being the growth rate, it's one way of dealing with the quarterly compounding effect.

And No. 3, most jurisdictions where I testify rely on the forward test year or a mixture of historical and forward test year. When you're doing quarterly compounding adjustments, you're overcompensating investors. It's akin to somebody going to the bank and investing $1,000 but you get interest on 1,100, because in a forward test year the rate base is augmented. So in order to avoid that, I generally do not include a quarterly timing adjustment.

Q. But you included it in your rebuttal testimony, correct?

A. Yes, I did, because of the Commission's policy.

Q. At this time I'd like to turn to that rebuttal testimony, if you don't mind. As you just mentioned, that contains a cost of capital update, correct?

A. Yes, sir.

Q. When you performed this update, you eliminated the 30 basis point flotation cost adjustment, correct?

A. Yes, sir.

MR. BYRNE: Objection. The question's been asked and answered three times.

JUDGE WOODRUFF: I'll sustain the

objection.
BY MR. DEARMONT:
Q. And you included a 20 basis point upward adjustment for quarterly dividend compounding to your DCF?
A. Yes, sir.
Q. You didn't actually perform a dividend compounding calculation for the companies in your proxy group, did you?
A. No, I did not. If I had, it would have resulted in a 20 basis points increase in the DCF estimate.
Q. A 20 basis points adjustment is higher than the upward adjustment made by the Commission in the last case, is it not?
A. I don't know.
Q. Does five basis points sound correct?
A. Yes.
Q. Will you please turn to page 55 of your rebuttal testimony?
A. I have it.
Q. On page 55 of your rebuttal, you chose to use the median of the results for your updated estimate, correct?
A. Correct.
Q. And that median is 10.8 percent?

A. Correct.

Q. Would you agree that the mean of those results is approximately 10.6 percent?

A. That's correct, but in order to provide --

Q. That's correct?

A. That is correct, but the reason is to provide less weight on the CAPM.

Q. Well, if I ask about the reason, then I expect an answer on the reason.

COMMISSIONER DAVIS: Judge, do you just want to remind the witness to answer the question? He's got a lawyer who can ask him questions later.

BY MR. DEARMONT:

Q. Can you explain why the mean was appropriate to use as your estimate of the cost of capital in your direct testimony but it was not appropriate to use in your rebuttal testimony?

A. Because the CAPM estimates are outliers, and they should be given less weight, and I believe some of the witnesses in this case agree with that position.

Q. Just to be very clear, the updated estimate on page 55 of your rebuttal does not include flotation costs but does include a 20 basis point upward adjustment to the DCF for quarterly dividend compounding?

MR. BYRNE: Asked and answered, your Honor.

MR. DEARMONT: I understand it has, but I'm trying to --

JUDGE WOODRUFF: I'll overrule the objection. It's just a summary question.

THE WITNESS: The answer is yes.

BY MR. DEARMONT:

Q. So if you were to remove that 20 basis point quarterly compounding adjustment from those DCF results, we would calculate the mean of your updated cost of equity to be 10.46 percent; would you agree?

A. I do.

Q. And as we discussed earlier, the results that you provide in direct without flotation and without quarterly dividend compounding was 10.2 percent, correct?

A. Run that by me again.

Q. Sure.

A. In the original direct?

Q. Yes. I understand that your estimate was 11.5 percent in direct.

A. Well, it was amended -- no. It was 10.9 with the flotation -- I'm sorry. Yes, you're correct.

Q. If I remove flotation --

A. Yes, I agree.

Q. -- from your direct filing --

A. Yes, I agree with that.

Q. -- 11.2?

So your testimony indicates, then, that between the time you filed direct in July of 2009 and the time you filed rebuttal in February of 2010, that the cost of equity for AmerenUE has declined 75 basis points?

A. That's correct, in response to the recovery from the financial crisis and the increase in stock prices.

Q. Are you aware that the company has updated its capital structure?

A. Yes.

Q. Do you know the updated capital structure percentages?

A. Approximately 51 percent common equity.

Q. Did you take this update into account when you filed your rebuttal and surrebuttal testimonies?

A. No, I did not. I thought that the slightly higher than average equity ratio is a way of compensating for the company's use of historical test year and the regulatory lag and all these factors that distinguish it from other utilities.

Q. I'm going to hand you --

MR. DEARMONT: May I approach the witness, Judge?

JUDGE WOODRUFF: Yes.

BY MR. DEARMONT:

Q. I'm going to hand you a document. Do you recognize that?

A. Yes.

Q. Can you describe for us what it is?

A. Direct testimony in a Washington Utilities and Transportation Commission case on behalf of Puget Sound Energy.

Q. And that's testimony that you filed, correct?

A. Yes.

Q. Will you please turn to page 61 of that testimony.

A. I have it.

Q. Will you please read into the record lines 7 through 14.

A. Question: What capital structure assumption underlies your recommended return on PSC's common equity capital? PSC being Puget Sound.

Answer: My recommended return on common equity for PSC is predicated on the adoption of PSC's projected test year capital structure consisting of 48 percent common equity capital. Should the commission decide to deviate from the capital structure, the empirical finance literature demonstrates that with each reduction in common equity ratio of 1 percent, the return on equity increases by approximately 10 basis points and conversely, of course.

Q. And that statement "conversely, of course" would mean that for every percentage increase in common equity ratio, the return on equity would decrease by approximately ten basis points, correct?

A. That's correct, assuming that the business risk remains the same. That's the key assumption.

Q. At this point I'd like to turn to your surrebuttal testimony filed in this case.

A. I have it.

Q. At page 10 of your surrebuttal, you respond to Staff witness Hill's comment that you have changed the index on which your risk premium analysis is based on which that -- let me start over.

At page 10 of your surrebuttal, you respond to Staff witness Hill's comments that you have changed the index on which your risk premium analysis is based from what you have done in the past, correct?

A. That's correct, but Moody's Index doesn't exist anymore. It's been bought out by Merchant, and they don't publish the index.

Q. We'll get there, but on page 10 you discuss that, correct?

A. Yes.
Q. Great. Now, in the past, for your risk premium analysis you used Moody's Electric Utility Index, and in your testimony in this proceeding you have selected to use Standard & Poor's Utility Index?
A. Yes, in all my testimonies I do S&P now because the index doesn't exist for Moody's.
Q. Sure. And Standard & Poor's Utility Index contains other companies besides the electric utilities, right?
A. It does, yes. It has some gas distribution companies.
Q. So yes?
A. Yes.
Q. One of the reasons you offer for this change over to Standard & Poor's Utility Index is that Moody's discontinued its publication of the Electric Utility Index in 2002, correct?
A. Correct.
Q. It's true, is it not, that in your testimony in the last AmerenUE rate case, which was filed in April of 2008, you used Moody's Electric Utility Index as a basis for your risk premium analysis?
A. That's correct.
Q. You state on page 10 of your surrebuttal

testimony in this case that your use of Standard & Poor's Utility Index is appropriate in this case because it offers consistency with your use of the electric utilities in your sample group. Is that an accurate summary?

A. The DCF is applied to S&P's utilities, and it makes sense to apply risk premium to the same S&P index.

Q. It's true, is it not, that in your testimony in AmerenUE's last case where you used Moody's Electric Utility Index as the basis for your risk premium, that you also used companies in Moody's Electric Utility Index as one of the sample groups for electric companies, correct?

A. That's correct. Again, Moody's has been bought out by Merchant. They no longer publish that index.

Q. But your use of Moody's Electric Utility Index in AmerenUE's 2008 rate case was supported by your use of the Moody's electric utilities in your sample group, right?

A. That's correct.

Q. Now I'd like to ask you to turn to page 11 of your surrebuttal testimony.

A. I have it.

Q. Would you agree that in this portion you respond to Staff's comments regarding your decision to omit the allowed return risk premium analysis?

A. Yes.

Q. For the benefit of the record, in the past when you performed an allowed risk premium analysis, you measured the difference between the average annual allowed ROEs for electric utilities and the average annual yield on long-term treasury bonds --

A. Correct.

Q. -- correct?

And in your surrebuttal on page 11, you state that UE eliminated that method, quote, a few years ago, correct?

A. Yes, because some people perceived it as being circular.

MR. MILLS: Judge, can we have that admonition again? Every question that Mr. Dearmont asks is basically what did you do, and every answer that the witness gives is here's why I did that. Not what I did, but here's why.

JUDGE WOODRUFF: I'll admonish the witness again, just answer without giving your explanation, unless the attorney asks for an explanation.

MR. DEARMONT: I'd like to ask that again.

COMMISSIONER DAVIS: Sorry, Mr. Dearmont.

So Dr. Morin, let's be clear. If he asks you what time that clock says on the wall back there, it's 9:46. We don't need an explanation. Thank you.

BY MR. DEARMONT:

Q. So in your surrebuttal in this case, you state that UE eliminated the previously discussed method, quote, a few years ago, yes?

A. Yes.

Q. You used the allowed return risk premium methodology in UE's last rate case when you filed your testimony in April of 2008, yes?

A. Yes. I think that was the last time I used it.

Q. You state in your testimony, and I believe you just mentioned in an explanation, that this method was, quote, deemed circular, correct?

A. Yes.

Q. Who deemed it circular?

A. In some of the orders that I've seen around the country, they perceived the method as involving circularity of logic.

Q. Were those orders issued recently?

A. Not to my knowledge, no.

Q. So when you used the allowed risk return premium -- excuse me, allowed return risk premium in UE's last case, you didn't make any reference to that method being circular, did you?

A. Correct.

Q. One final topic for you. I'd like you to take a look at a document I'm going -- do you recognize this one?

A. Oh, yes. That's a Canadian case.

Q. Right. And specifically would you agree that this is a rate application by Nova Scotia Power, Incorporated before the Nova Scotia Utility Review Board submitted in October of 2006?

A. Yes.

Q. Will you please turn to page 107 of that application.

A. I have it.

Q. Does this application indicate that section 5.5 beginning on page 107 was authored by Dr. Roger A. Morin?

A. Yes.

Q. Was that you?

A. That's me.

Q. Will please turn to page 109 of that document.

A. Yes.

Q. Will you read out loud the testimony found on lines 11 through 17.

A. As part of the -- of its application for 2007 rates, Nova Scotia Power is requesting to retain the 9.55 percent return on equity and the 37.5 percent common equity ratio authorized by the Nova Scotia Utility and Review Board in a decision issued on March 31st, 2005. I've been asked to provide an expert opinion on the fairness and reasonableness of the company's proposal of their current and prospective capital market conditions.

Q. And I, the word I referenced in that section is you, correct?

A. Yes.

Q. It's true, is it not, that Nova Scotia Power, Incorporated at the time you filed this testimony was a fully integrated electric company?

A. Yes. Still is.

Q. It's true that Nova Scotia Power, Incorporated at the time you filed this testimony had an S&P bond rating of triple B?

A. Yes.

Q. Will you please turn to page 110 of this application.

A. I have it.

Q. There are a few bullet points contained on this page, correct?

A. Yes.
Q. And you authored this section?
A. Yes.
Q. Will you please read bullet point No. 3 in its entirely into the record.
A. I conclude that a fair and reasonable ROE for an average risk Canadian energy utility is in the range of 9.5 to 10.5 percent. In view of the fact that NSPI possesses above average business risk, I concluded the upper portion of the range would be far more appropriate and reflective of the company's business risk.
Q. What ROE was awarded in that case?
A. I don't remember. It's 2007.
Q. One more. What ROE did the company apply for in that case?
MR. BYRNE: Your Honor, I'm going to object to this line of questioning on the grounds of relevance. This is a Canadian utility from years ago, completely different circumstances as far as I know. I don't know that this has any relevance to the Commission. He's laid no foundation that this utility's facing similar circumstances or has similar regulatory framework as AmerenUE.
JUDGE WOODRUFF: Any response?
MR. DEARMONT: Absolutely. I think that I

have. I think I've laid a foundation that they're a vertically integrated utility company, that they had an S&P triple bond rating. I understand it's a few years old, but -- and I believe the testimony in this case will demonstrate we're living in a global economic market. Therefore, I think it's absolutely relevant.

MR. BYRNE: And it's in a different country.

JUDGE WOODRUFF: I'm going to overrule the objection.

BY MR. DEARMONT:

Q. Again, I believe my question was, do you remember the ROE that was requested by the company in that proceeding?

A. I think it was 10.5, the upper end of the range.

Q. 9.55, would you accept that as true?

A. I don't recall. I mean, it was years ago.

Q. Do you want to go to page 109 of the application?

A. 9.55.

Q. Would you agree that on page 109, lines 11, 12 and 13 state that the company is requesting to retain a return on equity of 9.55 percent?

A. That's correct.

Q. NSPI is the largest utility subsidiary of Emera, correct?
A. Emera, correct.
Q. Emera. Excuse me. Is that correct?
A. Yes.
Q. That document that I just handed you, would you agree that that's a 2008 Emera annual financial report?
A. Yes.
Q. Will you turn to that annual report on page 12.
A. I have it.
Q. After having had a second to review this material, would you agree that in the case that we just talked about, the Canadian case years ago, that the utility board authorized a return on equity in the range of 9.3 to 9.8 percent?
A. Yes.
Q. Would you agree that rates were set in that proceeding at approximately 9.35 percent ROE?
A. Yes.
Q. Has Emera been able to raise common equity over the past couple of years?
A. I don't know.
Q. It's still a viable enterprise, is it not?

A. Yes, it is.

MR. DEARMONT: I have no further questions. Thank you very much.

THE WITNESS: Thank you.

JUDGE WOODRUFF: All right. Thank you. It's now nearly ten o'clock. We're due for a break. Let's come back at 10:10.

(A BREAK WAS TAKEN.)

JUDGE WOODRUFF: Before the break, we had completed cross-examination from the Staff. Now we'll move to MIEC.

MS. ILES: Thank you, your Honor.

CROSS-EXAMINATION BY MS. ILES:

Q. Good morning, Dr. Morin.

A. Good morning.

Q. My name is Carol Iles. I just have a few questions for you.

A. Nice to meet you.

Q. Nice to meet you.

A. I think I'm glad to meet you.

Q. Well, of course.

Now, it's already been established and I'm not going to ask you about whether or not the quarterly dividends adjustment were included in your DCF numbers, your final DCF numbers in your rebuttal. I'm not going to ask you that because you were real clear on that, that they are there.

I do want to ask you this. Were there any other upward adjustments to your results that are included in your final numbers on page 55 of your rebuttal testimony?

A. Flotation cost was removed and quarterly timing was added. That is it.

Q. Thank you. Now, did you provide schedules showing the development of your CAPM risk premium and DCF return estimates that you included in your rebuttal testimony?

A. I think they were subject of a Data Request. I'm not sure.

Q. But they were not included with your testimony as they were with your direct; isn't that correct?

A. That's correct. It was just an update.

Q. It was an update. Why didn't you provide that data with your testimony, just out of curiosity?

A. I wasn't asked. I would be glad to provide it. I have them here in my computer if you'd like me to provide them.

Q. Have you provided it in this case?

A. I'm not sure if I was asked by any party.

Q. I think we did ask your counsel.
A. I don't think so. I don't think I was asked. The schedules are replications of my direct, just updated.
Q. You said that your numbers are different in your rebuttal, correct?
A. Well, they are because we removed flotation costs and we added quarterly timing. That's the only difference.
Q. But --
A. And we updated the numbers, obviously.
Q. Yes. That's the part that there's no work papers to go along with. That's the part I'm concerned about, that we can't check those calculations, or nor can we determine what numbers you relied on exactly in making those determinations; isn't that correct?
A. I'll be glad to provide them.
Q. You did file work papers, but the rebuttal -- I'm sorry to ask this. You did file work papers, but it was the rebuttal calculations that were not included in those?
A. Correct.
Q. Now I want to ask you, Dr. Morin, a little bit about your use of the constant growth DCF return estimates.

A. Yes.
Q. All right. When you arrived at your proposal at 10.8 percent return on equity in this proceeding, you did not minimize your constant growth DCF return estimates, correct? You did not minimize those?
A. What do you mean minimize? Give less weight or --
Q. Correct.
A. No, I did not.
Q. You did not. But isn't it accurate that in the past there have been cases where you have recommended that a minimum weight be placed on constant growth DCF return estimates?
A. Yes, in the past there were times in capital markets when DCF estimates overstated investor returns, in the same way that CAPM estimates understate them right now.
Q. So what you're saying, then, in your explanation, and if you could just answer yes or no, in those cases the constant growth DCF return estimates you found were too low, and you determined that they downwardly biased your return on equity findings?
A. Correct.
Q. Now, have you ever, Dr. Morin, recommended that minimal weight be given to your DCF return estimates

because you found the growth rates were unreasonably high?
A. Yes.
Q. When was that?
A. Maybe three or four years ago, the growth rates for some of those companies were 21 percent and 18 percent because they were starting from a very, very, very low base, and I thought this biased the results upwards, and I decided to accord less weight to the DCF results.
Q. In what case was that?
A. I'd have to check my archives.
Q. Do you think it was in more than one case or just one case?
A. Probably more than one.
Q. Now I want to ask you some questions about the GDP growth forecast.
A. Yes.
Q. If you want to look at page 18 of your rebuttal testimony.
A. I have it.
Q. And on that page in your testimony, you take issue with Staff witness Murray's GDP growth forecast; isn't that correct?
A. Yes.
Q. And you state that using morning star's

data for GDP growth and treasury bond instruments for an inflation rate, you find that the real -- I'm sorry. You come up with a 6 percent -- 6 percent nominal GDP, correct?

A. That's correct. Real growth plus inflation.

Q. So the real growth number that you used there was 3.5 percent, correct?

A. Correct.

Q. All right. And you state that that comes from a Morningstar 2009 publication? I think you state that on the next page.

A. Yes.

Q. I have a document that I wanted to show you.

MS. ILES: Could I have this marked as an exhibit?

JUDGE WOODRUFF: Sure. MIEC's next number is 440.

(EXHIBIT NO. 440 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

MS. ILES: And we have some additional copies, I think, that we can share with everyone when we find them in all this paper. I'm sorry.

BY MS. ILES:

Q. All right. Is this that Morningstar publication?
A. Yes.
Q. All right.
A. This is the current edition.
Q. It's the 2009, which is what you said you relied on, correct?
A. Yes.
Q. All right. And isn't the number that you were talking about -- and isn't the number that you were talking about on the third page of that document, but rather than 3.5 percent it's actually 3.3 percent, correct?
A. Yes. That's why in my testimony I said approximately.
Q. All right. Thank you. So the actual number should have been 3.3?
A. For the real growth, yes, plus the inflation premium of 2.5 makes it 5.8 to be exact.
Q. All right. Thank you.
MS. ILES: I'd like to move for the admission of that document.
JUDGE WOODRUFF: Exhibit 440 has been offered. Any objection to its receipt?
MR. BYRNE: No objection.

JUDGE WOODRUFF: Hearing no objections, it will be received.

(EXHIBIT NO. 440 WAS RECEIVED INTO EVIDENCE.)

BY MS. ILES:

Q. Now I want to look at page 39 of your testimony.

A. Rebuttal?

Q. I'm sorry. Yes, rebuttal.

A. I have it.

Q. Now, isn't it true that on page 39 you assert that consensus analyst growth rate projections are likely to be considered by investors in making investment decisions?

A. Yes.

Q. And do you believe the consensus economists' projections of nominal and real GDP growth are considered by investors in making investment decisions?

A. Yes.

Q. And did you consider anywhere in your testimony consensus economists' published GDP growth forecasts?

A. No, I did not, because the --

Q. Okay. Thank you. I want to show you another document.

MS. ILES: Could I have this marked?
JUDGE WOODRUFF: Be 441.
(EXHIBIT NO. 441 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)
BY MS. ILES:
Q. I'd like to direct your attention to page 15 of that document --
A. Yes.
Q. -- that I just handed you.
And based on the consensus economist projection of future GDP growth forecast over the next five and ten years, isn't it accurate that the consensus based on this document of economist GDP growth forecasts are 2.1 percent and 2.2 percent?
MR. BYRNE: Ms. Iles, where are you referring to on the document?
MS. ILES: I'm sorry. I have the wrong numbers.
THE WITNESS: Page 15 on the upper right.
BY MS. ILES:
Q. I'm sorry. I said the wrong amounts. It should be 3.0 and 2.6. Would you agree with those numbers?
A. These are forecasts for 2011-2015 and 2016 to 2020. That's correct.

Q. Yes. Thank you. And as shown on the same page, the consensus real GDP growth outlooks are about -- how about the nominal GDP growth, let's look at that.
A. 4.9 and 4.7, for a five-year period.
Q. And I just would like to point out, would you agree that both of these forecasts are lower than the historically derived GDP forecast that you derived in your testimony, correct?
A. Yes, but as I discussed, they're incorrect.
Q. They are lower. But these are consensus forecasts, correct?
A. Only for five-year period, yes.
Q. All right. Thank you. I think for five and ten-year actually?
A. Five and ten years.
Q. Yes.
A. DCF requires perpetual growth rates.
Q. Okay. And isn't it reasonable to assume that the -- assume that the investment community would give some consideration to these analyst GDP growth forecasts in making investment decisions?
A. It is reasonable.
Q. And isn't it also possible that the investment community might expect the real GDP growth rate going forward to be different than it has been in the past

due to factors such as changing global economy?
A. It could be. Could go higher than this as well.
Q. I think my question was, it could be different?
A. Could be different.
MS. ILES: I have no further questions.
THE WITNESS: Thank you very much.
MS. ILES: I'd like to move for the admission of this document.
JUDGE WOODRUFF: 441 has been offered. Any objections to its receipt?
(No response.)
JUDGE WOODRUFF: Hearing none, it will be received.
(EXHIBIT NO. 441 WAS RECEIVED INTO EVIDENCE.)
JUDGE WOODRUFF: All right. That completes cross-examination. We'll come up for questions from the Bench. Commissioner Davis.
QUESTIONS BY COMMISSIONER DAVIS:
Q. Good morning, Dr. Morin.
A. Good morning, Mr. Commissioner.
Q. Okay. Let's go back to Mr. Mills' cross-examination first, and it's -- it's my recollection

that I heard you say that you didn't consider PSC Staff witness Mr. Murray to be an expert. I don't agree with that assessment because, I mean, he's fundamentally using the same formulas that you use, I mean, with some modifications, correct?

A. Yes.

Q. I mean, isn't it -- when it gets down to it, all it is -- I mean, the only difference is the assumptions that you plug in and make about some of these formulas, correct?

A. That's correct. But what's important is the veracity of reasonableness of those assumptions and are they based on sound economics.

Q. Okay. But, I mean, you'd agree that, I mean, he clearly understands the material and knows how to manipulate the data to achieve the desired outcome?

A. I believe he doesn't. Again, my comments are made with all due respect to Mr. Murray.

Q. Okay. Now, you've changed your testimony from your direct testimony to your rebuttal testimony, correct?

A. I updated it, yes, sir. I did update testimony, and I did allow for the Commission's policy on flotation costs and quarterly timing.

Q. Okay. Well, I guess the question is, I mean, it's not whether the Commission says do flotation costs or quarterly timing. The question is, what is the right thing to do?

A. Okay. Good question. The flotation cost policy, you have two choices. You can adjust the rate of return or you can expense it over time. If you expense it over time, you are burdening the current generation of ratepayers for the full cost of flotation costs that's going to last forever because equity lasts forever. So some people consider it a redistributional type of argument where expensing flotation costs penalizes current customers for capital that's going to be used for many generations over time.

So I think it's sounder policy to account for flotation costs through a rate of return adjustment, but the Commission favors expensing it, and I don't have a big, big problem with that, but -- other than the policy argument that I just put forth.

Q. What about Mr. Gorman's, he adds it into the capital structure, doesn't he, the flotation? Didn't he make some sort of flotation cost and add it into the capital structure?

A. I don't think so.

Q. Maybe I just misunderstood.

A. But there's nothing wrong with the

Commission's policy of expensing it other than penalizing, over-penalizing current generation of ratepayers.

Q. Okay. But I know you're not a lawyer, and I'm just looking for competent and substantial evidence to say this is the best way to do it. So what is the best way to do it or what is the appropriate way to do it or is there a difference?

A. All the textbooks in corporate finance adjust the cost of equity for flotation cost adjustment for the simple reason that when a company issues stock, let's say for a hundred bucks and the company only nets $95 a share because you've got to pay the underwriter, you have to earn a slightly higher rate of return on a slightly higher rate -- excuse me, lower rate base to account for that.

So if the stock's selling, I'll repeat, $100 and the company nets 95, you have to earn a little bit more on that diminished equity base to satisfy investor return requirements. That's why most textbooks, I think all textbooks advocate an adjustment on rate of return flotation costs.

Q. And would you agree that Staff's methodology in terms of expensing is, even though it may not be recommended by the textbooks, it's an equally sound way for the company to recover its money?

A. Yes, I agree with that, but again, subject to the caveat that the current generation of ratepayers are slightly overburdened for the cost of capital that's going to last 100 years. That's the only caveat.

Q. Right. But I guess in theory, if the current generation of ratepayers that is necessitating the capital investment, then it's the current generation that that should be expensed to, shouldn't it?

A. Yes.

Q. Okay. Now, going back to questions by Mr. Dearmont, you listed three reasons for a quarterly dividend method versus annual or semiannual?

A. Yes, sir.

Q. Could you restate those briefly for me again, please?

A. The first reason is, theoretically -- well, not theoretically. Practically as well, dividends are paid quarterly, and the stock price that we all see in the Wall Street Journal is predicated on a quarterly stream of dividends. And if suddenly the company was going to announce, well, instead of paying 25 cents a quarter, we're just going to pay you a dollar at the end of the year, because of the time value of money, the stock price would drop.

So when you're doing DCF analysis, the

stock price that you're working with is predicated on a quarterly dividend stream, no other, because that's the way it is done in practice. So theoretically that's correct.

The second reason is a way of accounting for that, rather subtle way of accounting for that is when you're using the dividend yield component in the DCF model, instead of inflating it by one-half of the growth rate, you inflate it by the full growth rate. That's the way of accounting for this quarterly compounding.

The third way, you know, there's a lot of controversy about quarterly compounding, and for reasons of conservatism, sometimes and most of the time I eliminate it. And the final reason, that's a really subtle reason, is in a forward test year jurisdiction, if you were to allow the quarterly timing adjustment, you overcompensate investors, because in a forward test year if the rate base is, let's say, a thousand dollars today, in a forward test year it's $1,100 at the end of the year, you're applying a return on too big a rate base.

I always give the example of giving a thousand dollars to the bank today but they give you interest in 1,100 bucks because it's a forward balance, so to speak. That's the analogy that I tend to use. So that's the reason why in future test year jurisdictions I use -- I do not use a quarterly timing adjustment. So these are some of the reasons that I don't do it and do it.

Q. Why didn't you use it in your direct testimony again?

A. Those four reasons that I gave you, conservatism, it's allowed for through the full growth rate adjustment factor, and it's been controversial in other jurisdictions, and I just decided not to use it.

Q. And then you -- and then you changed?

A. Well, in this particular jurisdiction, it's an historical test year, so there's more rationale for including it than there would be in a forward test year jurisdiction.

Q. And go back and if you would describe to me the whole growth rate, the one plus G.

A. If the spot dividend yield that you observe today is, let's say, 5 percent, the DCF model is predicated on a forward dividend yield, what we call D sub 1 instead of D sub zero if you want to be mathematical about it. And what most practitioners do, they take a spot dividend yield and they inflate it by one plus one-half the growth rate because of the quarterly nature of dividends throughout the year, sort of an averaging process.

Instead of doing that, I inflate it by one plus G, the full growth rate, and that's a conservative way of accounting for the compounding of dividends. I know it's very technical, but --

Q. Well, but I'm just trying to figure out, if you did the one plus G calculation in your direct testimony, then why would you need to update and add 20 basis points?

A. Because the Commission in the past has expressed a preference for a quarterly DCF adjustment. That's the only reason.

Q. If it was a custom in rate cases for witnesses to go back to the Missouri River bridge and jump off the bridge, would you do that, too?

A. It's not an unsound policy, particularly in the historical test year jurisdiction, which is unique.

Q. Okay. Growth rates.

A. Yes, sir.

Q. I was a little unclear, and it's -- I think it's spelled out in your testimony. When you're using -- when you're calculating the growth rate, do you use the dividend growth rate, the earnings growth rate, book value growth rate, average the three? What's the most appropriate and why?

A. Good question. Fundamental question. I --

in theory, the DCF model requires dividend growth rates because that's what investors receive in their pocket in cash dividends. But dividends can only be driven by earnings, so earnings is the driving motor behind dividend. The ability to pay dividends stems from the ability to generate earnings.

No. 2 reason why I prefer to rely on earnings growth rate is because there's an abundance of earnings growth rate forecasts, Zaks, Thompson, First Call, and so forth. ValueLine publishes earnings forecasts. Whereas, in the case of dividends forecasts, they're very, very, very rare, very scarce. Other than ValueLine, I'm not sure there's any other source of dividend forecast. So from a practical and a theoretical point of view, I prefer to rely on analyst earnings growth forecasts.

The other reason why you should discard history is because when analysts make forecasts, they already account for historical trends in their forecasts. So it's sort of redundant to rely on both historical growth rates and forecasts because history is already impounded into the earnings forecasts for the future.

So those are the reasons why I prefer to use analyst forecasts of earnings rather than dividends. There's so much of them around, and earnings drive dividends.

Q. I'm not sure if I'd say that dividends are explicit or implicit in earnings, but it's definitely a component of earnings?

A. Yes. You pay dividends out of earnings, and the difference is plowed back in the company, is reinvested in the company's asset structure.

Q. What about book value growth?

A. Well, there's really not much of a connection between book value and earnings and dividends, because again, investors receive dividends that are driven by earnings, and book value is a distant, a more distant driver of earnings and dividends.

And the other practical reason is, other than ValueLine, I don't know of any other source of book value forecast.

Q. Okay. It's fair to say that DCF focuses on either earnings or dividends?

A. Yes. That's correct, sir.

Q. So you're not aware of any textbooks that would advocate for an average of the three growth rates?

A. I have never seen it.

Q. Have you ever seen it adopted in any jurisdiction?

A. Not explicitly.

Q. Implicitly?

A. It's hard to say because rate orders are naturally reluctant to disseminate the details of all -- how they arrive at the ROE that they allowed. They don't go into that much detail as to why we chose book value or dividend growth.

Q. All right. With regard to the DCF, you've got single-stage DCF, two-stage DCF, multistage DCF, and then which is appropriate to use when and why?

A. Another good question. I would think that, in practice, Wall Street analysts and also in textbooks, there's a preponderance in terms of application of multistage models. The reason I'm a little bit reluctant to rely on that model is because the growth rates from the plain vanilla DCF model are the same thing as the growth rates long term, for example, from the GDP forecast.

Earlier in cross-examination we were talking about GDP growth forecasts of 5.8 percent in nominal terms. My growth rates in the first stage are between 5 and 6 percent. So they're consistent with one another, so there's really no need to rely on multiple stages.

The second reason is, how do you determine the long-term growth rate in stage No. 2 and stage No. 3? Mr. Gorman, for example, uses GDP growth forecasts, and I don't have a problem with that, but that sometimes can be problematic and controversial as to how do you get a growth rate in perpetuity.

So they're all correct theoretically. Some are more applicable at certain times, but I don't have a problem with multistage DCF at all.

Q. Okay.

A. As long as you use the right inputs.

Q. Right. Okay. Now let's go to CAPM analysis. You, Mr. Gorman and Mr. Lawton, I believe, all use an arithmetic mean; is that correct?

A. Yes, sir, that's correct.

Q. Did Lawton do a geometric mean, too?

A. I think he gives weight to the arithmetic mean, and that's the right way to do it.

Q. And why is that?

A. Well, the technical reason is that the CAPM is an additive model, so the expected rate of return is an arithmetic mean of one period. If you kind of visualize in your mind a bell-shaped distribution of returns the investor's looking at, the arithmetic mean is the central tendency, the expectation, the middle of that bell-shaped curve. That's the technical reason.

The second reason is, that geometric mean is a very good measure of performance of a portfolio over a long historical time period, but the problem is it doesn't tell you anything about the trip on the way from year one to year ten, for example. You can have a stock that's very, very, very volatile and one that's very, very stable and they both have the same geometric mean, but the investor would require much higher rate of return on the volatile stock than the one that's very, very steady, and the geometric mean doesn't pick that up. The arithmetic mean incorporates volatility, if you wish.

So those are the two main reasons, to keep it, you know, nontechnical, why one would prefer an arithmetic mean. The Ibbotson Yearbook, of course, where we all get our data, strongly advocates the use of the arithmetic mean, and most of the leading textbooks in finance also advocate the arithmetic mean for measuring the cost of equity.

That doesn't mean we can't use a geometric mean for some other purpose like figuring out performance of a mutual fund over the last 20 years. There's nothing wrong with that. It's a summary figure, but it doesn't tell you anything along the way year to year to year to year.

Q.   Okay. Are you aware that fuel adjustment is an issue in this case?

A.   Yes. I thought it was settled, but I guess it is an issue now. Yes, I am aware.

Q. Okay. If this Commission were to adopt a sharing, an 80/20 sharing mechanism, a 50/50 sharing mechanism, or not adopt a fuel adjustment for AmerenUE at all, how -- or would it change your recommendation and, if so, how?

A. Well, the mainstream policy in the United States and in Canada is for one on one. That's the mainstream policy.

Q. I'm sorry. What's one on one?

A. Pass on of one to one, dollar for dollar.

Q. Okay.

A. Sharing mechanisms are rather rare. There is one in the state of Washington for Puget Sound that has very, very small bands. If we start at the extreme here with no fuel cost adjustment at all, if you -- you probably don't recall, but if you recall in my last appearance before this Commission, I think I convinced you that the cost of equity would be 25 basis points higher without the fuel adjustment clause.

And just prior to that hearing, the bonds of the company were put on credit watch and negative outlook for lack of a fuel adjustment clause. That has since disappeared because you did approve in the last order a fuel adjustment clause.

Now, if you're going to change course here again, that might rattle the investment community a little bit. I don't have too much of a problem with a 95/5, but as soon as you're going towards, you know, 90 and 80 and 50/50, it becomes riskier and riskier and riskier for the company, and I think that has negative consequences on creditworthiness of the bonds, and I think the bond rating agencies would react negatively to that.

So I would strongly, strongly urge the Commission to keep the full fuel adjustment clause as it is, because that's the mainstream policy and I think it's a good policy. It lowers the cost of capital for the utility and, therefore, the ratepayers' burden.

Q. Is there anything else that you would like to add, any impressions from this morning that you haven't had a chance to comment on that you'd like to comment on now?

A. What a nice question that is.

MR. MILLS: Judge, I'm not going to object to the question, but I certainly hope that the other witnesses get the same opportunity for a free-flowing discussion.

COMMISSIONER DAVIS: Mr. Mills, I'll give -- and we'll limit them to five minutes or less.

MR. MILLS: Thank you. At $300 an hour, I appreciate that.

THE WITNESS: No, I don't have any strong comment to make. The one comment I would make is, if you look at Mr. Lawton and Mr. Gorman and myself and you look at DCF estimates, we're pretty close really. There are subtle differences in styles of presentation of their results, perhaps, but we're pretty, pretty close.

It's not as controversial as some attorneys make it sound, that it's all over the place and depends on your assumptions. Of course, there is judgment involved, but one of my mentors when I was at the Wharton School always told me that judgment is only 50 basis points thick. If there's more than 50 basis points difference between testimonies, one smells a rat a little bit.

So it's not as disparate and as controversial as it appears to be. If you look at the ranges and the top of the ranges and the bottom of my range, we're pretty consistent between Lawton, Gorman and myself anyway. That's one comment I would make.

The other comment I would make is, Missouri is quite different, because I've testified in 46 states and two countries and nine provinces, and it is a little bit different here, particularly the historical test year. I would urge you to sort of think about that a little bit. It's very difficult for AmerenUE to earn its allowed rate of return because of historical test year and regulatory lag. That's the only comment that I have.

BY COMMISSIONER DAVIS:

Q. Okay. I think one of the attorneys asked some -- a hypothetical question about, you know, Company A and Company B.

A. Right.

Q. Let's say you have company -- two companies, Company A and B. They have the same capital structure. Everything's the same about them, except that one company is a distribution utility, it's in a deregulated state, and the other company is a vertically integrated company, and it owns a nuclear power plant, a large coal fleet. Which utility would be riskier, and how -- and how would you account for that risk?

A. Let's say Company A is distribution and Company B is vertically integrated. Company A is unencumbered by the riskier power production function and would be perceived as less risky than Company B who has the power production function that's more competitive and more risk and so forth and coal and nuclear, et cetera.

In terms of empirical evidence, the allowed returns for distribution only or wires companies are typically a little bit smaller than the allowed ROEs for vertically integrated companies because the latter are riskier.

You also find that the betas, which is a very popular measure of risk in finance, are a little bit lower for gas distribution companies, for example, and distribution only companies like Consolidated Edison than it would be the case for Company B.

So I think there is clear evidence and I think logic that supports the notion that distribution only is less risky than vertically integrated.

Q. And a distribution only electric company is not that much different than a gas LDC, is it?

A. No. In fact, I often use gas LDCs, gas distribution companies as proxies for, well, what I call DISCOS, distribution only companies.

COMMISSIONER DAVIS: Thank you.

THE WITNESS: You're welcome, sir.

JUDGE WOODRUFF: Commissioner Gunn?

COMMISSIONER GUNN: Yes.

QUESTIONS BY COMMISSIONER GUNN:

Q. Thanks for coming. I just have a couple preliminary questions and then I'll be into it. Have you ever -- in all the times that you've testified, have they all been for the utility?

A. Yes.

Q. Have you ever attended a local public

hearing in this case or any of the other cases?
A. I have attended some in other cases, but not this one.
Q. Did you watch any of them or review any of the transcripts?
A. No.
Q. I want to go back to something you said earlier. You said that the fuel trackers or the different trackers don't have a significant impact, but you didn't know what the fuel costs were and you didn't know what the storm recovery costs were, but you still say that it doesn't matter what those costs were because it's not significant?
A. I did say that the fuel trackers are huge.
Q. Right. But the vegetation management, storm?
A. Those are -- in the grand scheme of things, they're further away on the radar screen of investors in terms of impact on risk and perceptions of risk because of the small magnitude of the numbers involved relative to something like CWIP or investments in renewable resources or investments in environmental compliance type of things for coal-related production and so forth. Those are the big ticket items, and those are looked at by the investment community.

The smaller ones, it's very difficult to quantify, to say, well, it's five basis points or ten basis points on the ROE. Let's say it has a positive impact on risk. It reduces risk, but it's almost impossible to determine by how much.

Q. And that's based on what the rating agencies characterize?

A. Yes, and reading equity research reports, the language that they use, the factors that they examine, and the blend of factors that they look at, usually business risk, financial risk, regulatory policies, fuel trackers, what test year they use. Those are the big ticket items.

Q. Do you ever get counterintuitive results with any of the stuff that you run, stuff that you didn't expect?

A. Yes. I didn't expect the CAPM numbers to be so low as they are currently, as several years ago I was surprised that the DCF numbers were so high. Sometimes you get surprises. It seems that markets sometimes overreact to things, and yes, I do get surprises.

That's why it's important to use a whole bunch of techniques. One usually hedges the other. When CAPM numbers tend to be very low, the DCF numbers tend to offset that, and it works in reverse as well.

Q. Right. I want to talk about the zone of reasonableness for a second.

A. Okay.

Q. When you did your initial analysis, did you -- was the zone of reasonableness anywhere in your mind when you did your initial analysis?

A. It's something that's very much on my mind because I'm a strong advocate of allowing a range of rates of returns, and if the company stays within the range, everything is okay.

Q. So when -- in your rebuttal testimony you have this RRA.

A. Yes.

Q. It's one of the schedules.

A. Yes.

Q. It says that the average return on equity authorized in 2009 approximately approximated 10.5 and was unchanged from the prior year.

A. Yes. It's on page 2.

Q. So when you came back with 11.5, were you troubled by the fact that it was on the very upper edge of kind of a zone of reasonableness?

A. I was a little bit troubled by the low, low, low stock prices and the high dividend yields and the high growth rates that still remain at that time from analyst forecasts.

Q. That's not what I'm asking.

A. Oh, okay.

Q. I'm asking whether you were troubled by your results at 11.5 because it was at the very top edge of the zone of reasonableness.

A. I was --

Q. Did that question your analysis?

A. Yeah, I was a little bit troubled by that. I thought, you know, it was higher than I would have expected.

Q. But you didn't change it?

A. Well, no, because the data is the data.

Q. And that's kind of my point. The data is the data, and I've never been a big fan of the zone of reasonableness. So if you had done exactly the same -- the same analysis and your ROE became 11.6, which was outside of this so-called zone of reasonableness, but you recheck your numbers and see that the data is the data, would you adjust that recommendation down because of the zone of reasonableness?

A. Yes, I would not. That becomes so judgmental and so qualitative and so controversial, and to me you're departing from the scientific technique of relying on data.

Q. So the point is we-- you don't believe that the zone of reasonableness should be an automatic circuit breaker for this Commission to disregard testimony or disregard results?

A. I think you should view it as a very important benchmark, and it provides a perspective on the recommendations of various witnesses if you're way out of line or within line or way out of line the other way.

Q. Well, you said 50 basis points you smell a rat, but you were way above 50 basis points than Gorman and Lawton in the initial filing, right?

A. Well, in the initial filing. I don't know what their numbers would have been if they'd been testifying or relying on financial crisis data last summer. I suppose their recommendation would have been higher also because the stock prices have gone up substantially since then and growth forecasts have turned down a little bit, too.

Q. I want to go -- you talked a lot about the bond rating agencies, and you say that -- the bond rating agencies don't always get it right, do they?

A. No, and we have things like Enron, for example, and --

Q. Lehman Brothers?

A. Lehman Brothers. They didn't see it coming. So they're not the gospel and they're not infallible.

Q. And we shouldn't make our recommendation based on what a bond rating agency may or may not do, if the numbers are supported in the evidence?

A. You should not base your recommendation solely on bond rating agencies, but one would be concerned if you're fooling around with investment grade or slightly below investment grade or one notch away from investment grade. That would alarm me, because that means the cost of capital would go way up.

Q. What about cost to consumers, do you think that's something we should take into account?

A. Of course.

Q. So I was interested in your response saying that a higher ROE actually lessens the cost to the consumer. That was in response --

A. Yes.

Q. That's a long-term -- that's a long-term potential reduction in cost, right?

A. Yes.

Q. Not short-term?

A. The way I like to express it is more is less. That means that if you give a reasonable ROE today, that will lower the capital costs of all the funds incrementally that have to be raised by this company, and eventually that's good for ratepayers.

Q. But in the short term there's significant costs to the customers, the ratepayers?

A. There's a short-term, slightly shorter term paying for a much longer term gain.

Q. So are you familiar with the stipulation that was filed late last night on rate design?

A. No. Sorry.

Q. Well, let me represent this to you, and if the parties want to ask questions about it, I'm looking at -- it says that if there is -- if we were to grant hypothetically a rate increase of $325 million, then residential rates would increase by about 16 and a half percent, 16.29 percent. The lawyers can challenge that. I'm reading off the stipulation. I know some people haven't signed it, but they can follow up on questions if they don't agree with that.

Do you think that's -- I mean, that's a significant short-term cost, right?

A. Absolutely.

Q. And that's not going to go down any time soon?

A. I don't think so. I agree with you because the infrastructure investments that have to be made are gigantic. Some people estimate the industry will have to invest $25 trillion by 2025. So I agree with you, it's not likely to go down.

Q. And in reality, because infrastructure is always being replaced, the curve of rates over a long period of time is up, the pattern?

A. Yes, I agree with that.

Q. You're not going to see -- if the company continues to replace and retire and do everything that they're supposed to do, you're not going to see significant reductions in rates over a long period of time. They may be -- they may be less than what you would depending on different scenarios, but we're still looking at rate increases?

A. I think you are for the median term anyway. I would urge you to look at what's going on in Hawaii, which is a revolutionary look at the future and revolutionary policy in terms of renewables, in terms of how to curtail demand of electricity and how to increase supply, and it's an all-out attack basically on renewables and to try to curtail consumption, and it's very, very interesting what's going on over there --

Q. They have no --

A. -- as a model for what's going to come on the mainland.

Q. Well, they use mostly oil?

A. Of course, they use oil. It's an island, too.

Q They have no access to other --

A. No.

Q. And transportation costs are huge, so it's --

A. What they're doing is, I think, heroic and merits the Commission looking at it --

Q. I want to go back to --

A. -- to try to curtail that demand.

Q. Sure. I agree with you. I think efficiency and demand response are very important --

A. Absolutely.

Q. -- aspects of this, and those programs actually have the potential to reduce rates --

A. Yes, they do.

Q. -- for ratepayers much more than some of the other things.

A. That's why I mentioned it.

Q. And I appreciate that. I think that's absolutely right.

And I just want to go back. I don't claim to be an expert on this stuff. That's why we look to you.

But at least your contention is right now that Mr. Lawton, Mr. Gorman and your analysis are all theoretically sound, the structures of them are theoretically sound?

A. I agree with that.

Q. The quibbles are with what the inputs are?

A. Well, that's one quibble, but the other quibble is how you present the anatomy of your results.

Q. And your problem with Mr. Murray's testimony is not that the structure isn't theoretically sound, it's the inputs are so far out --

A. They're out of the mainstream, basically.

Q. You talked about mainstream, too. That's interesting, because your 11.5 recommendation was pretty far out of the mainstream according to that chart, right?

A. Well, yeah. If you look at today's chart, yes. But if you look at the chart in early 2009 in the midst of the financial crisis, it wouldn't have appeared so ludicrous. Put it that way.

Q. You're not saying your 11.5 is ludicrous?

A. Today it would be, yes.

Q. Okay.

A. Today it would be.

Q. Okay. But the analysis was based -- I feel like I need to help you here. But the analysis was based on conditions in 2009, and that's why the ROE was higher?

A. That's correct.
Q. And conditions have improved such that your corrected and revised numbers are now 10.8?
A. That's correct.
COMMISSIONER GUNN: I don't think I have anything else. Thank you, sir. I appreciate it.
THE WITNESS: Thank you. Good discussion.
JUDGE WOODRUFF: Commissioner Kenney?
QUESTIONS BY COMMISSIONER KENNEY:
Q. Dr. Morin, thank you for --
A. Yes, sir.
Q. -- being here, and let me ask you some questions. Can you -- and I'm going to -- my questions may appear kind of rudimentary, so bear with me. Okay?
A. Those are the hardest ones to answer.
Q. Let me turn first to your rebuttal testimony on page 55.
A. I'm there.
Q. Now, your ultimate conclusion is that 10.8 percent ROE is fair and reasonable although conservative, right?
A. Yes.
Q. And that 10.18 is derived from somehow an amalgamation of the above updated ROEs right above that, right?

A. Yes. It's the central tendency of the results shown in that table.

Q. So CAPM, the empirical CAPM, risk premium electric and the four different types of DCFs?

A. Yes, sir.

Q. All right. I just want to be sure that I understand these terms. CAPM stands for capital asset pricing model, correct?

A. Yes.

Q. And then you have the DCF is discounted cash flow?

A. Yes.

Q. And then the third one is the risk premium electric?

A. Yes.

Q. And then with respect to the CAPM, you have a tradition and empirical?

A. Yes.

Q. And with respect to the DCF, you have multistage and single-stage?

A. Only single-stage.

Q. Only single-stage. Okay.

A. Because the growth rates from my single-stage are only identical to the growth rates I would use from multistage, so there was really no point there to using multistage.

Q. Now, with the CAPM analysis, you have to come up with some type of risk-free baseline; is that right?

A. Yeah. You need a risk-free rate to which you add a risk premium to infer the return on equity.

Q. And for the CAPM, the risk-free rate that you start with is based upon what?

A. I used the yield on long-term U.S. Treasury bonds.

Q. The yield on long-term U.S. Treasury bonds, is that the same as a 30-year Treasury bond?

A. Yes.

Q. Do you also use -- with respect to the risk premium analysis, do you also have to start with a risk-free premium or a risk-free rate?

A. You can start either with a risk-free rate, Treasury bond yields, or you can start with utility bond yields. Really doesn't matter.

Q. It doesn't make any difference?

A. No, because as long as the spread between corporate bond yields and Treasury bond yields remain the same, if that spread remains the same, it doesn't make any difference.

Q. With -- and this brings me to the question that I guess Mr. Hill had and that you address in your surrebuttal testimony at page 11. You used to use -- you changed the risk-free rate that you used to use. You used to use the 30-year Treasury bond for the risk premium analysis, and then you switched to using utility bonds, true?

A. That's correct, because the spread between utility bonds and U.S. Treasury bonds increased markedly as a result of the financial crisis, and it's still a little bit higher than historical averages, although it's returning to almost normal levels historically. That's the main reason. In other words, the cost of equity tracks utility bond yields better than it tracks Treasury bond yields.

Q. As you continued -- I guess what I'm not understanding, and this is where my question may be a bit rudimentary. Why wouldn't you have also used that same risk-free analysis in the CAPM analysis? Why wouldn't you have switched to using utility bond there also?

A. Well, the CAPM is a formal quantitative paradigm in finance that says that the cost of equity is the risk-free rate plus an appropriate risk premium.

Q. Right.

A. You can't use a bond yield because a bond yield has some risk within it, interest rate risk, default risk, inflation risk. It's not really risk-free.

Q. Don't you --

A. But the risk premium technique is simply empirical. There's no real formal theory or model underlying it. It's just a commonsense notion that stocks are riskier than bonds, and you add a certain risk premium to the bond yields and you'll get the cost of equity. That's it. The CAPM is much more formal than that.

Q. With respect to the risk premium analysis, had you used the 30-year Treasury bonds, what would the result have been?

A. I would have used a Treasury bond yield of 4.6 percent, which is the one I used here, and the historical risk premium I believe something of the order of 6 percent. So I would have obtained a result of somewhere around 10.5, 10.6 without flotation costs. It's very, very similar to the result I would have obtained using corporate bond yields. That would not have been the case last year in the middle of the financial crisis.

Q. On page 24 of your direct testimony, you set out a formula for computing the CAPM, and I guess you refer to it as kind of a plain vanilla CAPM analysis; is that right?

A. Yes.

Q. Plain vanilla's not a technical term, is it?

A. No. It's my own, meaning the orthodox model, if you wish.

Q. K equals the expected return. RF is the risk-free?

A. Right.

Q. Beta is the beta?

A. Yeah.

Q. RM is the overall market risk --

A. Overall return on the market over, over and above RF, which is the risk-free rate.

Q. Minus the risk-free rate.

A. The bracketed expression we refer as the market price premium.

Q. The bracketed expression meaning beta times the --

A. No. The bracketed expression.

Q. What do you mean?

A. RM minus RF, what's in brackets.

Q. RM minus RF is the market risk?

A. The market risk premium.

Q. And you multiply that by the beta?

A. Correct.

Q. All right. I didn't see where the RM was expressed in your formula.

A. Instead of specifying the RM directly, it's preferable to use -- to focus on the bracketed expression as a whole, on the market risk premium.

Q. You used 6.5?

A. 6.5. That's the difference between return on the market and the risk-free rate based on historical relationships.

Q. Now, let me ask, your ultimate -- your ultimate ROE is 10.8?

A. Yes, sir.

Q. Some of the other folks are around 10.2?

A. Yeah. The midpoint, yes.

Q. What is -- if you're able to quantify it, what would it do to the bond rating, that 60 basis point difference? What impact would it have on the bond rating? Are you able to -- let me ask you that question first. Are you able to quantify it?

A. I cannot quantify it because bond rating agencies are concerned with creditworthiness. The risk of a bond is not the same as the risk of equity. Shareholders, equity owners are interested in volatility. That's their version of risk, not so much creditworthiness.

The 10.2 I don't think would have a huge impact. I don't think it would, it would result in a downgrade, for example. It would go in that direction, but I'm almost sure it would not result in a downgrade. I think what investors are very concerned about is the fact that whatever rate of the return is set, the company's got to be able to earn it. It's got to have the opportunity to earn it. I keep stressing that.

Q. But at the end of the day, there's no way to quantify what impact it would have?

A. No, but you can only talk about the direction. It's not a good -- it's not in the right direction. Put it that way,

Q. Now, somewhere in your testimony, I don't remember which page it was on, but you identified three bases or three things that you identify as increasing Ameren's risk?

A. Oh, yes.

Q. You're talking about regulatory lag?

A. Historical test year.

Q. Historical test year?

A. And coal.

Q. Potential environmental costs?

A. These are the three.

Q. Would those fall under the rubric of regulatory lag -- I mean regulatory risk?

A. Yes, they do.

Q. As opposed to business or financial risk?
A. That's correct.
Q. So the only risks you're identifying at least with respect to why you reached the conclusion of 10.8 percent ROE are regulatory risks?
A. Correct.
Q. When we use the term regulatory lag, it is the subject, I think, of some confusion. What's your definition of regulatory lag?
A. Regulatory lag is simply the time that elapses between the time when the rates are set and, based on the costs, a year, two years earlier. So if you're spending $100 today and you're not going to recover it until the next rate case let's say a year from now, regulatory lag is 12 months, one year.
So it's the lapse of time between the moment that the company makes investments and the moment that it recaptures a return on that investment and of that investment.
Q. And it's your opinion, then, that regulatory lag in and of itself is a negative?
A. Yes. It's negative particularly because of the historical test year, and that's why many, many jurisdictions opt for either a mixed historical/forward test year or a fully forward test year.

Q. How many jurisdictions, if you know?

A. The last study that I did on that is that one-half of the jurisdictions in the United States have either a mixture, a hybrid, forward and historical, or fully historical. I would say probably more than 25 jurisdictions.

Q. And the other half use the traditional historical basis?

A. Yes, they do, but they have other mechanisms, like CWIP in rate base.

Q. We'll get to those. We'll get to those. The theory that undergirds the historic test year is that what has happened in history is the best predictor of what's going to happen in the future, right, absent the ability to read a crystal ball?

A. That's correct, but in times of inflation, it works against you. In times of deflation, it works for you. And some people argue that regulatory lag is a good thing because it incents the company to be more efficient.

Q. Well, there you've anticipated my next question.

A. Yeah.

Q. Isn't there a benefit to regulatory lag that it incents the company to behave in a prudent fashion, and doesn't the existence of risk incent good behavior in management of your resources in the most prudent way?

A. I would agree that some regulatory lag is a good incentive device and motivates the company to be more efficient. But I think in this case, the fact that the company is completely unable to earn its authorized rate of return, I think we're beyond that point.

Q. But you can't -- so I guess the ultimate logical conclusion that you're getting to is that Ameren's inability to earn its authorized rate of return is solely attributable to regulatory lag. I mean, because that sounds like -- if I take what you're saying to its ultimate conclusion, that's what I conclude. Is that what you're attempting to say?

A. Yeah, that's a fair characterization.

Q. All right. So if we have regulated monopolies that have no other competition in the marketplace and this Commission stands in the shoes of that competition, if there is no regulatory lag that incents the company to behave in a prudent fashion, what else is there?

A. The ultimate judge of a company's abilities is the stock price. That's where you have the collective judgment of all investors as to the company's policies, investments, have they been wise or not wise, have they been prudent or not prudent. That's the ultimate judge is the stock price of the company.

Q. So we're irrelevant, then?

A. No.

Q. I mean, if you take what you're saying to the logical conclusion --

A No. You contribute to that by the very good policies that you pursue and implement. I mean, regulatory risk is a huge part of the total investment risk for utilities. I would say it's the most important one.

Q. All right. So you're not a fan of regulatory lag in all of it's permutations; is that fair?

A. No. I'm a proponent of forward test years.

Q. What were the other two risks that we had talked about, the other two regulatory risks?

A. Historical test year, regulatory lag, and the third one was investments in environment and dependence on coal, which is heavier than industry average in this company.

Q. Taking those three components together, are you able to quantify, could you translate that into some amount of basis points that that translates into that Ameren should be allowed to have based on those three components that you've identified?

A. I would say in the ballpark of zero to 25 basis points. Now, I'm basing that on --

Q. That was my next question. Thank you. What are you basing that on?

A. I'm looking at bond yields of A rated bonds and B double A rated bonds, and the difference right now is somewhere around 60 basis points. And one notch -- there's three notches between B double A and single A. One notch would be one-third of 60 or 20 basis points. That would be one benchmark.

I'm also looking at the spread in betas in the utility industry, and if we did not have those risk elements, I think the beta would be lower by something like .05, looking at the spread of utility betas. And using the CAPM, that translates into about 30 basis points.

And I'm also looking at Standard & Poor's business risk scores and for different levels of common equity ratio, and the difference to go from score No. 1 to score No. 2 to score No. 3 to score No. 4 on the risk ladder is roughly 20 basis points.

Q. That's S&P?

A. Yeah, S&P. So these are the three sort of benchmarks that I use, and also my experience and judgment in these matters for the last 30 years.

Q. Do you have a different opinion today in 2009 -- I guess subsequent to the global financial crisis, do you have a different opinion today of S&P, Moody's and Fitch's than you did, say, 20 years ago with respect to their utility and their efficacy that is in providing ratings?

A. Not for the utilities because it's very rare that you see split bond ratings between Moody's, S&P and Fitch. And the three of them are independent processors of information and risk, and they almost unanimously arrive at the same bond ratings. So that gives me some comfort in their ability to discriminate between utilities and their risk profiles.

Q. The fact that they all fall around the same --

A. Yeah. Right. It's very rare you have split ratings for utilities.

No 2, we talked about the scandals, like Enron and Goldman Sachs and so forth. That kind of bothers me a little bit. So there is a bit of discomfort that I think you share about that, but not so much for utilities.

Q. Okay.

A. Because of the --

Q. You still have confidence in them with respect to the job that they do in rating utilities --

A. Yes, I do.

Q. -- but you are a little bit disturbed by their past behavior with respect to every other industry?

A. That's well said.

Q. I want to just ask you a few other questions about -- these were already touched on. You are making $300 an hour?

A. Yes.

Q. For your -- is that the same rate to show up here and testify?

A. No. To testify, it's double.

Q. $600 an hour?

A. Yes, for time on the witness stand.

Q. All right. And this is probably in a schedule attached to your testimony somewhere. Have you ever testified on behalf of an office of public counsel?

A. No, I have not.

Q. And how long have you been doing this?

A. Thirty years.

Q. Thirty?

A. Uh-huh. But I have to say --

Q. You don't have to. That's okay.

A. Okay.

Q. Especially at $600 an hour.

COMMISSIONER KENNEY: Dr. Gorman -- or Dr. Morin, thank you for your time. I don't have any other questions.

THE WITNESS: Thank you, sir.

JUDGE WOODRUFF: Commissioner Gunn, you had another.

FURTHER QUESTIONS BY COMMISSIONER GUNN:

Q. I just had one question I forgot to ask. Do you think it was a coincidence that Ameren stock was put on a credit watch on the eve of the last rate case?

A. I have no opinion on that at all.

Q. You're not suspicious in the slightest?

A. No, not really. I think what was bothering them was the lack of a fuel clause.

Q. But they just happened to express that concern on the eve of an evidentiary hearing in the last rate case?

A. I don't think bond rating agencies are Machiavellian in any way. I just don't know.

Q. Of course not. Thank you.

COMMISSIONER KENNEY: Were you being facetious just now or were you being --

THE WITNESS: No. I'm serious. I just don't think they're --

COMMISSIONER KENNEY: Okay. I'm sorry.

THE WITNESS: It's not in their interests.

JUDGE WOODRUFF: Chairman Clayton.

CHAIRMAN CLAYTON: Thank you, Judge.

QUESTIONS BY CHAIRMAN CLAYTON:

Q. Doctor, thank you for being here today. I just want to follow up on one comment that you just made. I want to make sure that I understood your answer.

Commissioner Kenney asked you some questions, and you replied that the ultimate measure of performance of a utility was by looking at its stock price. Did I understand that answer correctly?

A. Yeah. I think it's -- the stock price represents the collective judgment of a myriad of investors as to the company's policies and performance and so on.

Q. So it's not measuring whether a utility provides the most reliable service or whether they provide the best service to customers or looking at the price that the utility provides? Those are irrelevant? It is only the stock price that the shareholders are able to benefit from is the ultimate measure of performance?

A. No. The stock price is derived in terms by the quality of earnings, for example, the ability of the company to control costs to produce higher earnings, cash flows. So the stock price is the final result, a blend of all of these factors, including affordable service and quality of service and so forth.

Q. How does -- if a company is pro -- I'm not -- don't make the assumption that I'm saying that Ameren is providing poor service. I'm not suggesting that. But in what you have just said, if a company is providing poor or unreliable service, how does that appear in their stock price?

A. Well, the best way to answer that is with an example. When Nevada Power was accused of being imprudent in its management of fuels and the commission reacted by an ROE penalty, that translated into the stock price immediately, pretty steep decrease in stock price.

Q. So there would be appropriate occasions for a regulatory commission to make a policy decision that would have an impact on the stock price, you're saying that's what would then lead to a measure of their level of performance?

A. That's correct. Remember Hope and Bluefield, they talk about prudent investments and prudent management, and imprudent, of course, would lead to a lower stock price and conversely, everything else being constant.

CHAIRMAN CLAYTON: Thank you very much.

THE WITNESS: Thank you, sir.

COMMISSIONER DAVIS: Judge, can I go back?
JUDGE WOODRUFF: Sure.
FURTHER QUESTIONS BY COMMISSIONER DAVIS:
Q. With regard to credit rating agencies, looking at Ameren's capital structure, it's roughly half equity, half debt?
A. That's correct.
Q. If AmerenUE or Ameren Corporation has to issue debt or wants to issue debt, is it necessary for them to have a rating from either S&P, Moody's or Fitch, one of the big three?
A. There's really not much choice in having a bond rating because institutional investors are generally precluded from investing in anything that's not rated by an agency. So it's really almost a must that you need a bond rating.
Q. Okay. So it doesn't matter if we like the rating agencies or not. The fact is, if anybody wants to sell debt to an institutional investor or a mutual fund, then they're going to have to have a rating from one of those agencies?
A. Correct. That's absolutely correct.
Q. And is it -- I think some of the other witnesses describe it in more detail than you do, but there are some objective criteria, you know, for some of

those class-- for those classifications, some ratios, are there not?

A. Yeah. There are three principal ratios. They look at how much debt you have relative to equity, in other words, how strong your balance sheet is. No. 2, they look at your ability to cover interest payments, how much cash do you have to cover interest. They also look at cash flow versus the amount of debt you have. So those are the three benchmarks that they formally look at.

But they also look at qualitative factors like quality of regulation, cost comparisons with their peers, various regulatory policies of this commission, the regional economics of the territory. Those are qualitative issues. Trackers, no trackers. So they look at a whole variety of qualitative and quantitative factors. And S&P is very transparent about all this. They tell you, this is what we're looking at for a certain bond rating.

Q. Is it fair to say that cash flow is king?

A. Yes, cash flow is -- cash is king.

Q. Apparently in the past they've overlooked that for some people?

A. Yeah. There's been an interesting shift in the last ten years. Bond rating agencies used to like accounting numbers, which are not cash, and they kind of switched over to cash flow type measures over time.

Q. Okay. Earlier you testified, I believe, regarding the difference between A rated and, say, triple B rated utilities, and you said that was roughly 50, 60 basis points?

A. Yeah. 60 to 70 basis points in the last several weeks.

Q. And what's the difference between triple B and triple B minus?

A. Triple B and triple B minus. Probably around 30 basis points, 20 to 30 basis points.

Q. Anything below triple B minus is junk bond?

A. Yes. It's -- yeah. We call them high yield bonds to be politically correct now. We don't call them junk bonds.

Q. All right. And --

A. You don't want to go there.

Q. Right. That's -- when you -- once you get to these, quote, having to issue high yield bonds, I mean, what kind of basis point differential are we looking at there?

A. First of all, we don't even know if we can issue them at all. As the financial crisis taught us last year, anything less than A would have tremendous difficulty of getting money at all. The spreads go through the roof between junk bonds and investment grade bonds, 2-, 3-, 400 basis points.

Q. Okay. So --

A. You don't want to go there.

Q. All right. So if you go there, then you're looking at double digit interest rates to issue debt?

A. Yes, at certain times, and last year we did for junk bonds, if you can get access to money at all.

Q. Well, if you pay enough interest, theoretically somebody will take a risk, in theory?

A. Yeah. Well, yes. Sometimes bonds become equity.

COMMISSIONER DAVIS: No further questions. Thanks.

THE WITNESS: Thank you, sir.

JUDGE WOODRUFF: I do have a couple questions also.

QUESTIONS BY JUDGE WOODRUFF:

Q. There's been a lot of talk about how Ameren's having a hard time earning their authorized ROE. Is that a general problem across other electric utilities?

A. No.

Q. Just Ameren?

A. It's very specific to Ameren.

JUDGE WOODRUFF: That was my only question.

We'll then go to recross based on questions from the Bench, beginning with Public Counsel.

MR. MILLS: Thank you.

RECROSS-EXAMINATION BY MR. MILLS:

Q. Dr. Morin, do you still have your rebuttal testimony in front of you?

A. Yes.

Q. Can I get you to turn to page 55?

A. Yes.

Q. Now, I believe you had some discussion with Commissioner Gunn, and you told him that you were surprised that the CAPMs were so low; is that correct?

A. Yes.

Q. Are you referring to the CAPMs at lines 8 and 9 --

A. Yes.

Q. -- on page 55?

A. Yes.

Q. And is it because the CAPMs were so low that you used the median to come up with your recommendation in your rebuttal testimony?

A. Yes. It's because historical betas are downward biased because they're measured over a five-year period. They don't capture the current risk posture of the company.

Q. I think it was -- earlier you said it was also partly because of the fact that the CAPMs were such outliers; is that correct?

A. They're outliers because of what I just said.

Q. And can you please define median for me the way you use it?

A. The central tendency of the result.

Q. Okay. So if you have seven results, then it would be the one that has three above it and three below it?

A. Correct.

Q. Which line reflects the number that has three above it and three below it on page 55?

A. Well, 10.8 is the median.

Q. Didn't you just tell me the median is the one that has three above and three below it?

A. Well, you'd have to go through rounding to the third or fourth decimal point to decide that, but 10.8 is the center of gravity of the result, so to speak.

Q. So it's not the one that has three above it and three below it as you just testified?

A. In this case, it has one, two, three below and one, two -- four above. Let's say three and a half numbers below and three and a half above.

Q. Hang on a second. You have seven numbers there, right?

A. Yes. 10.8 is the median, period, as defined by Excel Spreadsheets and any statistical textbook.

Q. So the median is not the number that has three above and three below? It's not the middle number?

A. Well, roughly.

Q. How is it roughly?

A. Well, it is. If you count, there's four below and three above here. Excuse me. Three above and four below.

Q. If you take 10.8, there are two below and four above; is that not true?

A. 9.4, 9.8, 10.50. Those are three numbers.

Q. I'm sorry. I'm on page 55 of your rebuttal testimony.

A. Yes. So am I.

Q. Where do you see 10.50?

A. DCF number on line 13.

Q. Okay.

A. Okay.

Q. Now, with respect -- and you did a similar calculation on page 55 in your rebuttal testimony -- I mean in your direct testimony as you did in your rebuttal testimony, did you not?

A. Yes, I think I did.

Q. And can you look at the table on page 56 of your direct testimony?

A. Yes.

Q. And in coming up with the recommendation based upon those results, in that instance you used the average --

A. Correct.

Q. -- rather than the median; is that correct?

A. Correct. Yes.

Q. Statistically, are not the CAPM and the ECAPM in your direct testimony more outliers than they are in your rebuttal testimony at page 55?

A. Well, both CAPM on page 55 are below 10. Here the empirical CAPM is at 10.

Q. Statistically, are they not more outliers compared to the rest of the data in your direct than they are in your rebuttal?

A. The DCF numbers are around the 12.2, 12.3. CAPM is around 9.8. So they're far apart.

Q. Is that a yes to my question?

A. Yes.

Q. Now, you testified in response to a question from Commissioner Kenney that, in your judgment, you thought it unlikely the 10.2 -- if the Commission awarded a 10.2 ROE in this case, it would not result in a downgrade; is that correct?

A. I said the probability of a downgrade would increase, but I don't think it would be the immediate reaction of the bond rating agencies to downgrade the company.

Q. Is it fair to say that you would consider it unlikely?

A. I think it would be unlikely.

Q. Okay.

A. Everything else staying the same.

Q. Would the same be true if the Commission awarded an ROE of 10.0 percent?

A. The bond rating agencies would start becoming nervous because the ROE drives the financial metrics that we talked about earlier with the Commission, and you're starting to really have a significant probability of a downgrade and possibly be put on credit watch if the metrics get outside the B double A2 range.

Q. Let's go there, then. Would 10.0 in this case get AmerenUE outside of that range?

A. I did not do those calculations.

Q. You're an expert. Do you think that it would?

A. Yes. I think it endangers the quality of the company's bonds at 10 percent because you're getting to be outside the zones of authorized returns in the country, and that would alarm the agencies.

Q. It's your sworn testimony that an award of 10.0 from the Commission in this case would move AmerenUE outside of the mathematical range of investment grade?

A. No. It's my testimony that it would increase the probability of negative outlook and downgrade, period.

Q. Not that it would move them from one category to another mathematically?

A. It depends on the whole package of the rate order, too, not just ROE.

Q. Now, I believe you testified in response to some questions about the historical test year and regulatory lag and in general that AmerenUE has, quote, been, quote, completely unable to earn its authorized rate of return, close quote. Is that your testimony?

A. That's correct.

Q. How much revenue makes up a basis point?

A. Approximately $46 million for 1 percent change in ROE.

Q. So if they are -- if the company was approximately -- if the company was a percentage point off of earning its authorized rate of return, it would be roughly $460 million short of earnings?

A. Approximately, but I didn't do those calculations.

Q. That's a big, big number.

A. Yeah, but the company's authorized 10.76 and they're earning 7.

Q. That's 300 basis points?

A. Right.

Q. Times 46 million? That's how much you're testifying that they're under-earning by?

A. They're under-earning by more than 300 basis points, correct. 376 basis points.

Q. So you would multiple 376 times 46 million to determine the revenue shortfall?

A. Yes.

Q. Okay.

A. Simple arithmetic.

Q. Now, you had some questions about rating agencies. Isn't it true that the rating agencies are compensated the same way whether or not the target company is a utility or from some other industry?

A. I don't know the answer to that question. There's obviously a fee to have a bond rating, and it's roughly around $50,000 per bond rating per security.

Q. And --
A. Regardless of whether it's a utility or not. I believe that's --
Q. So regardless of whether it's a utility or not, the target company pays the fee to the rating agency?
A. Correct.
Q. Now, you were asked some questions about regulatory lag; is that correct?
A. Yes.
Q. Is Missouri a traditional rate of return regulation state?
A. What do you mean by traditional?
Q. Well, as opposed to incentive mechanisms or something like that.
A. Yes, if that's your definition, I would agree with that.
Q. And is that type of rate of return regulation consistent with the goals of Hope and Bluefield?
A. I believe it is.
Q. Let me ask if you would agree with this definition of regulatory lag. Regulatory lag is the time from the period in which a utility is unable to earn a reasonable return on equity and time when rates can be adjusted to reflect a reasonable return on equity.

A. That's a good definition.

MR. MILLS: That's all I have. Thank you.

JUDGE WOODRUFF: Recross from Staff?

MR. DEARMONT: I have just a few questions.

RECROSS-EXAMINATION BY MR. DEARMONT:

Q. First of all, do you know if Ameren issued equity during the test year in this case?

A. They did not.

Q. Do you know if Missouri operated under a historical test year before you filed your direct testimony in this case?

A. They did operate under historical test year.

Q. And just to clarify, is it your testimony that 100 basis points is equal to $46 million in revenue requirement?

A. I believe that's the number. What you do, you simply take the equity dollars and you can do the math.

Q. That's fine. I was just confused as to whether we were talking about basis points versus percentage points. I wanted to clarify.

MR. DEARMONT: I have no further questions. Thank you.

JUDGE WOODRUFF: For MIEC?

RECROSS-EXAMINATION BY MS. ILES:

Q. Dr. Morin, we've been talking a lot about historical test years. What's your definition of a historical test year?

A. When the numbers are based on realized results as opposed to projected results.

Q. And in this case, what is the test year?

A. I'd have to look at it. 2009, ending December 31st. I'm not sure.

Q. And isn't there also a true-up period in this case?

A. Yes.

Q. Do you know what the true-up period is?

A. No.

Q. Isn't it true that typically when a historical test year is used, the true-up period is used as well?

A. Sometimes there's provision for what we call known changes.

Q. Okay.

A. And measurable changes, I should say.

Q. All right. Now, you talked about how you advocated for a future-looking test year rather than historical?

A. Yes.

Q. Are you aware of the fact that in Illinois Ameren typically chooses a historic test year when given a choice between historic and forward-looking?

A. I'm not aware of that. Illinois is a restructured state. I'm just not aware of it.

MS. ILES: No further questions.

JUDGE WOODRUFF: Redirect?

MR. BYRNE: Yes, your Honor, I do have some.

REDIRECT EXAMINATION BY MR. BYRNE:

Q. Let me start with something recent. I think when Commissioner Kenney was asking you questions about -- I think he asked you if you'd ever represented Public Counsel or somebody other than the utility. I think there was more that you wanted to add. What else did you want to add, if anything?

A. I do a lot of work with utility commission staffs. I give in-house seminars to regulatory staffs. I participate in brainstorming sessions with certain commissions, like Florida and Illinois about issues in the industry. And I do teach a national seminar that everybody attends with a partner from a staff commission of Nevada. I just wanted to add that.

Q. Okay. Ms. Iles just asked you about true-up, and she ask you if you knew about the true-up in this case. And I guess I'd like to ask -- I'd like to ask you if you would assume hypothetically that the true-up is January 31st, 2009 in this case -- or 2010, I'm sorry, January 1st, 2010, and assume hypothetically that the rates go into effect for this case in June of 2010. Is that true-up as good as a projected test year in terms of cost recovery?

A. No. You have approximately a six-month lag there.

Q. Mr. Mills discussed the level of AmerenUE's under-earnings, and I think a few minutes ago you talked about 300 basis point under-earnings being the equivalent of $46 million per 100 basis points. I think you clarified that with Staff; is that correct?

A. Yes.

Q. And let me ask you this. Is under-earnings of that magnitude, does that create problems for investors at AmerenUE?

A. Yes, because whatever ROE number is allowed, they're not going to earn it. So they would factor that in to their projections and estimates and expected returns.

Q. And is that level of under-earnings of a sufficient magnitude that it would hit the radar screen for investors?

A. Yes. I mean, I believe the reason that Ameren is on the sell list, the strong sell list from people like Goldman Sachs is in part due to that.

Q. Earlier today Mr. Mills was asking you some questions about trackers, and one of the things you mentioned was that some utilities have investment trackers. Do you recall that?

A. Yes.

Q. Can you explain what an investment tracker?

A. An investment tracker is an automatic inclusion of certain investment in infrastructure in rate base. For example, any investment into renewable energy would automatically become part of the rate base, would be factored in as a rider. Another example would be environmental related type of expenditures for compliance with coal standards, coal emission standards would be part of CWIP, or construction work in progress, would be part of the rate base.

So these are three very prominent examples of regulatory polices that are in place in states like Indiana and others.

Q. Does AmerenUE have any of those kind of mechanisms?

A. No, they do not, and that's a distinguishing feature that AmerenUE has vis-a-vis the

rest of the industry. Makes them riskier.
Q. And how do those -- those kinds of trackers, how different are those from like storm trackers and vegetation management trackers?
A. They're very, very similar. Just the magnitude that is not quite the same, but they are very similar in nature.
Q. Okay. Let me ask you this. There's -- someone asking you, I think maybe Mr. Mills, about different kinds of trackers. Some are riders where you can change the rates, and some are situations where you can defer --
A. Yes.
Q. -- costs for future recovery. Do you have an opinion as to which kind of a tracker is better?
A. Well, a deferral as opposed to pay as you go would be far riskier than the other one, the other category because the deferred balance can reach a certain stage that they're deemed to be either excessive or imprudent and you don't get the money until you get to that point.
Q. Are you guaranteed recovery of an accounting deferral?
A. No, you're not.
Q. You also mentioned trackers related to

renewable energy. Do you recall that?
A. Yes.
Q. Can you elaborate on those kind of trackers a little bit?
A. Yes. For example, in Hawaii there's a provision that any investment made in renewable energy, renewable energies of any kind are automatically put into rate base essentially. They're tracked, in order to incent the utility to invest in renewables.
Q. If you step back, Dr. Morin, from looking at individual trackers or individual items and look at the overall picture of regulatory lag, which was also discussed, I think, by several people that have questioned you, do you have an opinion as to where Missouri ranks in terms of regulatory lag compared to other states?
A. I would say in the bottom decile.
Q. You were asked, I believe, by Mr. Mills about your -- you have a 20 basis point adjustment for quarterly dividends; is that correct?
A. That's correct.
Q. And I think Mr. -- Mr. Dearmont also asked you about that and asked you about the Commission's decision in the last case where they allowed five basis points for that item. Do you recall that discussion?
A. I do.

Q. Why is it appropriate for the Commission to have a 20 basis point as opposed to a 5 basis point adjustment for that?

A. If you compared the output of a standard annual DCF to the output of a quarterly adjusted DCF model, the difference is typically approximately 18 to 22 basis points. The best example or analogy is if you go to a bank and they pay you interest annually 10 percent and the bank across the street pays 10 percent compounded quarterly, your effective return would be 10.20 percent at the second bank. It's the same idea.

Q. Mr. Dearmont asked you some questions about a Puget Sound case before the Washington Utilities Commission. Do you remember that discussion?

A. Yes.

Q. And I think he referred you to a portion of your testimony where you had, I think it said each reduction in common equity ratio of 1 percent means the return on equity increases by 10 basis points. Do you remember that?

A. Yes.

Q. I think this was another -- this is an example of where I think maybe you wanted to say a little bit more about that but were cut off and told your attorney could ask you on redirect. So I'm asking you on redirect, I think you started to say something about business risk, but what did you want to add in response to that question?

A. I just wanted to add that that adjustment for differences in common equity ratios assumes that the business risks of the two companies remain the same, everything else is remaining constant. If a company like Ameren is slightly riskier in terms of business risk or regulatory risk, that rule doesn't apply. That's what I wanted to say.

Q. Okay.

A. Business risk has to be constant.

Q. Okay. You know, more where you were cut off a little bit and told to wait for redirect was, you were talking a little bit with Mr. Dearmont about the, I guess it was the elimination of the Moody's Electric Index?

A. Yes.

Q. And I guess as I understood the questioning, you had previously relied on the Moody's Electric Index and now you no longer do because maybe it doesn't exist anymore. But it seemed like you wanted to add something to your answer to Mr. Dearmont's question.

A. Yeah. I just wanted to assure the Commission that the reason for the change was because the index is no longer published, and switching over to the S&P Utility Index, which includes many other utilities than Moody's did, includes a lot of gas distribution companies that are presumably less risky than vertically integrated utilities. So there's really no material change. As a matter of fact, if you check the results, the risk premiums are about the same regardless of which index you use.

The other thing I wanted to add is, in my DCF second sample, I used the S&P utilities, so it made sense to use the S&P utilities in the risk premium as well.

Q. And I mean, does the S&P Utility Index also include wires-only electric utilities?

A. Yes, it does.

Q. And would those be more or less risky than an integrated utility like merenUE?

A. The wires utilities are less risky.

Q. Okay. Another case that Mr. Dearmont referred you to, and I'm not finding it, but anyway it was a Nova Scotia case. Do you remember that?

A. Yes, very much so.

Q. Thanks, Mr. Dearmont.

And I guess my question to you is, are there relevant differences between the Nova Scotia company that Mr. Dearmont referred you to and the Nova Scotia regulatory framework that should be -- that are necessary to explain the differences?

A. Yeah. The Canadian environment, regulatory environment is completely different than that of the U.S. One flagrant difference is in terms of rate design, there are demand charges that assure you of covering 100 percent of your fixed costs. That's pretty different than most companies here in the U.S. That's a huge difference.

The second one is that the -- most utilities in Canada are regulated on the basis of the National Energy Board Formula, which is essentially a robot or an automatic algebraic formula which indexes the ROE each and every year based on interest rate changes.

That formula is in turn based on CAPM, and I discussed earlier in my comments why the CAPM should be given less weight, especially nowadays. Again, it's a completely different environment in terms of taxes, in terms of test years that are typically forward-looking in Canada. So I'm not sure the company comparison between Nova Scotia and AmerenUE is appropriate here.

Q. Here's another one where you got cut off. I believe Ms. Iles earlier was asking -- I think I wrote this down right -- why did you not consider consumer economist real GDP growth.

A. Oh, yes.

Q. Does that sound like a familiar question? And I think she showed you maybe one of these -- she had an exhibit where she showed you what that was. Again, I think you were cut off and said it's more appropriate for redirect. So what would you like to add in response to that question?

A. My reservation on using the GDP growth forecast over a five and ten-year period is that the DCF model requires a long, long, long, long-term grow estimate, and historically for a hundred years the growth rate of the U.S. economy has been somewhere around 6 percent, 5.8, 5.9, 6 percent. To me, that would be a more appropriate choice for a very, very, very long-term growth rate that is specifically required by the DCF model instead of a growth rate based on five to ten-year forecast. That's the only reservation I have on that.

Q. Okay. Commissioner Davis had a little bit of a discussion with you about flotation costs. Do you remember that?

A. Yes.

Q. And I think the gist of the discussion was, there's an argument to include flotation costs as part of the capital structure. Do you remember that?

A. Yes.
Q. I guess my question is, if you chose that route, would you include it as an adjustment in your -- to your capital structure in every case regardless of whether you issued stock in that case or not?
A. Yes, you would.
Q. And do you know if the Commission has allowed that kind of adjustment to the capital structure in any previous cases?
A. No, it has not.
Q. Would it be reasonable to switch policies on that in a year when the company actually issued flotation costs?
A. Well, either you expense them or you adjust the rate of return. I think I elucidated on the policy implications of these two mechanisms.
Q. Okay. You may have covered this, but Commissioner Gunn asked you some questions about bond rating agencies and some of the problems they've had. Could you just -- could you explain why bond rating agencies are necessary for electric utilities?
A. They're necessary because institutional investors, either by internal policy or by law, are precluded from investing in companies that do not have a bond rating, and some of them are even precluded from

investing in something that's not investment grade. And it goes even further than that. Some financial institutions cannot invest in anything less than A rated. So it's absolutely essential that you have to have a bond rating.

Q. Commissioner Gunn was also asking you some questions about the pretty substantial difference between your initial recommendation, 11.5 percent, and Mr. Lawton and Mr. Gorman's recommendations. Can you elaborate a little bit about why those were so different and why yours is closer to theirs now?

A. Well, the obvious reason for that is last summer we were still in the midst of the financial crisis and tremendous amount of uncertainty and volatility in the capital market. Utility stock prices were very, very much lower than they are today, and spreads between Treasury bonds and corporate bonds were at historical highs.

So for all of these reasons, the numbers were pretty high last summer. Fortunately, I think we have returned to a quasi-normal capital market environment, and that's why the ROE recommendation of mine is much lower than it was, in a nutshell.

Q. Commissioner Kenney had a discussion with you about why you don't use corporate bonds for your CAPM. Do you remember that? Do you think you could explain that a little bit more for me? I didn't follow that discussion.

A. Because the CAPM requires specifically and formally a risk-free rate instrument. That's the way the model is specified. Because if the risk-free had already had risk within it, you'd sort of be double counting risk along with beta. So the CAPM specifically requires an estimate of the risk-free rate. And most experts on all sides of the aisle use long-term Treasury bonds as proxies for that

Q. What risk does a corporate bond have that make it not a risk-free rate?

A. Obviously default risk.

Q. You discussed with Commissioner Kenney and some other people regulatory lag. It's been a -- well, you discussed it with several of the people who asked you questions. And I guess is there actual loss of money associated with regulatory lag or is it just a delay in recovering costs?

A. It's loss of money because you won't recover the return on the investments and the cost increases during that period of regulatory lag. It's gone.

Q. Now, I think in response to questions from Mr. Mills, you were talking a little bit about using the median versus the average or -- yeah, I think that's right, and he was asking you in your rebuttal testimony on page 55 about the seven numbers. Do you remember that whole discussion?

A. Yes.

Q. And I think -- I just want to make sure the record's clear. You picked the middle number of the seven numbers on page 55, didn't you?

A. Yes.

Q. I think maybe Mr. Mills didn't see the 10.5 near the bottom of the list. Is that probably why he was asking you questions about that?

A. Probably.

Q. Okay. You also discussed CAPMs being outliers. Do you remember that?

A. Uh-huh.

Q. And I guess I -- could you elaborate a little bit about why those CAPMs are outliers and what significance that has?

A. Okay. As a result of the financial crisis, the utility stocks were increasingly disconnected from the rest of the marketplace because they were perceived to be safer havens, and when you disconnect utility stocks from the overall market, that means a lower beta because beta is a measure of that connection with the market.

And betas are measured historically over the last five years, and I think they're downward biased in capturing the current, today's risk posture of utilities. And that's one of the problems when you're dealing with historical betas over five-year periods.

Q. I mean, is there an argument for giving them less weight because of that?

A. Yes, there is. I make that argument. Mr. Lawton makes that argument as well.

Q. Mr. Mills asked you a series of questions, and I guess I would summarize it by saying how low can this Commission go? It was like the limbo. Could they lower the ROE to 10.3 percent and would it change things? Could they lower it to 10.2? Could they lower it to 10.1? And at what point would it result in a bond downgrade? Do you recall that line, those questions?

A. Yes, I do.

Q. I guess my question is, is that an appropriate way, in your opinion, for a commission to look at their task of setting as ROE for a regulated utility?

A. I do not believe it is. We operate under the umbrella of rate of return rate base regulation, not under the umbrella of bond rating determinations.

Q. Even if there wasn't downgrades from the bond markets, could there be other adverse consequences for going as low as you can possibly go?

A. Well, access to capital. You're competing with everybody else for funds. Utilities are monopolies on the output side, but they are in perfect competition with everybody else on the input side, labor, materials and, of course, funds, money, capital. So you've got to offer a competitive rate of return, as per Hope and Bluefield.

MR. BYRNE: Thank you very much, Dr. Morin.

JUDGE WOODRUFF: You can step down.

THE WITNESS: Thank you, sir.

JUDGE WOODRUFF: We'll break for lunch before we go to the next witness. I do want to bring up one other thing. How are we going to deal with Mr. Nickloy?

MR. BYRNE: I was just going to put his testimony in. I don't think anyone has expressed an interest in cross-examining him.

JUDGE WOODRUFF: Do you want to do that now?

MR. BYRNE: Sure. I would offer Exhibit 114, which is Mr. Nickloy's direct testimony.

JUDGE WOODRUFF: 114 has been offered. Any objections to its receipt?

(No response.)

JUDGE WOODRUFF: Hearing none, it will be received into evidence.

(EXHIBIT NO. 114 WAS RECEIVED INTO EVIDENCE.)

COMMISSIONER DAVIS: Judge, I just want to say that I don't have any questions for Mr. Nickloy at this time, but if we're going to continue going down the road of how much -- how much cash flow can we give you before you get downgraded, then I may want to call Mr. Nickloy and ask him some questions.

JUDGE WOODRUFF: Mr. Nickloy no longer works for the company.

MR. BYRNE: You can call him, but he probably won't come.

JUDGE WOODRUFF: There was discussion about this on the first day.

MR. BYRNE: We can provide a witness who can answer those questions for you.

COMMISSIONER DAVIS: Someone can adopt Mr. Nickloy's testimony?

MR. BYRNE: Yes. And we can supply a witness that can answer questions about credit markets if you like, Commissioner.

COMMISSIONER DAVIS: Okay. Thank you.

JUDGE WOODRUFF: Then we'll come back with

Mr. O'Bryan after lunch. Let's come back at one o'clock.

(A BREAK WAS TAKEN.)

JUDGE WOODRUFF: Welcome back from lunch. I believe the next witness on the list is Mr. O'Bryan for Ameren.

MS. VUYLSTEKE: Judge Woodruff, I'm sorry to interrupt, but I wanted to bring up another matter before we start with the next witness. It's a little bit time sensitive. I believe there was some discussion this morning with Mr. Mills about the Nonunanimous Stipulation that was filed late last night and the possibility of asking the Commission to consider shortening the usual seven-day period for parties to request a hearing.

In this case, I think it would be a good thing to do, particularly since we have two days scheduled for rate design hearings, and we have quite a number of witnesses from out of the -- out of town and one from out of the United States that would be coming in for the rate design hearing and that are presently planning to be present.

So if we could shorten the period, I guess our request would be if the Commission could make that decision to shorten the period to close of business Monday for parties to oppose.

JUDGE WOODRUFF: Staff, I believe you're

the only party here who didn't actually sign this. Do you have a view on that?

MR. DEARMONT: I personally have no view, and I don't know. So I will look into it and get back to you by the end of today, Judge.

MR. BYRNE: Your Honor, we didn't sign it either, but we're not opposed to it.

MR. DEARMONT: My assumption is the Staff would not be opposed to that, but I -- subject to check.

JUDGE WOODRUFF: Staff did oppose it in the last rate case.

MR. DEARMONT: Did oppose?

JUDGE WOODRUFF: Did oppose.

MR. DEARMONT: The shortening of the time?

JUDGE WOODRUFF: No. Opposed the Stipulation & Agreement.

MR. DEARMONT: It's my understanding that we will not oppose the Stipulation & Agreement, but as far as your question on the shortening of the time, I don't know that.

JUDGE WOODRUFF: The other party that might be interested in this would be MEUA. I don't know if anyone's talked to them or not.

MR. MILLS: The MEUA got a copy -- well, first of all, MEUA has known the outline of this for some time and got an advance copy yesterday fairly early in the evening before the filed copy around midnight.

JUDGE WOODRUFF: Let me ask MIEC, is MEUA still going to be deposing Mr. Smith on Monday?

MS. VUYLSTEKE: Yes. My understanding is they're deposing Mr. Smith on Monday morning at 9 a.m., and I think that there is -- based on what I know from Mr. Woodsmall, he certainly at this point may very well request a full hearing.

If the Commission would like, I can certainly try to get in touch with him and he can either let you know what his intentions are and whether that shortened time would cause him inconvenience. Maybe that -- would that be productive?

JUDGE WOODRUFF: That would certainly be helpful if I knew.

All right. Well, let's go ahead with Mr. O'Bryan. Good afternoon.

THE WITNESS: Good afternoon.

(Witness sworn.)

JUDGE WOODRUFF: You may be seated. I'll give you the little speech also that you may have heard this morning. Please only answer the questions that are asked. Don't feel like you have a need to explain your answers. Your counsel will have an opportunity to come back and explain answers. If someone asks you a yes or no question, just answer yes or no or I don't know.

THE WITNESS: Okay.

JUDGE WOODRUFF: Thank you. You may inquire.

MR. BYRNE: Thank you, your Honor.

MICHAEL G. O'BRYAN testified as follows

DIRECT EXAMINATION BY MR. BYRNE:

Q. Could you please state your name for the record.

A. Michael O'Bryan.

Q. And by whom are you employed, Mr. O'Bryan?

A. Ameren Services.

Q. And Mr. O'Bryan, are you the same Michael G. O'Bryan that caused to be filed direct testimony in this proceeding that's been marked as Exhibit No. 115 and rebuttal testimony that's been marked as Exhibit 116?

A. Yes.

Q. Do you have any corrections that you need to make to that testimony?

A. No, I do not.

Q. And is the information contained in that prefiled testimony true and correct to the best of your knowledge and belief?

A. It is.
Q. Mr. O'Bryan, if I was to ask you the questions contained in that prefiled testimony here today when you're under oath, would your answers be the same?
A. They would.
MR. BYRNE: Thank you. I would offer Exhibits No. 115 and 116 and tender Mr. O'Bryan for cross-examination.
JUDGE WOODRUFF: 115 and 116 have been offered. Are there any objections to their receipt?
(No response.)
JUDGE WOODRUFF: Hearing none, they will be received.
(EXHIBIT NO. 115 AND 116 WERE MARKED AND RECEIVED INTO EVIDENCE.)
JUDGE WOODRUFF: All right. For cross-examination, beginning with Public Counsel.
MR. MILLS: Just very briefly, your Honor.
CROSS-EXAMINATION BY MR. MILLS:
Q. Mr. O'Bryan, is it correct that your testimony is to establish the capital structure for the company and the cost of debt?
A. Yes.
Q. And you don't really weigh in on the question of the cost of equity; is that correct?

A. No, I do not. That's Dr. Morin's territory.

Q. To your knowledge, is there any dispute over the capital structure and the cost of debt?

A. Not to my knowledge, no.

MR. MILLS: Thank you. No further questions.

JUDGE WOODRUFF: For Staff?

MR. DEARMONT: Staff has no questions for this witness.

JUDGE WOODRUFF: MIEC?

MS. ILES: No questions, your Honor.

JUDGE WOODRUFF: Questions from the Bench, then. Commissioner Davis?

COMMISSIONER DAVIS: No questions.

JUDGE WOODRUFF: Commissioner Gunn?

COMMISSIONER GUNN: I don't have any questions.

JUDGE WOODRUFF: I have no questions. So no need for recross. Redirect?

MR. BYRNE: No questions.

JUDGE WOODRUFF: Mr. O'Bryan, you can step down.

(Witness excused.)

JUDGE WOODRUFF: The next name on my list is Mr. Lawton. I believe he's going to be here tomorrow. Is that right, Mr. Mills? Mr. Mills?

MR. MILLS: I'm sorry.

JUDGE WOODRUFF: The next name on my list is Mr. Lawton. As I understand, he's going to be here tomorrow morning?

MR. MILLS: That's correct. We talked about that this morning, and I believe all the parties are agreeable to taking him up, and I appreciate their indulgence given the travel arrangements for Mr. Lawton.

JUDGE WOODRUFF: That's fine. The next name on the list, then, is Mr. Gorman. As he's coming up, I just want to ask the parties, are there any other witnesses on the list for today that we need to do today? The question would be Mr. Hill, I guess, is he going to be here for both days?

MR. DEARMONT: He will be here tomorrow.

JUDGE WOODRUFF: Thank you. All right. If you'd please raise your right hand.

(Witness sworn.)

JUDGE WOODRUFF: And you heard my speech about only responding to questions and not giving speeches?

THE WITNESS: Yes.

MICHAEL GORMAN testified as follows:

DIRECT EXAMINATION BY MS. ILES:

Q. Please state your name and business address for the record.

A. My name is Michael Gorman. My business address is Swingley Ridge Road, Chesterfield, Missouri.

Q. Are you the same Michael Gorman who prepared and caused to be filed direct testimony, rebuttal testimony and surrebuttal testimony which have been marked as Exhibits 408, 409 and 410 respectively?

A. Yes.

Q. Do you have any corrections to that testimony?

A. I do not.

Q. And if I were to ask you the same questions that's included in this testimony today while you're here under oath, would your answers be the same?

A. Yes.

MS. ILES: At this time I'd like to request that Exhibits 408, 409 and 410 be admitted into the record, your Honor.

JUDGE WOODRUFF: 408, 409 and 410 have been offered. Any objection to their receipt?

(No response.)

MS. ILES: I tender the witness.

JUDGE WOODRUFF: Hearing no objection, they will be received.

(EXHIBIT NOS. 408, 409 AND 410 WERE MARKED AND RECEIVED INTO EVIDENCE.)

JUDGE WOODRUFF: For cross-examination, we begin again with Public Counsel.

MR. MILLS: Yes, your Honor.

CROSS-EXAMINATION BY MR. MILLS:

Q. Mr. Gorman, you constantly follow economic and market trends, do you not?

A. I do.

Q. Do you have a clear enough memory of conditions at the end of July 2009 to be able to estimate how much different your ROE recommendation would have been had you filed then as opposed to when you did file?

A. Well, just generally speaking, in some rate cases where I did file testimony around that point in time, I believe it was about 20 to 30 basis points higher than the return on equity recommendation I made in this case.

Q. Now, assume with me that being 50 basis points away from a reasonable ROE makes a particular recommendation stink. Okay. Are you with me with that assumption?

A. Yes.

Q. Given that assumption, does Dr. Morin's

11.5 percent ROE at the end of July 2009 stink?
A. I believe it does, yes.
MR. MILLS: Thank you. No further questions.
JUDGE WOODRUFF: Okay. Then for Staff?
MR. DEARMONT: Staff has no questions for Mr. Gorman.
JUDGE WOODRUFF: For AmerenUE?
MR. BYRNE: Yes, I do have a few.
CROSS-EXAMINATION BY MR. BYRNE:
Q. Do you have a calculator, Mr. Gorman?
A. Yes, I do.
Q. I think you're going to need a calculator and a couple of things. A couple things I might need you to refer to is your direct testimony from the last AmerenUE rate case. Do you happen to have that with you?
A. I do not.
Q. And also your deposition that I took on January 29th. Do you have that with you?
A. Not with me up here.
MR. BYRNE: May I approach the witness, your Honor?
JUDGE WOODRUFF: You may.
BY MR. BYRNE:
Q. Here's an extra copy.

A. Thank you.
Q. Mr. Gorman, my understanding is that your recommendation for a return on equity for AmerenUE consists of a range and a point recommendation; is that correct?
A. Yes.
Q. And what is your range?
A. 9.5 percent to 10.5 percent.
Q. And as I understand it, your point recommendation is the midpoint, 10 percent; is that correct?
A. Yes.
Q. Okay. You would agree, would you not, that estimating an appropriate ROE for a public utility is not an exact science?
A. I do.
Q. And would it be fair to say that estimating an appropriate return on equity requires a lot of judgment in deciding what analyses to use and what the inputs to those analyses should be?
A. It certainly requires judgment for each of those factors.
Q. Okay. And is that why cost of capital experts often recommend a range, as you have in this case?
A. Generally, yes.

Q. Okay. In your opinion, would it be reasonable if the Commission ultimately decided to adopt an ROE for AmerenUE that is within your range?

A. I believe it would.

Q. Okay. Is it true -- isn't it true, Mr. Gorman, that there is a relationship between the risk a utility faces and the cost of equity for that utility?

A. Yes. The risk investors face by making investment in the utility and their required return for making that investment.

Q. And as a general rule, as risk increases, the investors would demand a higher return as compensation for their risk; is that fair to say?

A. Yes.

Q. And conversely, as risk declines, investors would demand a lower return for their risk -- for their investment?

A. Correct.

Q. Okay. And would you agree -- would you agree with me that, as a general rule, integrated electric utilities are more risky than gas distribution companies that use straight fixed variable rate design?

A. Well, straight fixed variable rate design generally, yes, will render those very strict parameters, yes.

Q. And you would agree with me that AmerenUE has about average risk for an integrated electric utility?
A. I would agree with that, yes.
Q. And I'd like to take a look at the results of your analyses that appear, I believe, on page 48 of your direct testimony. Is that the table where your results appear?
A. Yes.
Q. I tried to blow those results up onto a chart so we could talk about them. I'm putting up this chart, and I'd like to ask you if this represents the results of the analyses you did and then your recommendation. That chart shows DCF of 10.46 percent, risk premium of 10.06, CAPM of 9.54. Do those all correspond with what's on your, I think it's Table 4 --
A. Yes.
Q. -- in your direct testimony?
And then here's your 9 and a half, 10 and a half recommended range and then midpoint of 10. That's all consistent with your analysis and your testimony, right?
A. Yes.
Q. And my understanding is that the -- that the way you establish your range was the top end of your range was the DCF and rounded to 10 and a half, and the

bottom end of your range was the CAPM rounded to 9 and a half; is that right?

A. Generally, yes.

Q. Okay. And my understanding also is that you used the same proxy groups as Dr. Morin for your analyses; is that correct?

A. It is.

Q. And my understanding also is that that DCF number that appears in your table is actually the average of three separate DCF calculations that you ran which are set forth on Table 3 of page 38 of your direct testimony; is that correct?

A. Yes.

Q. And those three DCF models, one of them is the constant growth model, which I understand is the constant growth model that this Commission has typically relied upon; is that correct?

A. Well, it's a constant growth model relying on security analysts' growth rate projections. I don't -- I can't state that this Commission has typically relied on security analysts as the favorite growth rate source.

Q. Okay. But other than that, is that the model that the Commission has typically used when they reference the DCF?

A. The constant growth DCF model is, yes.

Q. Okay. And then you've got another, a second constant -- and the result from that constant growth model was 11.02 percent; is that correct?
A. Yes.
Q. And then you've got a second constant growth DCF model that you identified as the constant growth with sustainable growth in parentheses; is that correct?
A. Correct.
Q. And my understanding from your deposition is that at least at that time you didn't know of a case where the Missouri Commission had relied upon that model to develop their ROE in whole or in part; is that correct?
A. That they specifically relied on that as the source of their authorized return on equity, that is correct.
Q. And the amount for that model, that sustainable growth DCF model in your Table 3 is 10.2 percent; is that correct?
A. Yes.
Q. And then the third DCF analysis that you did was the multistage DCF; is that correct?
A. Yes.
Q. And that resulted on Table 3 in a -- in an ROE of 10.16 percent, correct?

A. Yes.
Q. And so then when you averaged all three of those results, that got you to this 10.46 percent that appears on Table 4; is that right?
A. Correct.
Q. Now, Mr. Gorman, it appears there are some differences between what you did in this case and what you did in AmerenUE's last case; would that be fair to say?
A. Well, there is because the Commission --
Q. Well, that answers my question. And, for example, one difference is, last case you calculated a sustainable growth DCF ROE but then, as I understand it, it wasn't used in calculating your recommendation; is that correct?
A. That's in part correct.
Q. Okay. And did you use -- is it in part correct because you used it to verify the results of your --
A. It was used to determine the reasonableness of some return on equity estimates which at the end of the analysis were used to develop a recommended range.
Q. Okay.
A. So it was used in part to determine my recommended range.
Q. But it didn't go into the calculation in

the same way as, say, your DCF or your CAPM did in this case; would that be fair to say?

A. Well, I did not set forth a table similar to what I did on page 38 of my testimony in the last case to average all the DCF return estimates to show what my estimated DCF cost of equity is in the last case like I have done in this case.

Q. Okay. And in the last case, and you've got your testimony there from the last case, I was looking at how you calculated the recommendation in your direct testimony. I think it's on page 37. And can you verify for me that the way you calculated the range last case is you averaged your CAPM and risk premium results for one parameter of the range and then you averaged your DCF results for the other parameter of the range? Can you verify that's true?

A. Sorry. Could you repeat that question again?

Q. Sure. And I guess I'm asking you how you developed your range in the last rate case, and I'm suggesting that for one parameter of your range you -- you set one parameter by averaging the CAPM and the risk premium results; is that correct?

A. Yes.

Q. And then for the other parameter of the range was established by averaging your DCF results; is that correct?

A. No. There were various versions of the DCF model. The low end of my range was based on my two-stage and multistage growth DCF return.

Q. But you averaged the ones that you used, right?

A. I averaged those two multi-growth stage DCF return estimates to produce the low end of my range.

Q. All right. Well, I guess what I'd like to ask you is, if you had done that in this case, if you had established one parameter by averaging -- of your range by averaging your DCF results, wouldn't that parameter have been 10.46 percent?

A. If I would have used the same methodology in the last case to produce a range in this case, is that your question?

Q. Well, I guess I really asked if you would have averaged your DCF results to establish one parameter of your range in this case, wouldn't that parameter have been 10.46 percent, which is really what you did?

A. That is what I did.

Q. Okay. And if you had averaged the CAPM and risk premium to establish the other parameter of your range, what would that parameter have been?

A. That's not what I did in the last case, but it would be the average of 10.06 and 9.54, roughly about 9.8 percent.
Q. Well, I'm going to write that down and perhaps you can clarify. I have it as what you did in the last case, but perhaps you can explain why it's not.
So the range then would be 10.46 percent, which is the DCF, and what's the bottom end of the range, the average of the risk premium and the CAPM? If you have your calculator, you can use it maybe.
A. 9.8.
Q. 9.8. And what would the midpoint of such a range be?
A. 10.13.
Q. 10.13. Okay. And then I'd like to take a look at the way you calculated the results on your various DCF analyses, if I could. My understanding is when you did the first constant growth analysis, the one that's not the sustained growth --
A. The analyst growth?
Q. Yes.
A. Okay.
Q. You applied that to the two proxy groups that are the same for you and Dr. Morin; is that correct?
A. Yes.

Q. And you calculated those results on Schedule MGP-6; is that correct?
A. Yes.
Q. And can you turn to that schedule, if you would, and my understanding is that for both of the proxy groups you calculated an average and a median; is that correct?
A. It is.
Q. But when you -- when you put them together for your results, as I understand it, you averaged the two medians; is that correct?
A. Yeah. The two proxy group medians, that's correct.
Q. And what were the two proxy group medians?
A. Shown on page 1 of Schedule MPG-6, the integrated electric utility proxy group median was 11.03 percent, and on page 2 of Schedule MPG-6, the median for the S&P electric utility proxy group was 11.01.
Q. And you averaged those together and that's how you got the 11.2 that's shown on your Table 3, correct?
A. 11.02, yes.
Q. I'm sorry. 11.02 that's shown on Table 3?
A. Yes.
Q. But the averages of these -- of these

groups is much higher than the medians; isn't that correct?

A. It is.

Q. For example, the average for the integrated electric utilities group was 12.02 percent; isn't that correct?

A. Yes.

Q. And the average for the S&P electric utilities group was 11.99 percent; isn't that correct?

A. Yes.

Q. And looking back at your direct testimony from our last rate case, and I'm -- particularly I'm looking on page 18, if you have that.

A. I'm there.

Q. Isn't it true that in that case you averaged the results in order to get your constant growth DCF?

A. Yes.

Q. Okay. What if --

A. That's not different, but yes, that's what I did.

Q. What if in this case, instead of averaging the medians of your two proxy groups, you had averaged the averages, what would that result have been?

A. Would have been the average of

12.02 percent and 11.99 percent.

Q. And how much would that be?

A. 12.00 percent, 12.01.

Q. Between 12.0 and 12.1?

A. No, .01. Sorry.

Q. And let me ask you this. What if you had used all four numbers, what if you had used both the two medians that you calculated for the proxy groups and the two averages, what would the average of those four numbers have been?

A. 11.51.

Q. Okay. And if you could keep track of those numbers, the 12 percent that you just calculated being the average of the averages and the 11.51 which is the average of all four numbers for your constant growth, I would appreciate it.

A. All right.

Q. Let's take a look at your sustainable constant growth model calculations. Again, my understanding is that you applied that model to the two proxy groups and, again, you calculated an average and a median for each of the proxy groups; is that correct?

A. Yes.

Q. But then in developing the number that you put on Table 3, as I understand it, you used -- well, can you tell me what schedules those calculations are on in your direct testimony?

A. Schedule MPG-12.

Q. And if I look at Schedule MPG-12, it looks like for the first proxy group, the integrated electric utilities proxy group, the average you calculated was 10.68 percent; is that correct?

A. The average is, yes.

Q. And then the median is 10.20 percent --

A. Correct.

Q. -- is that correct?

And then for the second proxy group, the S&P electric utilities, the average is 11.59 percent, correct?

A. Yes.

Q. And the median is 11.50 percent, correct?

A. Yes.

Q. But of those four numbers, the number that you used on Table 3 was the lowest of those four, 10.2 percent; is that correct?

A. That was -- yes.

Q. Okay. I guess again if you had -- if you had used the average of the averages for your two proxy groups, which would be 10.68 percent for the integrated electric utilities and 11.59 percent for the S&P

utilities, what result would you have gotten?

A. 11.13.

Q. And when you calculated your sustainable growth model last case, didn't you use averages, if you know? And I think it's on Schedule MPG-9, but take a look and see. Are you on Schedule MPG-9 from that testimony, Mr. Gorman?

A. Yes.

Q. I just -- I'm looking at the bottom of the page. It seems to have average average, like page 1 of 6 and 2 of 6. Am I reading that right?

A. You are. I'm just looking for where I develop the DCF estimate using that -- this schedule derives the growth rate predominantly. I'm looking for where the growth rate was used in the DCF estimate.

Q. Take your time.

A. Well, there doesn't appear to be a schedule where I used that growth rate in the DCF models.

Q. Wouldn't it be reasonable to suggest based on Schedule MPG-9, pages 1 and 2, that you're calculating averages for your sustained growth model?

A. It did not include a median, so yes.

Q. Okay. What if -- again, it's the same type of question. If you would have used averages of both of the proxy groups for your sustained growth DCF, what would that amount have been? And particularly it's the 10.68 average for your integrated electric utilities proxy group and the 11.59 average for your S&P electric utilities proxy group. What would that have averaged to?

A. That averages 11.13 percent.

Q. Okay. I'm sorry. You may have already calculated that. And what if you had used all four numbers, the two averages and the two medians for your two proxy groups, what would that average have been?

A. 10.99.

Q. Okay. And now let's take a look back at Table 3 and see how the results of that would have been affected had you used different things, and I guess I'd like to start with the averages. If you had used averages for your first -- averages of the proxy group results for your first constant growth DCF, I believe you said that result would be 12 percent; is that correct?

A. I'm sorry. Let me get to Table 3, please.

Q. Okay.

A. Yeah. The average for the constant growth DCF model but using the analyst growth would be 12 percent.

Q. Okay. Instead of 11.02 which is on there now, correct?

A. Correct.

Q. Similarly for the constant growth DCF models with sustainable growth in parentheses, if you had used averages of the two proxy groups, it would be 11.13 percent; is that correct?

A. Yes.

Q. Okay. And then -- and then what would those two changes have done to your average DCF return?

A. The average would have increased to 11.10 percent.

Q. And then if 11.10 percent were on Table 4, isn't it true that your range would have run from 11.10 down to the 9.54 of your CAPM?

A. Well, some judgment goes into the recommended range, but if you're asking me if I substitute 10.46 with 11.1 --

Q. Yes.

A. -- then the high end of that range would be 11.1 and the low end would be about 9.5.

Q. Okay. And what would the midpoint of that range be?

A. 10.3.

Q. Okay. Mr. Gorman, isn't it true that some of the other experts in this case, particularly Dr. Morin and Mr. Lawton, considered their DCF results separately, and by that I mean they didn't average them, but the separate DCF results that they used appeared on their equivalent of Table 4 to your testimony; isn't that true?

A. Well, they didn't include an estimate for their DCF based on all their studies in listing what the results of their studies were. They instead identified the results of each of the studies. When they did multiple DCF, they were listed multiple DCF.

Q. Well, let me -- if all of the results of your individual DCF analyses appeared on Table 4 instead of the average, isn't it true that the range reflected on Table 4 would run from 11.02 percent, which is your constant growth DCF result, and still down to your 9.54 percent CAPM result?

A. Well, that's not how I -- necessarily how I would have derived the range, but if you listed them individually and took the highest and lowest, that would be the result.

Q. And so the highest would be the 11.02 percent for your constant growth DCF, right?

A. Yes.

Q. And then the low on the chart would still be the 9.54 percent that's your CAPM, correct?

A. Correct.

Q. And what would the midpoint of that range have been?

A. 10.28.
Q. Okay. And what if you had used the average of the averages for your constant growth DCF, which you said was 12 percent, correct?
A. Yes.
Q. And what if you would have used the average of the averages for your constant growth/sustainable growth, which was 11.13 percent; is that correct?
A. Yes.
Q. And what if you would have listed the results on Table 4 and established the range from those results, wouldn't the top end of your range then have been 12 percent?
A. That would have been the highest number, yes.
Q. And then the bottom end of your range would still have been the 9.54 percent, correct?
A. Yep.
Q. And what would the midpoint of that range have been?
A. 10.77.
Q. Okay. Let me ask you this. Isn't it true, Mr. Gorman, that you used -- you used projected growth rates in your DCF analyses?
A. Well, the analyst growth rates are

projected. Sustainable growth rates are also based on projected data, yes. So yes, it is.

Q. So that's what you use in your DCF analyses, correct?

A. Yes.

Q. And isn't it true that the reason you use those projected growth figures is because the projected growth rates reflect investors' expectations?

A. The objective for the growth rates is to reflect investor expectations. The issue is whether or not forecasted growth rates better reflect that than do historical growth rates. I believe projected growth rates are a better reflection of investor expectations.

MR. BYRNE: Your Honor, I'd like to have this marked as an exhibit and offer it into the record if I could, and I can have it reduced to piece of paper so that we don't have a board going into the record.

JUDGE WOODRUFF: All right. Your next number is 172. 172 has been offered. Are there any objections to its receipt?

MR. MILLS: Judge, I object.

JUDGE WOODRUFF: What's your objection?

MR. MILLS: Foundation. Without some foundation that Mr. Gorman the expert agrees that these are appropriate calculations or some showing that

Mr. Byrne is somehow an expert, then there's no foundation that this has any value based on expert testimony. It's simply a recombination of numbers that might as well -- it really has no probative value because it has no expert saying that it has any value to it. There's no foundation for it.

MR. BYRNE: Your Honor, it is a recombination of the analyses that Mr. Gorman performed. I'm not substituting my judgment for him as an expert, but I am recombining the analyses that he is relying on as an expert. I think it's a fair representation of that.

MR. MILLS: But there's no showing by an expert and no testimony by an expert that they've been recombined in any kind of a way that makes any sense at all. I think Mr. Byrne can try and lay that foundation with this witness, but without that foundation, I don't think it has any value.

MR. BYRNE: I disagree, your Honor. These are his analyses. I haven't challenged the underlying analyses. It's just the combination of them. It doesn't require expertise.

JUDGE WOODRUFF: I'm going to overrule the objection. The document can be put into evidence, will be received into evidence.

(EXHIBIT NO. 172 WAS RECEIVED INTO

EVIDENCE.)

MR. BYRNE: I'll have it reduced to a piece of paper, your Honor.

JUDGE WOODRUFF: I'm going to get a shot of it on the screen here as well so it will be preserved on the record in that way.

MR. BYRNE: Thank you, Mr. Gorman. I have no further questions.

THE WITNESS: Thank you.

JUDGE WOODRUFF: All right. Then we'll come up for questions from the Bench. Commissioner Kenney?

QUESTIONS BY COMMISSIONER KENNEY:

Q. Mr. Gorman, thank you for your time. I just have a couple of questions for you.

To what extent do you think regulatory lag plays a role in the overall risk of an electric utility like Ameren?

A. I believe regulatory lag is a very commonly understood term. It is characteristics of a regulated utility that must get authority to change prices in response to changes in cost of service. So it is -- it is and always has been a part of the operating risk characteristics of a regulated entity.

Q. So it's a feature of the regulatory

paradigm, but in your opinion, does it increase or enhance the risk of the integrated electric utility?

A. Well, it is a risk of a regulated entity, and it can also be an opportunity because it takes time to adjust rates if rates are producing more than the cost of service. That has been the case frequently in the last 15 years or so for AmerenUE.

But because it can delay the recognition of changes of cost that are outside of management's control, it is a risk of operating within a regulated industry to charge prices that reflect reasonable and prudent cost of service.

Q. And a similar question with respect to our traditional and historic use of a historic test year. To what extent is it your opinion that that enhances the risk of an integrated electric utility?

A. Well, it's a characteristic of the risk. The use of a historical test year is a methodology that tries to use a consistent time period to develop prices that will be put into effect through a rate effective period. The historical test year traditionally is based exclusively on some historical period with audited financial information where the revenues, the investments and the operating expenses are a stated point in time and all that data has been audited.

In Missouri, it's more of a hybrid. It's not strictly historical test year because that historical information is adjusted for the true-up period, which may allow for recognition of costs that are more current closer to the period that rates will actually be put into effect. Other jurisdictions rely more on traditional historic test years.

The ratemaking methodologies for Missouri is, I believe, publicly disclosed and is available to the investment public. So it is part of the overall assessment of the operating risk of Missouri utilities. And I would note that Missouri regulatory procedures are generally looked upon as balanced in Missouri. Regulatory risk is a component of that.

And I reach that conclusion based on reviews of Regulatory Research Associates' assessments of regulatory procedures in Missouri relative to other jurisdictions, and the RRA finds that you're an average regulatory jurisdiction. It's balanced.

ValueLine Investment Survey also looks at the regulatory procedures in Missouri relative to other jurisdictions and rates Missouri as average. We're balanced.

So the test year methodologies and rules are part of the information that's available to those types of agencies when they review Missouri's regulatory risk and rank it and find that it is a balanced jurisdiction.

Q. Then one last question. Are you able to quantify -- actually, never mind. Thank for your time.

A. Thank you.

COMMISSIONER KENNEY: Those are all the questions I have.

JUDGE WOODRUFF: Commissioner Davis?

QUESTIONS BY COMMISSIONER DAVIS:

Q. All right. Good afternoon, Mr. Gorman.

A Good afternoon.

Q. What was your recommendation for the three Ameren subsidiaries in Illinois in the recent rate case?

A. I believe it was 10 percent.

Q. 10 percent. And obviously same parent company?

A. Correct.

Q. You've got a distribution -- a distribution system in a state that has restructured?

A. Correct.

Q. And would you agree with me that things appear to have settled down in Illinois with regard to the Illinois General Assembly, the Legislature, whatever they call themselves? Appears to be -- would you agree with that assessment, that there appears to be more stability in that area now?

A. I would agree with you that things have stabilized and the investment public has started to regain its trust of the Illinois regulatory environment, but the utility -- AmerenUE Illinois Utilities' bond ratings have not recovered from the reduction in credit standing that happened during the period where there was significant uncertainty about whether or not they'd fully recover their purchased power costs.

Q. And what are their bond ratings?

A. From Standard & Poor's, I believe it's triple B minus, which is the same for AmerenUE. For Moody's -- that's corporate credit ratings, not senior secured. Moody's bond rating for Ameren Illinois Utilities I believe is B double A2, which is about two notches below. It's one notch below corporate credit rating for AmerenUE. So from a Moody's rating standpoint, they are more risky than AmerenUE.

Q. Okay. Now, we've had some discussion about credit rating agencies here earlier today. Ameren actually has to pay these companies to get them to rate them, don't they?

A. Yes.

Q. And so if they don't like the rating, there's not a lot they can do about it, is there?

A. Well, I mean, there's three credit rating agencies.

Q. Right.

A. They don't have to use all three of them.

Q. Right. Right. But in the end, would you characterize it as something like an oligopoly?

A. There are very limited companies that are recognized as credible credit rating agencies, so I would say it is a very small market, yes.

Q. Okay. So your recommendation in the Illinois rate cases was 10 percent, and your recommendation here is 10 percent?

A. Yes, sir.

Q. And Illinois, the -- was it the corporate credit rating for the Illinois subsidiaries was a little less?

A. No, sir. The utility credit ratings for the Illinois operating utility companies from Moody's is a little weaker than the Moody's operating credit rating for AmerenUE.

Q. Okay. The Moody's credit rating for AmerenUE, but S&P is the same?

A. Yes.

Q. Okay. And AmerenUE operates a fleet of generation, including a nuclear plant, correct?

A. Yes.

Q. And is that more risk than operating a distribution system without?

A. Well, there is more operating risk, but if you're referring to what the market sees, it's a combination of total risk, which is more than just operating risk.

Q. So yes, they have more risk from an operational standpoint?

A. They have to operate their generating stations, but yes.

Q. Okay. Now --

A. If I may, depending on the purchased power agreements for AmerenUE Illinois, they may take some of the operating risk of the generation suppliers through those purchased power agreements. They can do that through taker pay provisions, demanded energy components, which would produce some -- transfer some of the financial risk of the merchant generators to the utility company.

Q. Okay. Now --

A. Let me continue.

Q. I'm sorry. Go ahead, Mr. Gorman.

A. I need to clear that up because now there's an Illinois Power Agency which acts as an intermediary between Illinois Utility affiliates and the merchant generator. So that risk is no longer a concern for Ameren Illinois Utilities.

Q. All right. Ameren Illinois Utilities now get 100 percent of their purchased power costs recovered, don't they?

A. Yes.

Q. Now, does AmerenUE?

A. They can -- their fuel adjustment mechanism as I understand it allows for a bandwidth which would allow them to either slightly over-recover their fuel costs or possibly slightly under-recover.

Q. When you get -- when you get 95 percent of any additional cost, that's not 100 percent, is it?

A. It would not be if you got 95 percent, but it would be if you got 105 percent recovery of -- $1.05 for every dollar -- revenue for every dollar of fuel expense.

Q. And how -- how would you get to recover 105 percent?

A. If your fuel adjustment mechanism was developed in such a way that you're allowed to charge customers $1 for 95 cents of fuel expense. And as I understand it, the fuel adjustment mechanism has a 5 percent bandwidth for over and under-recoveries before adjustments are made to prices.

Q. Right.

A. So if you're charging customers a dollar and your actual fuel expense is 95 cents, you get to keep -- Ameren gets to keep the dollar.

Q. Okay. But isn't there some -- isn't there some netting involved?

A. There is if they collect a dollar and their fuel expense is less than 95 cents, then that overcollection would be refunded to customers.

Q. Let's look at actual experience here. I believe it was your testimony in the interim rate case that Ameren has recovered, what was it, approximately 225 million in fuel costs, fuel purchased power? Didn't I remember you testifying referring to a number? Maybe it was in Mr. Baxter's testimony.

A. Yeah, I do recall that. I think of the original $400 million of claimed revenue deficiency they originally named, about 225 million of that was related to fuel expense and 175 was non-fuel expense.

Q. Right. Okay. And so are you saying that of that 225 million, that that's actually 105 percent?

A. No, sir.

Q. Is it more likely that it's 95 percent?

A. No, sir.

Q. So what is it?
A. It's $225 million of fuel expense that they said was not reflected in their rates.
Q. Okay. And so we're still -- so we're still truing that up; is that fair?
A. If that $225 million of under-recovery is left to be recovered through adjustment to the fuel adjustment clause, then my understanding is about 5 percent of that cost would not be recovered by Ameren.
Q. All right. So in the grand scheme of things, you don't think that there's more financial risk there than with the way Illinois does it?
A. Well, it's a balance. The regulatory mechanism allows for over- and under-recoveries, but it's not an automatic 100 percent true-up mechanism. So that component by itself I would say exposes Ameren to risk that the Ameren Illinois utilities are not exposed to.
Q. So it's your position that the two utilities are of equal risk, the Ameren Illinois utilities being one utility and the AmerenUE utility being another utility?
A. Well, strictly speaking, from a Moody's credit rating, corporate credit rating standpoint, the Ameren Illinois utilities are slightly more risky than AmerenUE. They have a weaker credit rating.

But recognizing that, I would say that the bond rating is close enough. It's the same for S&P. It's pretty close for Moody's. Conservatively, I would say that, based on the market's perception of the risk, both financial and operating for the Illinois utilities, it's comparable to the financial and operating risk for the Missouri utility.

Q. And there was more -- you would agree that there is more operational risk to AmerenUE?

A. I would agree that an integrated utility has more operational risk, generally speaking, than a wires utility, but typically that greater level of operating risk is usually balanced out with lower financial risk in the total investment risk than the comparable.

That's certainly the case with the Ameren family of utilities. The common equity ratio here in Missouri after the equity issuance is over 50 percent. It was well under 50 percent for their Ameren Illinois utility affiliates. So they certainly do have more financial risk than AmerenUE.

Q. Now, moving -- in your Illinois testimony in your schedules, you had filed an exhibit, and in essence the exhibit was entitled Electricity Sales are Linked to U.S Economic Growth. And essentially it demonstrates that at times electricity usage has exceeded real GDP, and for the last few years it has tracked it but just slightly less than the real GDP. Is that a fair assessment?

A. It is. And for your information, that same schedule is in this testimony.

Q. Okay.

A. Schedule MPG-9.

Q. Sorry. I missed that. And it's possible that -- would you agree with me that it's possible that the link could be even closer, but that in the last few years energy efficiency has become more in vogue? Would you agree with that statement?

A. It certainly can impact. You know, productivity gains would certainly impact that, and energy efficiency is a means of enhancing the productivity of utility consumption. So I would expect that that might be characteristic of that relationship you'd see going forward.

Q. Now, can you refresh for my recollection what your position on quarterly versus annual DCF is?

A. My position is as follows: First, it is an expectation that if an investor receives cash flows periodically throughout the year, that that investor would expect to be able to reinvest those cash flows and enhance his return or her return by the end of the year.

With respect to a utility company, I believe that that dividend reinvestment return is not a cost to the utility. If a utility investor for stock or bond receives cash flows throughout the year -- maybe an example can help illustrate this.

If you bought a utility bond investment that paid semiannual coupon payments of $30 per year, and the mathematical construct of developing the value of that bond and the expected return is that that cash flow can be reinvested in another investment of comparable return. So in this example, let's assume that a bank account is a comparable risk investment with the same expected return. If the utility bond paid two $30 semiannual coupon payments and had a face value of $1,000, then an investor would expect to receive $60 on that bond from the utility during the year for a $1,000 investment or 6 percent expected return.

Also an investor would know that that $30 coupon payment he receives in six months could be reinvested in his bank account and he could earn 6 percent on that $30 coupon payment for the last six months of the year and could then earn, six months at 6 percent, about another $1.80 return from that bank. So at the end of the year, the investor would have $60 from the utility, $1.80

from the bank, and would have total income of $61.80.

The cost of that expected income to the investor for the utility is the $60 coupon payment. The $1.80 income comes from a different investment, from the bank account. It is not a cost to the utility. So the reinvestment return available to investors from receiving cash flows throughout the year is a real expectation for investors, but they are not costs, they are not part of the utility's cost of capital.

Q. I'm sorry. I'm going to have to ask you to just explain that to me one more time again. I'm just -- call me a little slow today. I'm going to need your help.

A. All right. I'll try to make the numbers -- well, it was a $1,000 investment, bond investment that you're going to receive $30 coupon payments every six months --

Q. Right.

A. -- from the utility.

Q. Uh-huh.

A. So the utility has to make a $30 payment July 1st or June 30th, a $30 payment on December 31st. At the end of the year, that investor will receive $60 from the utility, but the investor will also be able to take the $30 coupon he or she received at June 30th, invest it in a bank account that pays an annual interest rate of

6 percent, and will get six months worth of interest income on that $30 investment by the end of the year.

So at the end of the year, the investor will have $60 in coupon payments from the utility, about $1.80 of interest from the bank account. So their total compensation would be about $61.80.

Q. Right.

A. So the investor expected return for assuming that investment would be about 6.18 percent. Part of that return is the cost of capital to the utility, with is the 6 percent. The other part of the -- 6.18 percent. The .18 percent would be the return the investor would expect by receiving periodic cash flows from the utility and investing them somewhere else and earning an additional return.

Q. Okay. But you weren't here -- you weren't here for Mr. Schwarz' opening argument, but isn't that what we're talking about is investor expectations?

A. We rely on investor expectations in order to estimate what the utility's cost of capital is. The utility's cost of capital is what investors expect to receive from the utility. Investors, while they do expect to be able to reinvest periodic cash flows, they do not expect those returns on investing periodic cash flows to come from the utility.

So the utility's cost of capital should not include quarterly compounding for quarterly payment of utility dividends in our return on equity estimate, and it should also not include the compounding return for bond investments.

Q. But then doesn't the utility lose an opportunity cost by paying out those quarterly dividends because you lose that amount of capital?

A. The utility investors will not lose out on it.

Q. The utility investors don't, but if you're --

A. The utility means nothing without its investors. Investors are entitled to all earnings of the company, whether paid out as dividends or retained in the company. It's all owned by the investors. So the investors are made whole by paying quarterly dividends and giving them an opportunity to reinvest in other investments of comparable risk, or they're also made whole that those earnings, instead of being paid out as dividends are reinvested in the utility, because particularly in Missouri, those reinvested earnings go into additional plant investment which is reflected in the true-up mechanism of the regulatory process here.

So the earnings are reinvest-- reinvested earnings is part of the rate base for establishing the operating income of the utility.

Q. No mas, Mr. Gorman. This is going to require further study on my part.

I offered this opportunity to the good doctor over there. I'm sorry. His name has escaped me. I'm sorry. But anyway, so Mr. Gorman, I'll offer you this opportunity, too. Anything else you want to say in five minutes or less? Anything else you think we're missing or that we need to pay attention to?

A. I would like to comment on Mr. Byrne's chart over there. The first line he says Case No. ER-2008-0318 and claims that the way he asked me to read numbers off to him was comparable to what I did in the last case. It is not.

In the last case, when I used the DCF return estimate to develop one end of the range, it was only based on the multi-growth stage analyses. The number he lists there includes the constant growth and the multi-growth stage DCF analysis.

If I would have constructed that line item truly consistent with what I did in the last case, then the range would be 10.16 percent on the high end and 9.8 percent on the low end, which would have produced a return on equity of roughly 10 percent, actually a little less than 10 percent, which is exactly the same return on equity recommendation I have in my testimony in this case.

His other proposals to use average results from my proxy groups instead of median results completely contradicts his own witness determinations of appropriate findings from the same proxy group he and I used, because Dr. Morin also used group median results in interpreting his DCF and risk premium studies, not group average results. So those numbers should be disregarded as inconsistent with his own expert witness testimony.

And the other manipulations, the other parts of the analysis simply produce numbers within my recommended range. But importantly, if only the median group results are used and the averages are set aside for the reasons I listed in my testimony and Dr. Morin listed in his, then the numbers that are roughly -- they're higher than 10 percent, should be given very little consideration.

Q. Mr. Gorman, is it fair to say that you have appeared here at the Missouri Public Service Commission several times since I've been on this Commission and many times in total?

A. Yes.

Q. If I were to -- and for many different -- in many different contexts with regard to Empire and other

Missouri -- Missouri Gas Energy, I'm not sure what all cases?

A. Missouri American Water Company, Laclede Gas Company, KCP&L, Empire District Electric, Union Electric, maybe some others.

Q. Now, if I were going to plot out on a graph your ROE recommendations, would it -- would it be -- through the years, would it be fairly safe to say that in the last five or six years, there would be -- it would be almost a straight line, that there would be very little deviation from the 10.0 mark?

A. There would be deviations. I think my recommendations in the '07 to '05 time frame were under 10 percent, 9.6, 9.7 percent area.

COMMISSIONER DAVIS: Okay. Thank you, Mr. Gorman.

JUDGE WOODRUFF: Commissioner Kenney?

FURTHER QUESTIONS BY COMMISSIONER KENNEY:

Q. I'm sorry. I should have asked you this before. I apologize. In your discussion of the summary of your DCF results, Table 3 on page 38 of your direct testimony, you indicate that you had concerns about the constant growth DCF model but you included it in the average anyway?

A. Yes.

Q. Can you tell me why? Why did you have -- well, I know why you had concerns, but why did you include it anyway?

A. Well, it's -- I think the Commission gave me pretty clear instruction the last time that they thought it would be appropriate to give some weight and consideration to the constant growth model, so I did that in this case.

However, in this case compared to the last case, I think the constant growth model results are more -- much more reasonable than they were in the last case but still high. Over time, I suspect we're going to see constant growth DCF return estimates fall back down to more normal levels where they were at the turn of the century and leading up to 2005 where they were producing more reasonable numbers.

There was a period in the early 1990s where I thought the DCF return estimates were too low and employed multi-growth stage DCF studies to raise the number to what I believed to be a more reasonable estimate. So I am symmetrical with that, but at this point in time, I think that the constant growth DCF numbers are coming down to a better level, but they're still high, still on the high side.

Q. And had you taken that out, would it have

changed the average to 10.18? Is my math right?
A. Just the constant growth studies?
Q. Yes.
A. Yeah, it would have been 10.18. That's correct.
Q. In all fairness, I should ask you the same questions I asked Dr. Morin. What's your hourly rate for appearing at depositions versus at trial?
A. My hourly rate's $215 an hour for all my work.
Q. For both appearance here today and for what you've already done to date?
A. Yes, sir.
COMMISSIONER KENNEY: All right. Thank you.
JUDGE WOODRUFF: Commissioner Gunn, did you have questions?
COMMISSIONER GUNN: Just a couple, and I apologize for not being here. I had another meeting.
QUESTIONS BY COMMISSIONER GUNN:
Q. I have one just kind of basic question, and this may have already been answered. This is kind of an educational thing for me. Why is the CAPM always the lowest number? Why does it always come out with the lowest?

A. It's not always the lowest.
Q. It just happens to be --
A. Right now it is, yes, and that was part of our cross with Dr. Morin, because back in the mid 1990s DCF numbers were real low and CAPM were high. At that time his range were largely related to the results of the CAPM study.
That's why he has testified, and I agree, that you need more than one methodology because any one of these methods can produce an unreasonable estimate as the inputs change over time. None of them are constantly reliable. So you have to rely on more than one methodology in order to make sure you're getting an accurate estimate of what the current cost of equity is.
Q. And again, I apologize, but in terms of the zone of reasonableness, when you're doing your analysis, is that something that you keep in mind when you're doing the analysis or does that even enter into your --
A. It enters my mind as to how I'm going to explain where I'm at when I sit here and you ask me that question, but the data, the input data is derived from the market, from market participants, from actual market activity and evaluation of securities. So that information is what I used to develop my recommended range. But when I'm done with that, I take a step back

and look at the number and try to gauge whether or not I think it's reasonable.

And one way I do that is to do the credit rating financial ratios that I do in my testimony, because I'm asking myself -- in Hope and Bluefield there's two standards. One's fair compensation and the other is maintaining the financial integrity of the enterprise, and financial ratios help answer the second question. Will a 10 percent return on equity provide adequate cash flows to this utility to support its investment grade bond rating? My answer to that is yes, it will. So --

Q. Do you -- Dr. Morin said that if he did his analysis and it came out above the zone of reasonableness and he rechecked it and found that he believed that his inputs would be -- were correct, he wouldn't hesitate in recommending an ROE outside of the zone of reasonableness. Do you agree with that?

A. Yes. I mean, if the objective is fair compensation and maintaining financial integrity, you have to listen to the market.

Q. So the zone of reasonableness should not be used as an automatic disqualifier?

A. That should be on both sides, whether or not cost of capital are increasing and rate of return should be increased or cost of capital are decreasing and return on equity should be decreased. I agree with that.

Q. Okay. Then Dr. Morin said that the biggest differential in the -- at least between you and Mr. Lawton and Dr. Morin is the growth rate input. Do you agree with that?

A. Specifically with Dr. Morin, I would say it would be the GD growth rate, because both of us rely on analyst growth rate, consensus analyst growth rate projections. He doesn't use a sustainable growth rate model. So that would be another distinctive difference between what he did and what I did. But we both rely at least in one study on consensus analyst growth rate projections.

Q. And you agree with him in terms of the methodology? Forget about the inputs for a while. The theoretical framework of all four analyses is sound?

A. Very similar, yes.

COMMISSIONER GUNN: Thank you. I don't have anything else. I apologize if that was repetitive.

JUDGE WOODRUFF: All right. We'll move to recross, then, beginning with Public Counsel.

MR. MILLS: No questions.

JUDGE WOODRUFF: Staff?

MR. DEARMONT: No questions.

JUDGE WOODRUFF: Ameren?

MR. BYRNE: I do have a few.

RECROSS-EXAMINATION BY MR. BYRNE:

Q. Mr. Gorman, one of your criticisms of my chart was that when some of the numbers are based on averages and that's inconsistent with what our expert Dr. Morin did, is that correct --

A. Yes.

Q. -- that was one of your criticisms?

Let me ask you this. If you had just used the medians, not the averages, but used both medians for your constant growth sustainable growth calculation, what would that have been? Because you excluded one of the proxy groups; isn't that correct?

A. I did, because that group contained so many outliers that it produced --

Q. I just asked if you did. And what would have happened to the number for your constant growth sustainable growth if you had averaged both medians? I think it's 10.2 percent now. Would -- on Table 3, what would have happened to that number if you had averaged the two medians?

A. It would have -- 10.85 percent.

Q. Okay. Then what would that have done to your average ROE if you had used that number in place of the 10.2 percent?

A. Would have gone from 10.46 to 10.68.
Q. Okay. You had a discussion with Commissioner Davis about the quarterly payment of dividends. Do you remember that?
A. Yes.
Q. And are you aware that Dr. Morin believes there should be an adjustment for quarterly payment of dividends?
A. That's my understanding, yes.
Q. Are you aware that other experts in the field of utility finance believe there should be an adjustment for the quarterly payment of dividends?
A. Most utility witnesses would likely argue that that would be appropriate, yes.
Q. Okay. Let me ask you, from the standpoint of the utility company, isn't it -- isn't there a cost to the utility company of paying out a dividend before the end of the year as opposed to if all of the dividend was paid at the end of the year? Isn't there a cost to that?
A. When you say -- I don't understand what you mean by cost to the utility. The utility or the investors. Is there a cost to investor by receiving quarterly dividends?
Q. No. I'm asking from the standpoint of the utility company, is there a higher cost to paying out the

same dividend quarterly than there is to paying that dividend out once on an annual basis at the end of the year? Isn't it true that there's a higher cost to paying quarterly from the utility standpoint?

A. If the utility didn't pay out dividends quarterly, they could keep the earnings in some interest bearing account if they expected to pay it out at the end of the year, and they could effectively accomplish the same thing investors could accomplish by earning interest on the dividends that would have otherwise been paid out.

Q. So that's a yes, I think? Is the answer yes, it's more costly to utilities to pay quarterly than to pay at the end of the year?

A. It is not more expensive for utilities to pay quarterly, but there is an opportunity cost to the utilities to pay quarterly dividends.

Q. And that opportunity cost is real, is it not?

A. It's balanced because the opportunity cost to the utility is an opportunity gain to the utility investors.

Q. Okay. There were some -- I think in response to one of the Commissioners' questions, you were talking about the regulatory environment in Missouri. Do you remember those questions?

A. Yes.
Q. And I was wondering if you had had a chance to see the March 12 Standard & Poor's issuance where they rated various jurisdictions around the country. Did you happen to see that?
A. Of this year?
Q. Yeah, March 12, 2010.
A. I have not seen that yet.
Q. Let me show you a copy of that.
MR. BYRNE: May I approach the witness, your Honor?
JUDGE WOODRUFF: You may.
BY MR. BYRNE:
Q. And that's from Standard & Poor's March 12, 2010; is that correct?
A. Yes.
Q. And where do they put Missouri?
A. In the less credit supportive category.
MR. BYRNE: Okay. Thank you very much, Mr. Gorman. I don't have any other questions.
JUDGE WOODRUFF: Thank you. Redirect.
MS. ILES: Thank you, your Honor.
REDIRECT EXAMINATION BY MS. ILES:
Q. Mr. Gorman, if we could just go back, I think you explained pretty clearly about your use of

medians. If we could just look at MPG-6, and could you tell us why you used the medians rather than the average?

A. Because the proxy group individual company estimates included several outliers, which --

Q. Could you point those out to us?

A. I'm sorry. Which schedule were you referring to?

Q. MPG-6.

A. Thank you. On MPG-6, page 1, on line -- excuse me, on line 12, Empire District had a constant growth DCF return estimate of 43.39 percent. I considered that to be an outlier. Had an impact on the group average results. There were also outliers such as line No. 2, Allegheny Energy, which had an analyst growth estimate of 10 percent which produced a DCF return of 12.61.

The lines 7 and 8, Clico and DP&L had very high analyst growth rates which produced DCF return estimates in the mid 14 percent area. Down on line 21, Pepco Holdings had a DCF return around 13.5 percent, which is much higher than the other ones. Tico Energy, again, this a company that is, from a holding company perspective, is recovering financially from merchant investment writeoffs from several years ago. Has high analyst growth projections and high dividend yields right now, and the DCF is around 13.6 percent.

So several of those companies helped skew up the average, but the median, the central tendency of the actual estimates themselves from the proxy group are much more better approximated by the group median than the average.

Q. Is the same explanation true for your use of the median in MPG-12?

A. It is, yes.

Q. Now, when Mr. Byrne was asking you questions about the numbers on the chart and he several different times asked you about a high number and would that be the high point of your range of recommendations, and you stated that would not necessarily be a high point of the end of your range, could you explain what you meant by that?

A. Yeah. Mr. Byrne was simply taking high numbers and plugging them in to the analysis to modify the range. I wouldn't do that in forming a recommended range. I would look at the reasonableness of the end points of the range itself. And that's very similar to what I did do in evaluating the actual results of my analyses.

So if I would have listed all the average and median group results, I would not have done what Mr. Byrne suggested I would do and simply grab the highest number and lowest number to develop the range. I would rather look for the central tendencies of the group results for my analyses to form a recommended range, which is reasonably consistent with the greater weight of evidence of my analyses that suggest what's the current market cost of equity.

Q. Commissioner Davis asked you about your recommendations in other cases before this Commission. Do you recall what your recommendation for return on equity in the last AmerenUE rate case was?

A. I can remind myself real quick. 10.2 percent.

MS. ILES: No further questions.

JUDGE WOODRUFF: All right. Thank you, Mr. Gorman. You may step down.

THE WITNESS: Thank you.

JUDGE WOODRUFF: We're due for our break. Before everybody leaves, though, I do want to say that I have received e-mails from David Woodsmall and from Lee Curtis indicating that both of their clients intend to oppose the Stipulation & Agreement that was filed last night. So we can discuss that further.

All right. We'll take a break. We'll come back at 2:45.

(A BREAK WAS TAKEN.)

MR. DEARMONT: If I may, just as a

follow-up, I checked with Staff. Staff has no opposition to shortening the response time on the MIEC motions.

JUDGE WOODRUFF: Thank you. All right. We're back from our break, and Mr. Murray has taken the stand, and please raise your right hand. I'll swear you in.

(Witness sworn.)

JUDGE WOODRUFF: You've been in here. You've heard my speech about only responding to questions that are asked rather than offering explanations and so forth.

THE WITNESS: Yes.

JUDGE WOODRUFF: Thank you. You may inquire.

DAVID MURRAY testified as follows:

DIRECT EXAMINATION BY MR. DEARMONT:

Q. Would you please state your name for the record.

A. My name is David Murray.

Q. By whom are you employed, Mr. Murray, and in what capacity?

A. The Missouri Public Service Commission. I am Acting Utility Manager for the Financial Analysis Department.

Q. Are you the same David Murray who prepared and caused to be filed the rate of return portion of the Staff Revenue Requirement Cost of Service Report marked as Exhibit 200?

A. Yes.

Q. Are you the same David Murray that prepared and caused to be filed capital schedules attached as Appendix 2 to that Cost of Service Report?

A. Yes.

Q. Have those schedules since been supplemented?

A. Yes. I had some corrections.

MR. DEARMONT: Okay. May I approach the witness?

JUDGE WOODRUFF: You may.

BY MR. DEARMONT:

Q. Do you recognize that material, Mr. Murray?

A. Yes, I do.

Q. Can you give us a description of that?

A. These are various source documents that I had relied on in my -- in the Cost of Service Report, and I was providing these to the Commission for purposes of providing all reports, articles, et cetera, that had -- that I had cited in my testimony.

Q. Were those filed as a supplement to your testimony in this case?

A. Yes, they were.

MR. DEARMONT: Judge, I don't know what number we're on, but I'd like to mark an exhibit, please.

JUDGE WOODRUFF: It would be 232.

MR. DEARMONT: That would represent Staff's supplemental direct testimony.

JUDGE WOODRUFF: For Mr. Murray?

MR. DEARMONT: Yes.

BY MR. DEARMONT:

Q. Do you have any corrections to your portion of the Staff Report or your capital schedules that have not been addressed in subsequent testimony?

A. Yes. One's minor. One's a little bit more substantive. On page 9, line 21 of the Cost of Service Report, I indicated that, when I was doing the quote, that the fed as pumped so much money. It's actually the fed has. There should be an H in front of the "as".

And the more substantive change I need to make has to do with a comment that I discussed about something that was testified about in the interim rate case hearing. On page 28, line 23, I had interpreted Mr. Nickloy's statement during the interim rate case hearing as that he said that UE's bonds were trading as if they were A rated. He specifically said that they were trading better than triple B. Obviously that's subject to interpretation.

Q. Okay. Other than the changes that you've just identified, do you have any additional changes to your portion of the Cost of Service Report?

A. No.

Q. Did you file any rebuttal testimony in this matter?

A. Yes.

Q. Do you have any corrections to that rebuttal testimony that have not been addressed in subsequent testimony?

A. No.

Q. Did you file any surrebuttal testimony?

A. Yes.

Q. Do you have any corrections to that surrebuttal testimony?

A. No.

Q. Mr. Murray, is the testimony that you have filed in this matter true and accurate to the best of your knowledge and belief?

A. Yes.

Q. If asked the same questions today as were contained in your testimony, would your answers today be the same?

A. Yes.

Q. Have you reviewed any materials that supports your recommendation and which were not provided with your testimony?

A. Yes.

Q. Can you be more specific?

A. In -- in discovery in this case, I had requested copies of equity research reports that, that address Ameren and Ameren and the electric industry in general, and they did make those available to me at their headquarters, and I went up and reviewed several equity analyst reports, and I took notes and in the cases where I cited very specifically from those reports, I provided that in testimony.

However, I believe they -- I believe they indicated, according to their subscription agreement, that they could not allow me to make copies of those. But I am aware that in the surrebuttal testimony of Dr. Morin in this case, he cited a couple of those Goldman Sachs reports and provided those with his -- in response to a DR that we just received those reports yesterday.

And I believe that in light of providing context to the various things that I comment on, I think it's important to provide those to the Commission.

Q. Okay. I'm going to hand you --

MR. DEARMONT: May I approach, Judge?

JUDGE WOODRUFF: You may.
BY MR. DEARMONT:
Q. I'm going to hand you two separate documents. Do you recognize this material?
A. Yes. They're both Goldman Sachs reports. One was a January 15th, 2009 Goldman Sachs report, and the other one was a separate September 29th, 2009 Goldman Sachs report, both referring about general electric utility company valuation.
Q. How did you get that material?
A. This material was specifically provided in response to a DR that Staff had submitted to UE asking for source documents from the company witnesses.
Q. When was it provided?
A. Yesterday.
MR. DEARMONT: I'd like to have those two documents marked, Judge.
JUDGE WOODRUFF: Do you want to mark them as separate exhibits?
MR. DEARMONT: Please.
JUDGE WOODRUFF: It would be 233 and 234.
(EXHIBIT NOS. 233 AND 234 WERE MARKED FOR IDENTIFICATION BY THE REPORTER.)
BY MR. DEARMONT:
Q. And have you had the chance to review that

material, Mr. Murray?

A. I had reviewed these reports when I was up at the headquarters, and I've reviewed them once again since they were provided, so yes.

MR. DEARMONT: At this time I would move for the admission of Mr. Murray's portion of the Cost of Service Report marked as Exhibit 200, Exhibit 210 and 211 representing the rebuttal testimony and surrebuttal testimony of Dave Murray, Exhibit 232 representing the supplemental schedules previously filed in EFIS, and Exhibits 233 and 234 representing the Goldman Sachs material that I just distributed.

JUDGE WOODRUFF: Do you have copies of 233 and 234 for the Commissioners?

MR. DEARMONT: I can get those.

JUDGE WOODRUFF: I appreciate that.

MR. DEARMONT: Absolutely.

JUDGE WOODRUFF: Portions of 200, 210, 211, 232, 233 and 234 have been offered. Are there any objections to their receipt?

MR. MILLS: I don't have any objections to 233 and 234, but I don't have them yet, so I'd like to reserve the right to make objections once I see them.

MR. BYRNE: Your Honor, I do have potentially some objections. May I inquire of counsel?

JUDGE WOODRUFF: Sure.

MR. BYRNE: In the material that you gave, the exhibits just before the Goldman reports, were those things that have already been prefiled by Staff?

MR. DEARMONT: Yes, it was.

MR. BYRNE: So I have no objection to any of the portion of the Staff Report, I have no objection to the testimony, and I have no objection to that exhibit that had already been filed.

But I do, your Honor, believe I have an objection to the two Goldman reports. I don't object to them being received into evidence, but I do object to the extent they're being presented for the truth of what they say. I believe it's a hearsay document.

I believe it's legitimate for you to admit them as a basis that Mr. Murray had for his opinions, so I don't object to them going into the record, but I do object to them being used for the truth of what they say without us having an opportunity to cross-examine the people that put the reports together.

JUDGE WOODRUFF: What is the purpose of putting the document in?

MR. DEARMONT: I think these documents do show, do give credit to the recommendation that is offered by Mr. Murray in this case.

And in addition, to the extent that the Commission would like to sustain that objection, I believe that these documents were offered to document some purported amount of regulatory lag that we have. So If they're not going to come in for the substance at all, we would similarly expect that they don't come in for that substance either.

JUDGE WOODRUFF: What substance do you mean?

MR. DEARMONT: I believe that they were --

JUDGE WOODRUFF: Who offered them in the past?

MR. DEARMONT: They were not offered. They were provided to Staff in response to a Data Request for work papers for the surrebuttal -- related to the surrebuttal testimony -- or excuse me, source documents cited in the surrebuttal testimony of Dr. Morin.

JUDGE WOODRUFF: How does that -- if they've not been offered, what are you asking that they not be -- that they be excluded from?

MR. DEARMONT: I'm just saying that if Staff cannot rely upon them for the basis of any of the content contained therein, I similarly would expect that the company would not rely on them for the very same basis.

JUDGE WOODRUFF: Well, the company hasn't offered them into evidence. They're documents that are being -- you indicated that -- or Mr. Murray has indicated he's relied upon them in his testimony.

MR. DEARMONT: Right.

JUDGE WOODRUFF: Okay. So at this point I don't actually hear an objection.

MR. BYRNE: I object on the grounds that they're hearsay. To the extent that they're offered for the truth of the content of them, I object. To the extent they just want to say this is what Mr. Murray looked at, I don't have a problem with it.

MR. DEARMONT: Judge, in addition, I think that the testimony in this case, both prefiled and that will be shown tomorrow, will say that Goldman Sachs is an expert in the field of -- in the field of financial estimation. Mr. Murray as an expert is entitled to rely upon the information contained in these expert reports.

JUDGE WOODRUFF: I don't think that's a question. Experts can always rely on hearsay. The question is, is this being admitted into this case as the expert testimony of the witnesses from Goldman?

MR. BYRNE: And there's no opportunity to cross-examine them.

JUDGE WOODRUFF: There's no opportunity to cross-examine the experts from Goldman.

MR. DEARMONT: Sure.

MR. MILLS: Judge, just as I reserve the right to object once I see them, can I also reserve the right to respond to the objection once I see them?

JUDGE WOODRUFF: Certainly. This is probably all premature with that debate. Let me deal with the other exhibits that have not -- which have not been objected to, which are the portions of 200, 211, 210 and 232. Those will be admitted.

(PORTIONS OF EXHIBIT 200, EXHIBITS 210, 211 AND 232 WERE RECEIVED INTO EVIDENCE.)

JUDGE WOODRUFF: Exhibits 233 and 234, I'll reserve ruling on those until such time as the parties have had an opportunity to review them.

MR. DEARMONT: Thank you. I'll make copies for OPC as well as the Commissioners.

MR. BYRNE: Maybe we can do this tomorrow morning, first thing.

JUDGE WOODRUFF: That's fine. I don't think we'll finish this issue today. All right. You can proceed.

MR. DEARMONT: I tender the witness for cross. Thank you.

JUDGE WOODRUFF: All right. For

cross-examination, we begin with Public Counsel.

MR. MILLS: No questions. Thank you.

JUDGE WOODRUFF: For MIEC? Did MIEC wish to cross?

MS. ILES: No, your Honor.

JUDGE WOODRUFF: For AmerenUE?

MR. BYRNE: Yes, your Honor, I do have some questions.

CROSS-EXAMINATION BY MR. BYRNE:

Q. Mr. Murray, do you have your deposition that I took of you up there?

A. I did. I'm pretty sure it's right here.

Q. I've got an extra if you don't have one.

A. If you can provide me the extra, I'd appreciate it. I thought I brought it up here with me.

Q. There's a lot of paper.

A. Thank you.

Q. Sure. Now, Mr. Murray, good afternoon, by the way.

A. Good afternoon.

Q. Would you agree with me that estimating cost of equity from an electric utility like AmerenUE is not an exact science?

A. Yes.

Q. And it requires judgment, does it not?

A. Yes.
Q. You have to use judgment to select the analyses that you're going to use; is that correct?
A. Yes.
Q. And you also have to use judgment in deciding what inputs to use for those analyses?
A. Yes.
Q. It's simply not a case of plugging numbers into a formula, correct?
A. Yes.
Q. Would you agree that that's why it's important to have experts estimate the cost of equity?
A. Yes.
Q. Would you agree with me that estimating the cost of equity for an electric utility like AmerenUE is complicated and difficult under any circumstances?
A. No.
Q. And I believe I've got a quote from your portion of the Staff Report that says -- I'm trying to find it, but I don't see it. Perhaps it'll ring a bell for you. Oh, here it is. On page 7, line 26, is that -- that's in part of your section of the Staff Report, is it not?
A. Yes, it is.
Q. And it says, the world and U.S. -- and the

U.S. economies are slowly recovering from a deep recession. Such transitional periods can make the estimation of a fair and reasonable cost of capital a tougher task than usual.

A. Yes.

Q. Similarly, it is also difficult for utility commissions to determine a fair and reasonable allowed return during these economic conditions. Is that correct?

A. Yes.

Q. So I guess as I understand your testimony, it might not be difficult all the time, but now it's kind of a more difficult time to estimate the cost of equity; is that fair?

A. Yes. Economic uncertainty causes problems.

Q. Would you agree with me that because of these difficulties that we're experiencing now, the expertise of the person trying to estimate the cost of equity is even more important than it usually is?

A. Yes.

Q. Mr. Murray, as I understand it, you have a range and a point estimate as well like Mr. Gorman did, is that correct, a range that you're recommending and a point?

A. Yes. 9 to 9.7, midpoint 9.35, that's correct.

Q. And, Mr. Murray, are you aware that last September AmerenUE received an infusion of equity?
A. Yes.
Q. And that equity infusion brought AmerenUE's equity percentage to just below where it was last rate case; are you aware of that?
A. I remember the low 50s. I think that's approximately correct.
Q. And it's my understanding that the Staff is accepting the updated capital structure; is that correct?
A. The Staff agreed to true up the capital structure and was going to address the true-up -- address the capital structure at the true-up time to determine if it was a capital structure that was still acceptable.
Q. Okay. So at this time you don't know whether Staff is going to accept the updated capital structure; is that true?
A. After further investigation, we'll have to investigate the details of that capital structure. I've not seen the numbers associated with that capital structure or how the equity infusion was done. I understand an equity infusion was done, and on its face I would say that's going to be acceptable, but I have not -- I don't even believe I've received any data regarding that as of this time.

Q. I mean, let me ask it a different way. As you sit here now, you don't have any reason to think Staff is going to oppose using the updated capital structure, do you?

A. My understanding is you raised equity at the parent company level and infused that equity at the subsidiary. I don't consider that to be a manipulation of the capital structure. So as of right now, I am not leaning towards raising red flags about my concerns about what you might be trying to do with your capital structure.

Q. Okay. And how about your return on equity, are you planning at this point to adjust your return on equity as a result of that capital infusion?

A. That's something that's still under consideration. I have not decided.

Q. So you may change your cost of equity?

A. It's possible, within the range.

Q. Okay. And I guess it would go down, right, because of the -- if it goes anywhere, it would go down from 9.35 percent to the lower number?

A. If we were strictly looking at just the capital structure and that's the only thing that occurred, then yes, you have less financial risk.

Q. Are you going to look at other things or just the capital structure?

A. Well, I guess we'd have to consider what's allowed in the true-up. You have a few issues that have been reintroduced in this case, I believe.

Q. So as of right now, we really don't know what your final ROE recommendation is going to be in this case; is that fair to say?

A. Not for purpose of true-up, that's correct.

Q. Mr. Murray, isn't it correct that in estimating a cost of equity, consideration of risk is important?

A. Yes.

Q. And will you agree with me, as Mr. Gorman did, that the higher the utility's risk is, the higher the cost of equity would be?

A. It should be, yes.

Q. And conversely, the lower the utility's risk is, the lower the cost of equity would be?

A. It should be, yes.

Q. Would you agree with me that an integrated electric utility like AmerenUE faces a number of risks?

A. Yes.

Q. It faces operational risks, doesn't it?

A. Yes.

Q. And risks associated with its Callaway

nuclear plant?
A. Yes.
Q. And it has risks associated with its coal and gas-fired generating plants, correct?
A. Yes.
Q. And risks associated with its hydroelectric plants, correct?
A. Yes.
Q. And it's true, is it not, that wires-only utilities don't have any of those risks associated with operating generating plants, right?
A. Please define risk.
Q. Well, it's the risk we were just talking about of operating all the different plants.
A. Operating risk.
Q. Yes.
A. Asset risk. We talked about this during the deposition.
Q. Yes.
A. Asset risk, I would agree with that, yes.
Q. And would you agree with me that, all other things being equal, wires-only utilities are less risky than integrated utilities like AmerenUE?
A. Please clarify risk once again for me, please.

Q. Well, let me refer you to your deposition. I guess looking at the deposition, asset risk, would you agree with me that wires-only utilities have less asset risk than integrated utilities?

A. There's less investment, so yes.

Q. Okay. And AmerenUE does face a number of other risks besides operational risk associated with its generating plants; would you agree with that? Like, for example, it faces risks associated with operating its transmission and distribution systems; would you agree with that?

A. As to the generating facilities?

Q. No. No. Just additional risks that AmerenUE faces. I'm sorry. Maybe I wasn't clear.

A. Sure. Yes.

Q. For example, it faces a risk that storms will knock out part of its distribution system; is that correct?

A. That's correct.

Q. And AmerenUE also faces regulatory risk, does it not?

A. Yes.

Q. It faces the risk that Congress will impose a carbon tax, doesn't it?

A. Yes.

Q. And it faces the risk that the EPA will require it to install expensive pollution control equipment on its generating facilities; isn't that correct?

A. Yes.

Q. Aren't those particularly significant risks given AmerenUE's substantial reliance on coal-fired generation?

A. Substantial seems to be a relative term. To the extent it's a regulated utility and those costs are allowed to be recovered in future rate cases, the risk of recovery to the extent those expenditures are not disallowed is, you know, is a lot less for a regulated integrated electric utility than it would be for a utility, a merchant generator. So that's why I say it's relative. I think we talked about that a little bit in the deposition.

Q. Well, doesn't AmerenUE also face the risk that it won't be able to timely recover the costs that it has to spend?

A. I believe we agreed there was a time value of money issue.

Q. And it also faces the risk of disallowance of costs, I guess, too, correct?

A. Yes.

Q. Okay. And Missouri does not allow construction work in progress in rate base, right?
A. For electric utilities, I believe that's the law, yes.
Q. And would you agree with me that that creates more risk than a utility that is allowed to put construction work in progress in rate base?
A. Are we going to do an all else equal?
Q. All else equal, yes.
A. Yes.
Q. Okay. And Missouri uses an historic test year as some of the other witnesses have talked about today; isn't that correct?
A. That's correct.
Q. And all else being equal, doesn't an electric utility that operates in a jurisdiction that uses an historical test year have more risk than one that operates in a utility using -- in a jurisdiction that uses projected test years?
A. I think we talked about this, too. It depends on how good you are with your projections. If the projections are always high, then I would presume that that's favorable to the utility. Obviously estimation practices are a matter of judgment. So I can't -- I don't think I would say generally that that is always going to

apply.

Q. Let me -- taking a step back, it's my understanding that your opinion is that the overall risk AmerenUE faces is about average for comparable companies; is that correct?

A. Yes.

Q. Now, in terms of how you developed your recommended cost of equity, my understanding is that you established your range based on the results of your multistage discounted cash flow or DCF analysis; is that correct?

A. That's correct.

Q. And my further understanding is that when you performed your multistage DCF analysis, you got a cost of equity of 9.2 percent from that analysis; is that correct?

A. That was midpoint, yes.

Q. And then my understanding is that you initially put a band of 50 basis points on either side of that 9.2 percent cost estimate?

A. Yes.

Q. And then -- but then you -- and that gave you a range of 8.7 to 9.7, correct?

A. Yes.

Q. But then you truncated the bottom half of the range at 9 percent --

A. Yes.

Q. -- is that right?

And why did you do that?

A. That was one of these considerations about, although I believe there's information that supports a cost of equity in the high 8s, and I believe I've provided that from the investment community, one of the things that I considered is obviously there's a belief from this Commission that I may be -- or at least certain Commissioners, that that may be too low, and -- and so I took that into consideration in adopting a recommended range of 9 to 9.7.

I think if somebody sees an 8, it frightens them. It cannot be possible. Based on my review of various folks that make investment decisions, it's quite possible, but I understand that, you know.

Q. You're not frightened of an 8, right?

A. I'm not frightened of looking at evidence.

Q. Okay. And my understanding is that there is a different DCF method called the constant growth method; is that correct?

A. I wouldn't say it's different. It's a different assumption. DCF is a discounted cash flow. It's just that there's different variations. Constant growth is a simplification of multistage DCF.

Q. And my understanding is it's called constant growth because it uses a single growth factor as opposed to the multistage which uses different growth factors in different stages; is that correct?

A. Yes.

Q. And in Staff's report on page 21, toward the bottom of that page, when you're talking about the constant growth DCF, you say that in most -- well, in most situations it's, and I'm quoting now, ideal for estimating the cost of common equity for regulated utilities due to the maturity of the industry. Did I read that correctly?

A. Maturity of the regulated utility industry. I can't remember if you left regulated off.

Q. You know, I did. Let me read it again. It's considered to be ideal for estimating the cost of common equity for regulated utilities due to the maturity of the regulated utility industry. Is that what it says?

A. Yes.

Q. And it's my understanding that the Staff consistently used the constant growth DCF analysis in electric cases up until the end of 2008 and the beginning of 2009; is that correct?

A. You're taking me back. I'm trying to remember the dates of the KCPL and Greater Missouri

Operations. I'll agree with you that up until KCPL Greater Missouri Operations case that, yes, that was the case. I don't remember the dates.

Q. It's in that vicinity, though?

A. Yes.

Q. And when you say the KCPL and KCPL Greater Missouri Operations cases, do you know if those -- my understanding is the KCPL case is Case No. ER-2009-0089, and the Greater Missouri Operations case is ER-2009-0090. Does that sound like the right case numbers to you?

A. Yes, it does.

Q. And you were the witness in both of those cases, correct?

A. Yes, I was.

Q. And both of those cases settled; is that correct?

A. That is correct.

Q. So would it be fair to say this is the first case that the Commission will rule on the Staff's switch from the constant growth DCF to the multistage DCF which you're using in this case?

A. On the Staff's use of it, that is correct.

Q. Okay. Let me say it a different way which might be more accurate. Is this the first case where the Staff has recommended not using the constant growth but instead using the multistage growth in a case that's gone to hearing for an electric utility?

A. That is correct.

Q. And my understanding is the Staff is still using the constant growth DCF analysis for gas utilities; is that correct?

A. That is correct.

Q. For example, the Staff used the constant growth DCF model in the most recent MGE case that was just decided; isn't that correct?

A. Yes.

Q. And again, do you know if that case is Case No. GR-2009-0355? Do you remember?

A. I believe that's correct.

Q. You're good with case numbers. I'm not so good.

And the Staff also used the constant growth DCF in a recent Empire District Electric Company gas case; is that also correct?

A. Yes, that's correct.

Q. And in the recent MGE case, were you the Staff witness who prepared the return on equity section of the Staff Report?

A. Yes, I was.

Q. Let me --

MR. BYRNE: May I approach the witness, your Honor?
BY MR. BYRNE:
Q. Let me hand you a copy of that Staff Report. Can you -- can you identify that for me, Mr. Murray?
A. Yes. This is the Staff Report, Staff Cost of Service Report for the Missouri Gas Energy case in Case No. GR-2009-0355.
Q. Can you tell when that report was filed?
A. In August of 2009.
Q. Okay. And could you turn to page 6 of the report and read me the two sentences beginning at line 17?
A. The Staff's recommended ROE is driven by applying a single-stage constant growth discounted cash flow analysis to a group of comparable companies. The Staff continues to believe the DCF methodology is the most reliable method available for estimating the utility company's cost of common equity.
Q. Okay. Mr. Murray, my understanding is that you believe that regulatory consistency is important to both utilities and customers?
A. Yes.
Q. And consistency in determining the rate of return is important to investors, wouldn't you agree?

A. Yes.
Q. Now, my understanding is even -- that you did not use the consent growth DCF to set the parameters of your range in this case and, in fact, it had no influence on your range; is that correct?
A. It did not influence my decision on what the range would be, that's correct.
Q. But nonetheless, you did calculate a constant growth DCF for this case; is that correct?
A. Yes, I did.
Q. And can you tell me what the result of your constant growth DCF was?
A. 9.2 to 10.2.
Q. 9.2 percent to 10.2 percent?
A. Yes.
Q. Okay. And as I understand it, the formula for the constant growth DCF analysis is dividend yield plus growth. Is that the right formula?
A. Yes, it is.
Q. Okay. And for the dividend yield in your constant growth DCF, you used 5.2 percent; is that correct?
A. Yes, that's correct.
Q. Okay. And can you tell me how you developed that? I think it's on -- if it helps, I think

it's on Schedule 15.

A. That's simply taking the expected dividend for next year divided by an average high/low stock price for the most recent three months for each of the comparable companies.

Q. Okay. For each of the companies in your proxy group?

A. Yes.

Q. And then did you average --

A. Yes, I did.

Q. -- the projected dividends yield for all of them?

A. Yes.

Q. And my understanding is for the growth component of the constant growth DCF analysis, you used 4 to 5 percent; is that correct?

A. Yes.

Q. And I think you -- in your deposition, you referred to that as a very generic growth rate that you had just thrown in; is that correct?

A. Yes.

Q. Okay.

A. It's generic and it's based on Staff's experience of what -- what type of electric utility growth rates we've used in constant growth DCFs in the past where we felt like those growth rates were much more sustainable, at least myself I should say.

Q. And would it be fair to say that your 4 to 5 percent growth rate is based on your judgment?

A. Yes, it is.

Q. It's not like there's a quantifiable schedule like there is for the dividend component of the --

A. There's no mechanical calculation to it, no.

Q. My understanding is that in past cases the Staff has typically used projected growth rates in its constant growth analysis; is that correct?

A. If I can specify --

Q. Go ahead.

A. -- please? The -- I believe beginning in 2000, I want to say around 2005, in that period, we started to rely more if not completely on projected earnings per share forecasts because, quite frankly, they seemed to be pretty consistent with what we considered to be sustainable constant growth rates.

And part -- part of the reason why we had to, I feel like we almost had to start doing it was there was a lot of issues within the electric utility industry due to the restructuring, which caused a lot of volatility for companies that I don't think necessarily is something that UE would have experienced because it's a purely regulated utility.

But what we found is those holding companies -- because your proxy groups are all holding companies, which can have some amount of non-regulated activities, and that's why it's important to try to minimize the amount of non-regulated operations in your proxy group. But that caused quite a bit of volatility in historical growth rates, and relying on those historical growth rates to try to determine what may be constant going forward was quite difficult.

There were a lot of negative growth rates. It's not that negative growth rates don't happen and don't affect investors' values, but -- so it just seemed to be reasonable to -- to use what we consider to be fairly constant and sustainable growth rate about maybe high 3s to mid 4s maybe. I can't remember the exact growth rates over that period of time.

Q. Well, did -- for example, I think Mr. Barnes used projected growth rates in a recent Empire case. Are you familiar with that?

A. I'm familiar with that. I can't remember the exact growth rate that was -- the average growth rate that was used in that case.

Q. Well, if you had used projected growth rates for your constant growth DCF analysis in this case, isn't it true that you would have used 6.02 percent instead of 4 to 5 percent?
A. Yes.
Q. Okay. And then if you would have done that, you would have added the 6.02 percent to your 5.2 percent and get a result of 11.22 percent; is that correct?
A. Yes.
Q. Okay. I want to ask you some questions about your multistage DCF analysis that you relied on in setting your range. As I understand it, your multistage DCF looks at three different -- uses three stages; is that correct?
A. Yes.
Q. Okay. And it would have been possible to pick a different number of stages, would it not have?
A. Anything's possible, yes.
Q. Like, Mr. Gorman I think picked a two-stage. You could have picked a two-stage, right?
A. I think he does a two-stage and a multistage, but yeah, you can use -- it's judgment of analyst.
Q. You could pick two or four or any number

you really wanted to, couldn't you?

A. Yeah. There's convention to financial analysis.

Q. I guess most experts use probably two or three; is that true?

A. That's the convention that I'm familiar with.

Q. And I guess if you would have picked a different number of stages, it would have affected the results of your analysis, wouldn't it have?

A. Could have.

Q. And as far as the lengths of your three stages go, as I understand it, the length of your first stage is five years; is that right?

A. Based on five-year earnings per share projection growth rates. If you've got five years of projected growth rates, that's what I would expect for the next maybe five years. If I'm going to accept it, I wouldn't expect it for perpetuity.

Q. Okay. So is five years the first stage because that's the length of the growth projections that are out there for use?

A. It's a five-year projected growth rate, yes.

Q. And then my understanding is your second stage is from years six through ten; is that correct?

A. Yes.

Q. And the third stage is from year 11 to infinity, is that --

A. Basically infinity, just long enough to be able to make the discount of the dividend in year 200. However, you know, whatever -- any of us within a range 9 to 11, it's not going to result in a penny. It's not significant.

Q. And for the Stage 1 of the growth rate, which I think you just said you used that 6.02 percent five-year analyst growth projected number, right, for your growth component?

A. Yes.

Q. And then for Stage 3, which is the perpetual growth stage, my understanding is you used projected growth in electricity demand; is that correct?

A. That's a component.

Q. Okay. And the other component is an inflation estimate; is that correct?

A. That's correct.

Q. And the total, as I understand it, was 3.1 percent; is that correct?

A. That's correct.

Q. And what were the components, if you know, of that 3.1 percent? How much was projected electricity demand growth and how much was inflation?

A. I believe the EIA data, Energy Information Administration data projects long-term 2020 through, I believe it goes through 2030 of a compound growth rate of .93 percent for electric demand, and then the inflation factor was, I believe, right around 2.15, .16, somewhere around there. I rounded obviously 2.1 percent.

And that was based on just, first of all, I looked at the observations of -- or the predictions of the Congressional Budget Office, and then I also, because we're doing market expectations, I decided it was important to look at the yield differential between 20-year Treasury inflation protected securities and the 20-year Treasury constant maturity, because one obviously does not provide the inflation protection. It's generally recognized to be a fair gauge of the inflation expectations of investors over a longer period of time.

Q. Now, my understanding is that Staff has never -- had never used this type of electricity demand plus inflation for growth in a DCF analysis until the recent KCPL and GMO cases that we just talked about; is that correct?

A. For its direct recommendation, that's correct, yes.

Q. And again, you were the witness in those cases, right?

A. Yes, I was.

Q. And again, they were settled, didn't go to the Commission; is that correct?

A. Yeah. I believe the recommendation was 9.25 to 10.25 in those cases.

Q. Okay. So once again, would you agree with me that this is the first opportunity that the Staff has taken this recommendation to use electricity demand plus inflation as the growth component in its multistage DCF to the Commission for decision; is that correct?

A. I just like the way you phrase those, the opportunity. I don't think I'm the only one that -- that can make that decision. But yes, we currently have the opportunity to -- for them to be able to look at whether or not this is an analysis that is supported, logical, sound.

Q. And having a first opportunity, it's valuable to the Staff to find out what the Commission thinks of it, I guess; would that be fair to say?

A. Oh, of course.

Q. Okay. And probably valuable to the utilities, too.

And another -- based on your deposition, it's my understanding you don't know of any commission anywhere that has used electricity consumption growth as a growth parameter in a DCF analysis; is that correct?

A. As a direct input, I -- yeah. We talked about that during the deposition. I couldn't think of anybody that uses it as a direct input. I think it's discussed as far as the reasonableness of growth rates, but as far as a direct input, I don't recall.

Q. Okay. And was it your idea to use electricity demand as a direct input into your model in the KCPL and GMO?

A. Yeah. After experience with reviewing the way investors look at things, it seemed to be a reasonable assumption. It was pretty consistent with perpetual growth rates I've observed for investors.

Q. So is it yes, it was your idea?

A. I'm sorry. Yes.

Q. And you are not aware of any other cost of capital expert who uses this information as a direct input into the DCF model, are you?

A. No, but I haven't studied all the 50 jurisdictions.

Q. Sure. I understand. In my understanding, is it a logical extension of your idea is if there were no growth in electricity consumption, then the growth component of the DCF would just be the projected rate of inflation; is that correct?

A. Yes, I believe that's very possible.

Q. And that would be -- at least right now, that would be about close to 2 percent, right?

A. I think the inflation projections may be up to, based on the differential between the TIPS and the Treasury constant maturity, may be in the 2.35 to 2.5 range.

Q. What did you use for inflation?

A. At the time the indication was about 2.16.

Q. Okay. And my understanding is, Mr. Murray, in your analysis you gave no weight to the CAPM analysis; is that correct?

A. To my CAPM analysis, that's correct.

Q. And looking at the Staff Report on page -- you have the Staff Report?

A. Yes, I do.

Q. A section of it at least. On page 4, line 20 -- line 23, it talks about the reason you didn't use the CAPM was due to Staff's concerns about the current reliability of the CAPM using traditional inputs. Did I read that correctly?

A. Yes.

Q. And, Mr. Murray, I understand you looked at

some information to check the reliability of your results in this case; is that correct?
A. Yes, I did.
Q. And it seemed like you used some things that traditionally hadn't been used to confirm the results of a cost of capital analysis; is that fair to say?
A. In the context of a utility regulatory ratemaking setting, yes. It's capital market information.
Q. Okay. Fair enough. And one type of information that we've had some discussion about was equity analyst reports; is that correct?
A. Yes.
Q. And again, my understanding is the Staff has not used equity analyst reports in the way that you're using them in this case until the recent KCPL and GMO cases; is that correct?
A. There's been times when we've mentioned equity research reports in the past, but I don't recall if we delved specifically into the cost of equity that those equity analysts were using. I think it was -- became more of a focal point, you know, as far as the testing of a cost of equity estimate in the KCPL case but equity research reports, and I believe utility companies bring those up.
Q. Sure. But I'm talking about in the way

that you're using them here to confirm the results of the DCF analysis. Isn't the KCPL and GMO cases the first time they've been used in that way?

A. Yes. I'm starting to become aware that they provide some other supporting analysis.

Q. And was it your idea to start using them in that way?

A. Yes.

Q. And my understanding is you and Mr. Hill both looked at those reports in AmerenUE's offices; is that correct?

A. Yes.

Q. And isn't it true that to the extent those reports dealt with Ameren, it was at the Ameren Corporation level rather than AmerenUE level?

A. They addressed the Ameren equity value in total, but they also did a sum of the parts analysis, which provided PDE ratios applied to estimated earnings per share for the regulated utility subsidiaries.

Q. Okay. And would it be fair to say that those analyst reports provided the expectations of earnings of corporations that they looked at?

A. Please define expectations, because those are used interchangeably in finance too often.

Q. Well, did it provide the -- the earnings that the analyst who was doing the analysis expected from the companies that they were analyzing, expected to actually achieve in the future?

A. They provided earnings, earnings projections, yes, they did.

Q. As I understand it, some of those earnings projections were even lower than your recommended ROE in this case; is that correct?

A. No. The earnings projections, they didn't provide ROE estimates based on earnings projections.

Q. Okay. And my understanding is your review of these analyst reports have caused you to call into question the whole premise of whether the constant growth DCF is reliable; is that correct? I'm looking -- I got that out of your deposition on page 70 if you want to look.

A. I wouldn't say that the -- please refer me to the part of the deposition that you're on.

Q. Sure. Look on page 70, and it's really line 22, then you're talking about the analyst reports and it says, talking about some estimates of 9 or 8.9 percent or in that range calls into question the whole premise of whether or not that type of constant growth DCF analysis is reliable. That's what I was referring to. Do you agree with that? First of all, did you say that?

A. Yeah. No. I think you really need to start on line 13 to understand as far as how the constant growth is used. I indicated that as far as just simply taking an earning per share, five-year earnings per share projection and plugging it in and applying it to a dividend yield calls into question whether or not that's a reliable constant growth DCF, but in no way I implied that if you used a sustainable constant growth rate, that the constant growth DCF could not be reliable.

Q. Okay. You just think the way commissions have used the constant growth DCF has -- is being called into question?

A. Well, I don't know that commissions have all been implying that because whenever earnings per share was applied to dividend yield and DCF was in the low 9s, commissions weren't accepting it. So I don't agree that that's what the commissions have been doing.

Q. Mr. Murray, when you -- did you review the analyses underlying the analyst reports that you looked at?

A. Yes.

Q. And where did you find those analyses?

A. In the reports. I mean, there's -- there may not be all their work papers, just like in a rate case, you know, with the report, but I didn't just look at an earnings per share growth rate and accept it. I went ahead and looked at the research report.

Q. Okay. But there are -- you would agree that there are analyses underlying those reports that you did not have access to; isn't that true?

A. I'm sure there is, yes.

Q. And you did not look at those, right?

A. I don't know that they would let me.

Q. Do you know whether any of these analysts have sell recommendations on Ameren Corporation's stock?

A. Goldman Sachs I recall specifically do.

Q. Is it just a sell or is it sell with conviction? Do you know?

A. I knew it was a sell. I don't know if they -- sometimes they upgrade to sell with conviction or buy with conviction, and it can vary.

Q. Is sell with conviction worse than sell?

A. It means there's more pressure to sell. I don't know as far as definition of worse. Maybe for Ameren they might think that's worse.

Q. Mr. Murray, would you agree with me that AmerenUE competes for capital with other utilities throughout the country?

A. Yes.

Q. And my understanding is that you know that the average return on equity that's been awarded in the last year for integrated electric utilities is 10.59 percent, correct?

A. Yes.

Q. And you agreed with me in your deposition, and I hope you will agree with me now, that the fact that integrated electric utilities are earning an average of 10.59 percent is a relevant consideration?

A. I hope we didn't say earning. Did we say earning?

Q. I'm sorry. No. Have been awarded returns of 10.5 percent is a relevant consideration. I apologize.

A. I think if -- yes, if that's the way it was -- I remember saying allowed ROE.

Q. Let me ask the question again because I muddled it all up.

Would you agree with me that the fact that integrated electric utilities have been awarded returns of 10.59 percent over the past year is a relevant consideration?

A. I believe it's relevant.

Q. Okay. And I think you said if the Commission decides to set a return on equity that's more in line with what other utilities are getting, that's something that the Commission ought to have the right to do?

A. Yes.

Q. Would you agree with me?

A. Yes.

Q. And Mr. Murray, are you aware of any integrated electric utility that has gotten a return on equity of less than 10 percent years in either 2008 or 2009?

A. That's funny. I think it's in one of these Goldman Sachs reports that's subject of maybe a dispute, but I believe Energy -- Energies Integrated Electric Utility in Arkansas received a 9.9.

Q. Okay.

A. I don't think that was in the RRA data.

Q. Is that the only one you know about?

A. That's the only one I know about as far as integrated electric utility.

Q. Okay. And you're aware, are you not, that AmerenUE has been actually earning far below its authorized return on equity?

A. I'm aware that's what's reported by UE on their financial statements. Obviously that's why we're here for a rate case, to determine whether or not all those factors should be considered and what is considered to be the appropriate expenses and income and what have you.

Q. You anticipated my next question. Is the fact that AmerenUE has been earning far below its authorized return on equity a relevant consideration that the Commission ought to take into account when it rules in this case?

MR. MILLS: I object to the form of the question. It assumes facts not in evidence. The witness just said he doesn't necessarily agree that it's the case that AmerenUE has been substantially under-earning its authorized rate of return, and that second question that I objected to said, isn't the fact that AmerenUE has been substantially --

JUDGE WOODRUFF: I'll sustain the objection. If you'd rephrase the question.

MR. BYRNE: Fair enough.

BY MR. BYRNE:

Q. If you would assume for me that AmerenUE has been earning far below its authorized return on equity, would that be a consideration that the Commission ought to take into account?

A. Yes, and I think the evidence that everybody provides will allow them to do that.

Q. Okay. But would it be fair to say you did not take that into account? That didn't affect the quantification --

A. No.

Q. -- of your recommendation; is that true?

A. No. I don't agree with that. Cost of equity takes into consideration risk factors, and one of those risk factors is regulatory lag. And again, I'll point to one of these Goldman Sachs reports that discusses the fact that regulatory lag is not an Ameren specific issue. It's something that happens with utilities, maybe to a lesser extent, but maybe to a greater extent some other companies.

So to the extent that that's an issue throughout the country, and I'm not aware that you're the only one that's in a building cycle, then that's going to affect their cost of capital. So it is in the recommendation.

Q. I guess it's in the recommendation -- would it be fair to say it's in the recommendation to the extent that the proxy group that you use in calculating the multistage DCF has the same problem; is that fair to say?

A. Yes, and that's just -- that is one factor out of many, obviously. I think Mr. Nickloy indicated that your bonds were trading more like better than triple B in a comparable group that I use. That's triple B rated bond rating.

Q. Would you agree with me that investors would react negatively if Staff's proposal was adopted in this case?
A. If they strictly looked at the ROE and that's all they paid attention to, they may -- it will cause them to raise their eyebrows. Obviously there's revenue requirement differences. That's not the way analysts look at it. Analysts look at the cash flow, the recommended rate increase.
Q. Okay. So was that a yes, no or I don't know? Would investors react negatively -- how about yes, no or I don't know, would investors react negatively if your ROE was adopted?
A. Could you define investors, please?
Q. People who buy AmerenUE stock.
A. My answer is no.
Q. Okay. Would credit rating agencies react negatively if the Staff's recommendation regarding ROE was adopted, yes, no or I don't know if you can?
A. I think I said that I believe S&P has focused on specific factors within a case, so yes, maybe S&P would.
Q. Would Moody's react negatively if the Staff's recommendation was adopted?
A. I haven't read enough of their analysis to

give you an answer on that. I don't know.

Q.   Let me ask about a second source of information that you used to confirm your cost of equity analysis, the Missouri State Employees Retirement System; is that correct?

A.   Yes.

Q.   And how did you use the data from MOSERS to confirm your recommendation?

A.   I didn't use it to confirm it.

Q.   What did you use it for, then?

A.   I used it for a test of reasonableness.

Q.   Okay.

A.   It's capital -- it's investor expectations. That's what we're talking about here, and that's an institutional investor that invests billions of dollars, and it's important to understand the context of what investors expect for returns for the long term to understand what is reasonable.

Q.   Isn't that a somewhat unusual source of information for a cost of equity expert to use to test the reasonableness of his recommendation?

A.   Expected returns?

Q.   From a state employees pension fund, yes. Isn't that a somewhat unusual source?

A.   I think institutional investors' views is important.

Q. How many times have you ever seen a cost of equity expert use a state retirement fund as a source of information to test the reasonableness of his recommendation?

A. Specifically a state retirement fund, I'm not aware of anybody else who used a state retirement fund.

Q. I mean, is it possible that a state retirement fund might have different investment objectives than an electric utility? Is that possible?

A. Yes, that's possible.

Q. Did you look at the underlying analyses of the state retirement fund information that you used?

A. I looked at what they had available on their website.

Q. Are there analyses underlying even that information?

A. I believe we talked about this before. Summit Strategies is their consultant that provides them capital market expectations to develop their strategic asset allocation, and so I'm sure there's some proprietary information that they would not want to provide.

Q. So you didn't look at any of that underlying information?

A. I don't think I'd be allowed to, but no, I did not.

Q. Did you check what specific types of investments are in the MOSERS portfolio?

A. Yes.

Q. Were there bonds in the MOSERS portfolio?

A. Yes.

Q. A third type of information that you used to test the reasonableness of your analysis is what you called the rule of thumb; is that correct?

A. Yes.

Q. And can you explain what that is?

A. I actually have made a copy of this because there's some inference that I may have just made this up. I brought a copy down. This is something that I pulled from --

Q. Well, I guess the question was, can you just explain to me what it is?

A. I was going to use this to help me explain. It's just something that indicates that a way to kind of get a reality check as to whether or not you're in the ballpark on a cost of equity estimate is to add a 3 to 4 percent risk premium to the cost of debt of the company that's issuing that equity.

Q. And has the Staff ever used this rule of thumb before to test the reasonableness of its recommendation on a return of equity?

A. Yes.

Q. And has any other Staff witness besides you ever used the rule of thumb to test the reasonableness of a return on equity investment?

A. I don't know. I don't recall any, but I haven't looked through all the testimony.

Q. Did you use it in the KCPL and GMO cases?

A. I believe I've been using it ever since I discovered the information because I thought, hey, it's more information.

Q. Mr. Murray, in your deposition you were -- and you've said a little bit today, too, you believe you're constantly considered to be an outsider and in particular, well, out there. Do you recall that? It's on page 105 of your deposition.

A. I think I might have even said radical. I think that might be the specific term that I used.

Q. And you've referenced that a little bit today in your -- in your cross-examination. Why do you think people think you're a radical?

A. Because my cost of equity estimates are not based on what other people come up with in regulatory ratemaking arenas.

Q. Mr. Murray, you made some errors in your analysis; is that correct?

A. That's correct.

Q. Can you tell me what errors you made in your analysis?

A. I believe there was a -- and Dr. Morin pointed these out in his rebuttal testimony. There was -- in the constant growth DCF, which I didn't use, we just established that, there was an average function that -- that should have been corrected that had an extension of an A, which if you had something that was a non-- a non-numerical number, if it -- for instance, a lot of times when you're reviewing financial analysis material and data, you'll see an NMF, and it will say not meaningful. And if you put an A, that actually -- that actually converts that to a zero. So that inappropriately brought the average down. I corrected that in my rebuttal testimony.

The other issue that was pointed out -- let me just go to Dr. Morin's rebuttal. Okay. I'm sorry. I'm there. I thought it was there. I apologize. Okay. I believe I already addressed the first one.

The second item he indicated something about growth numbers not matching, and I guess there was a transfer error from one cell to the next, and I corrected that, Schedule 15 attached to my rebuttal testimony.

There's some discussion about standard deviation, whether or not you should use a standard deviation of the population or standard deviation of a sample. I think that all depends on the user of the data. If you feel like you've drawn the population -- say, for instance, I feel like I drew the population of what are the appropriate -- what's the appropriate proxy group, then I would use a standard deviation of population.

Now, if I thought that was a true sample, then you include -- if you don't include the P, then that takes a standard deviation of the sample, which standard deviation of the sample would end up being higher because it assumes that you -- that it takes -- M minus 1. I'm trying to remember the specific formula. I'm sorry. I can't remember.

But after it's all said and done, if I had used what he suggested, the standard deviations would have actually been higher for some of those figures in my constant growth DCF numbers, and actually that would have probably given me even more pause as to whether or not it's good to rely on these growth rates for trying to estimate a constant growth DCF. So, if anything, it would have caused me to even be more alarmed about the higher standard deviation.

Then as far as the IRR, that's just a guess number. It's an iterative calculation. I think I found out, to my surprise, that you can put a zero in there and it will still come up with the same internal rate of return calculation. So as far as my multistage DCF, which is what I relied on in this case, it had no impact.

Q. Any other errors on your -- on other analyses aside from the multistage DCF?

A. I think I explained, I mean, I went over everything that was in here.

Q. I asked you some questions about some of the things that you used to test the reasonableness of your recommendation, and here's a question about each one that I didn't ask you. Mr. Murray, for example, on your -- the rule of thumb that was being used, are you aware of any textbooks, publications or authoritative references on cost of capital estimation that advocate using the rule of thumb? Just the question you were waiting for me to ask. I withdraw the question.

A. I heard the comment -- I heard the comment in opening about maybe I just made it up. I want to give you proof that I didn't just make it up.

Q. And what are you looking at there?

A. Analysis of Equity Investment Valuations by John Stowe, Thomas Robinson, Gerald Pinto, Dennis McLeavy.

This is produced for CFA Program, and specifically published in August of 2002. The chapter is 2, discounted dividend valuation, which is the same thing that we use. And then on page 54 it indicates, in U.S. markets the typical risk premium added to corporate bonds is 3 to 4 percent based on experience.

Q. But that was not in the context of setting a cost of equity for a regulated public utility, was it?

A. It's a test of reasonableness, but no, I mean, this is not -- this is mainstream finance. This is not a regulatory, you know, finance book.

Q. It's not in -- you agree with me that that's not in the context of setting a cost of equity for a regulated electric utility; is that correct?

A. It's not been used to estimate the cost of equity as far as the final recommendation.

Q. Okay. Fair enough. How about the same question for using MOSERS, do you know of any textbook, publication or authoritative references that suggest that's an appropriate test of reasonableness in the context of setting a cost of equity for an electric utility?

A. I think for estimating the cost of equity for any company, you would -- it's important to understand what's going on with the rest of the capital markets. I mean, that's what we're all supposed to be doing. As far as any specific source about utilities, I don't -- I don't know of anything specific.

MR. BYRNE: Okay. Thank you, Mr. Murray. That's all the questions I have.

JUDGE WOODRUFF: All right. We'll come up for questions from the Bench, then. Commissioner.

QUESTIONS BY COMMISSIONER KENNEY:

Q. Mr. Murray, how are you?

A. Pretty good. How are you doing, Commissioner?

Q. I'm doing well, thank you. I don't have too many questions for you.

To what extent do you think that the ROE Staff is recommending will have an impact on Ameren's creditworthiness?

A. Ameren's creditworthiness, that's a --

Q. Or Union Electric.

A. Union Electric. Well, first of all, I do think it's important to once again note that the bond rating agencies approach it differently. S&P approaches it on a consolidated basis. So to the extent that UE currently has a triple B minus credit rating, that's been due to S&P's views of the negative impacts of what's gone on with the merchant generation Illinois issues and what have you.

That -- even though I've said that S&P would react negatively, I don't think it would affect their bond rating because they already have a bond rating from S&O that's less than if it were standalone, if S&P did it differently. I think that's why there is actually a split rating right now for UE. UE has a, I believe a -- their secured bond ratings are A minus with Moody's and Fitch. Now, their corporate credit rating may be a little lower, but that's not the same for S&P. It's lower than Moody's and Fitch.

Now, as far as the impact, we've looked -- actually, we used OPC witness Mr. Lawton's ratio credit metric analysis to determine what would happen if the 9.35 percent were included, and actually Steve -- Staff witness Steve Hill has that in his testimony. But I can tell you that that is well within the benchmark for anywhere from a triple B plus to an A minus.

So what will the rating agencies do? That's a hard one to -- that's a hard one to determine.

Q. Okay. Fair enough. Similar question. To what extent do you accept the argument that a lower ROE will lead to a higher cost of debt and, therefore, higher rates to the ratepayers?

A. I would say Florida Power & Light is a great example of this right now. They were -- this caught a lot of attention because Florida has historically been a quite utility friendly state and authorized ROEs of probably around 11 percent. Then when they authorized this ROE of 10 percent in January, you know, it's important to look at what's going on with the capital markets and bond yields, and when I looked up Florida Power & Light's bond yields, they're trading below 6 percent. I consider that to be a pretty nice yield.

So to the extent that the impact on the cost of debt, I mean, they had asked for a billion dollar rate increase and they got, what, it was less than 100 million. So if somebody asks for too much, I don't think the bond rating agencies are factoring in that higher amount.

Q. And then one last question. Why is the multistage DCF preferable over a constant DCF or vice versa? Why did Staff opt for one over the other?

A. I would say it's definitely preferable right now for the electric utility industry, and the reason why it is because you really don't have a lot of good information on what could be a constant growth rate going forward because of the disruption that occurred within the electric utility industry.

And also one of the reasons that Staff

initially really started to contemplate using this was because of the economic issues that occurred in late '08, early '09. What Staff found was still significantly, what I consider significantly high earnings per share forecasts, although we had our Missouri utilities saying in the near term we're probably going to have negative normalized growth. That was -- that's a rarity.

So it just did not make a lot of sense to use 6 to 7 percent earnings per share projected growth rates to add that to the dividend yield. If investors see that the economic growth rate's going to slow down, naturally at least I think a wise investor, and I think 60 percent of them are institutional investors in a lot of utilities, would notch down their growth rate expectations.

And also part of it has to do with the fact that, you know, Staff has become more knowledgeable with time about what is done as far as an investment community. I think Dr. Morin said earlier that, I don't know of anything that -- any information out there that you can use to project perpetual growth rates.

Well, I can tell you, investment analysts have to do it because they're valuing the stocks, and when I've looked at the investment analysts' information, they're using about 3 percent or less for their perpetual growth rate, and I used 3.1 percent. If they used 5 to 6 percent as Dr. Morin proposes that should be used, or for that matter I think Mr. Lawton or Mr. Gorman are up there, not so much Mr. Gorman, but the valuation levels of those stocks at the cost equity that they use, which is 9 percent, that's what they consider to be their required return, would be higher than what the intrinsic value shows on the reports. So if that were the case, then everything -- everything would be a buy.

Q. Do you view the long-term growth rates that Mr. Morin used are not reflective of reality?

A. That's not what's done in practice.

COMMISSIONER KENNEY: I don't have any other questions. Thank you.

JUDGE WOODRUFF: Commissioner Davis.

QUESTIONS BY COMMISSIONER DAVIS:

Q. Good afternoon, Mr. Murray.

A. Good afternoon.

Q. I don't have many questions for you. You were here for opening statements, weren't you?

A. I listened, yes.

Q. You listened.

COMMISSIONER DAVIS: I'm sorry, Eric, I can't think of your last name.

MR. DEARMONT: Dearmont.

COMMISSIONER DAVIS: I'm sorry.
BY COMMISSIONER DAVIS:
Q. You recall Mr. Dearmont was talking about consistency. Do you remember that?
A. Yes, I do.
Q. Okay. Are you a baseball fan?
A. Depends on how it's going.
Q. Do you ever watch the Cardinals in the last few seasons?
A. Yes, I have.
Q. Do you remember Chris Duncan?
A. Yes, I do.
Q. He got traded last year?
A. Yes.
Q. Okay. He was a lifetime 260 hitter. That was a fairly consistent average, wasn't it?
A. I don't know.
Q. You don't know. If his batting average ranged from 227 to 293 over a period of five years, the average would be 260, wouldn't it? Well, it could be the median. Let's just assume that he -- that he had a 260 average over five years. Can we assume that?
A. Sure.
Q. We could say, then, that he was consistently a 260 hitter, correct?

A. On average, yes.
Q. Okay. On average. That doesn't imply how good a hitter he is, just he's a 260 hitter, correct?
A. There's difference obviously with runners in scoring position. I've had that argument with my father.
Q. All right. Some people would argue that, you know, 260 doesn't get you in the starting lineup, it will get you traded. Is that a fair analysis?
A. I remember him having a lot of fielding problems, too, but --
Q. Okay. Then Mr. Dearmont went on to talk about some references to the CFA curriculum.
A. Yes.
Q. Do you recall those references? So to the best of your knowledge, is there anything in your testimony that's inconsistent with the CFA curriculum?
A. To the best of my knowledge, no.
Q. Okay. So the portion in the CFA curriculum where it says that you rely on the arithmetic mean for forecasting periods in the future and the geometric mean for averaging historical, is that not correct?
A. Actually, I spent quite a bit of time addressing this. If you turn to my surrebuttal testimony, because I was aware that this was a concern of yours, and

I definitely don't -- I would like for the Commission to have confidence that I'm at least telling you what I believe is true, I mean, you may not agree with me, but that's fine, but beginning on page --

Q. Page 20?

A. Page 16.

Q. Oh, page 16.

A. Starting on page 16, on line 18, I address Dr. Morin's discussion on the use of arithmetic versus geometric averages, and I have a specific Q and A that asks, is this consistent with Staff's understanding of principles taught in the CFA program? Answer yes.

Then I go on to explain that I think there was maybe some reason why some individuals may interpret that the CFA curriculum just completely advocates arithmetic, and I looked back at the quantitative text that I had used when I took the Level 1 of the program and read that entire chapter, and when I read that chapter, I did see that there were paragraphs in there that inferred that the arithmetic should be used for estimating the cost of capital.

But then I also on page 18, line 8 through line 20, explained a situation where they indicate that, as noted previously, the arithmetic mean is always greater than or equal to the geometric mean. If we want to estimate the average return over a one period horizon, we should use the arithmetic mean because the arithmetic mean is the average of one period returns. If we want to estimate the average returns over more than one period, however, we should use the geometric mean of returns because the geometric mean captures how total returns are linked over time.

And then I can -- I thought, okay, is there any way this could be interpreted as they're trying to say what's --

JUDGE WOODRUFF: For some reason every day at 4:10 we lose the stream, and they haven't figured out why yet.

MR. LOWERY: Your Honor, I think I might know why. I was watching the screen, and I think they're scheduling your conference for a certain number of minutes and it's not scheduled long enough. You might ask the technical folks about that.

JUDGE WOODRUFF: They told me that wasn't the case, but I'll -- okay. We're back. You can continue.

THE WITNESS: Okay. And I was really concerned about whether or not I was misinterpreting this, so I looked back at several of the citations I provided in previous testimony and from other textbooks that are used in the CFA curriculum, and -- and I don't think that those citations could be any more clear. For instance, it says, in investment analysis of portfolio management, geometric mean is appropriate for long-run asset class comparisons; whereas, arithmetic mean is what you would use to estimate premium for a given year. And then --

BY COMMISSIONER DAVIS:

Q. Can I stop you there for a minute? I think that is an excellent point. If we are depreciating out assets over a long-run period, then we should use the geometric mean, correct?

A. I'm not an expert on depreciation. I'm talking about cost of capital analysis.

Q. Okay. But this is long -- long-run asset class comparisons?

A. For investment performance. For equity risk premiums. I mean, this textbook has nothing to do with depreciation.

Q. That's right. It says stock market. Okay. But in theory, would you agree with me that the geometric mean is more relied upon for historical purposes?

A. No. No, I would not. That's why I provided all these citations.

Q. Okay. That's why you've got all these citations.

A. The citations, and actually I went through the trouble of e-mailing an individual that is teaching the current Level 3 course and just frankly asked him, you know, is there a conflict in the CFA curriculum about use of arithmetic and geometric means?

And his response was, I don't see a discrepancy in the curriculum because it's saying to use the arithmetic mean to project one period into the future but use the geometric mean if you're projecting multiple periods or years into the future, which is reasonable since if you use the arithmetic mean you would be introducing an upward bias, which the geometric mean corrects for this.

Q. Okay. Are we projecting for multiple periods into the future?

A. I believe we are, yes.

Q. Aren't we setting a rate of return based on a historical test year?

A. I am recommending a required return based on investors' expectations over longer holding periods.

Q. Okay. And I understand that that's what you're -- you're recommending that it be based on a long-term holding period, but are you -- you're familiar with some of the other testimony in this case?

A. Yes.

Q. So you know that AmerenUE will be filing -- from the other testimony in this case, is likely to file another rate case towards the end of this year?

A. Yes, but I don't think that affects the investors' holding period.

Q. Well, if we're setting a rate of return, are we setting it for a period or for a longer period?

A. For the investors' holding period, that's what I'm trying to estimate. If AmerenUE files rate cases, you know, twice a year, I'm going to focus on what I think investors are doing.

Q. Okay. And so investors are doing -- I guess it's your testimony that MOSERS is seeking to earn, is it earn 8 and a half percent or that's what they expect the returns for large cap stocks to be?

A. That's the -- that's what they believe the market return will be. That's basically the systematic risk. They expect the capital market expectations for large company stocks in the U.S., the domestic equity market, to be 8.5 percent for the next ten years, and so that is an expected return.

That doesn't mean that -- obviously we were -- we hope MOSERS is attempting to achieve returns above the systematic return based on what it believes it should be -- I mean, I guess there's been some controversy about what type of value they should be adding. But that's -- that is the systematic risk. It's a market return, and that's what we use when we estimate cost of capital is market -- that's what we're doing with market risk premium. It's a -- it's basically just like investing in an index --

Q. Right.

A. -- mutual fund.

Q. Is Ameren a large cap?

A. I believe they are.

Q. What's your definition of large cap?

A. I think the financial crisis kind of changed that up a bit. There used to be some belief, and I think it depends on who the capital asset -- who's doing the investing, but I think at one time maybe 1 billion was considered -- anything below 1 billion might have been small cap. 1 to 2.5 might be mid cap. It varies based on -- I don't think there's a universal agreement as to -- as to what that would be. And it can't be constant because the market changes.

Q. Mr. Murray, you've been a great witness, and I do want to say that, you know, you've made it through two levels and hopefully you'll make it through the third level of the CFA exam. That's more than I'll ever get to. Congratulations because that is -- that's some work. Thank you.

A. Thank you.

JUDGE WOODRUFF: Back for recross based on questions from the Bench, beginning with Public Counsel.

MR. MILLS: I think just one or two.

RECROSS-EXAMINATION BY MR. MILLS:

Q. You were asked some questions from Commissioner Kenney about credit rating agencies and expected returns. Do you recall that?

A. Yes.

Q. Do you know what ROE credit rating agencies expect to be established in this case?

A. No.

Q. If we did know, assume that somehow we had a crystal ball and we knew what they expected, would it be fair to say that they would react negatively if the award was lower than what they expect?

A. Yes.

Q. And positively if it was higher?

A. Yes.

Q. So you can't really just say for any given number that it's going to be positive or negative, right?

A. Yes.

Q. The higher it is, the more positive they'll be, and the lower it is, the more negative they'll be, correct?

A. Yes.

MR. MILLS: That's all I have. Thank you.

JUDGE WOODRUFF: For MIEC?

MS. ILES: No questions.

JUDGE WOODRUFF: For Ameren?

MR. BYRNE: Just a couple.

RECROSS-EXAMINATION BY MR. BYRNE:

Q. Mr. Murray, would you agree that the CAPM is a single period model?

A. Yes.

Q. You were asked some questions about the Florida Power & Light decision recently. Do you recall those questions?

A. I think I actually brought it up, but yes, we discussed it.

Q. Maybe you brought it up. Are you aware that Florida Power & Light was downgraded by Standard & Poor's recently?

A. I'm aware that there might have been some negative action. I can't remember if it was a downgrade for sure or not.

Q. Are you aware that Florida Power & Light's stock has declined substantially since the decision from the commission?

A. Actually, yeah, I believe I looked up Florida Power & Light and UIL. I can't remember how it tracked the rest of the market, but there was some decline, yes.

Q. Are you aware that Florida Power & Light has sharply reduced its capital budget in the wake of the commission's decision in that case?

MR. MILLS: Judge, I'm going to object to the form of the question. Again, we have the attorney testifying. If he wants to ask a question, are you aware of what happened, but you can't ask a question as an attorney saying, here are some facts, do you know these.

MR. BYRNE: I can ask him if he knows that those are facts.

MR. MILLS: But not in such a leading way so that you're introducing the facts in the question.

JUDGE WOODRUFF: This is recross. Your objection is more to facts not in evidence, I guess.

MR. MILLS: Yes, exactly. He's rattling off some facts that he knows to see if the witness happens to know them.

MR. BYRNE: Let me withdraw the question and try again, your Honor. I will recognize some merit to what Mr. Mills is saying.

BY MR. BYRNE:

Q. Are you aware of what Florida Power & Light has done to its capital budget since the decision that you were discussing?

A. I believe there was some discussion about possibilities of reducing it. I don't know what the final action was.

Q. Do you think that's important?

A. Depends on if the projects are needed or not or if it's -- I mean, it's tough economic times. I can understand that there's reasons, there's economic reasons to postpone investment.

Q. Would you have any problem with AmerenUE slashing its capital budget?

A. Like I said, it depends on -- I don't know what your most efficient use of capital is. I mean, if it were projects that were considered crucial to the reliability of your system, I guess you would have to do that.

Q. Sure. What about projects not crucial to the reliability of the system?

A. I would think that would become a policy issue.

MR. BYRNE: Okay. Thank you. No other questions.

JUDGE WOODRUFF: Redirect.

REDIRECT EXAMINATION BY MR. DEARMONT:

Q. I' have just a few questions based on those asked previously by Mr. Byrne. Mr. Murray, you may have answered this in response to a question posed by Commissioner Kenney, but why have you elected to use constant growth -- the constant growth DCF for gas utilities but not for electric utilities?

A. Because when I looked at the historical growth rates, which included dividends per share, earnings per share, book value per share, which that's definitely relevant because they -- they all effect each other, and looked at the earnings per share projections, they were all fairly consistent, and we didn't have the same issue that we have in the electric utility industry where we have the market restructuring and what have you that's caused historical growth rates that are all over the board.

And I believe when you have almost a -- at least ten years of historical data and five years of projected data, that can provide you with some confidence. That's why I say cost equity can be a little easier if you have solid data.

Q. Is 6 percent a reasonable long-term growth rate for use in a single-stage DCF today?

A. No.

Q. Why did you select to use electric demand plus inflation as a proxy for long-term utility growth?

A. It's consistent with the fundamentals of the industry. I -- I've become more aware of how investment analysts look at the long-term sustainable growth rates that they were using in estimating the value they're willing to pay for stock, and they use perpetual growth rates similar to what I use.

Now, I can't tell you if they use the demand in electricity plus the inflation factor, but it just actually makes sense. It's just come from experience of looking at correlations between the rate base growth, consumption growth and actually earnings per share growth. That's -- I remember seeing lots of information about that.

Q. Do you believe that investors use electric demand growth to gauge expected growth in the electric industry?

A. Of course.

Q. Did you use equity analyst reports to estimate the cost of equity or to confirm the reasonableness of your estimation?

A. To confirm the reasonableness.

Q. In your opinion, why does Goldman Sachs have a sell or sell with conviction recommendation for

Ameren stock?

A. My opinion is the reason why Ameren has a market to book ratio below right now of .8 is because of the strain that is -- that Ameren is currently under due to its non-regulated generation operations, which they have quite a bit of coal in these merchant generation operations.

There's all sorts of concerns about whether or not some of these plants would have to be mothballed, we're going to have to close them down, or if they don't close them down, they will have to make expenditures with these plants. And, yes, there's risk to that, and there's definitely risk when that's under a non-regulated type of structure.

And then I also saw some information that showed projected earnings per share for the UE subsidiary that implies that at least Goldman Sachs estimates the market to book above 1 for the regulated utility operations of Ameren, for at least UE.

Q. Do you believe that investors view allowed ROE awards in isolation?

A. No.

Q. Cash flow is king?

A. Oh, obviously cash flow is what they're focused on.

MR. DEARMONT: No further questions.

JUDGE WOODRUFF: All right. Thank you, Mr. Murray. You may step down.

The next witness is Mr. Hill, and it's 4:30. Does anyone expect real extensive cross-examination of Mr. Hill or should we go ahead and get him started?

MR. MILLS: Judge, I don't have a lot of cross for Mr. Hill.

JUDGE WOODRUFF: Let's go ahead and start. Mr. Hill, if you'll go ahead and take the stand. Good afternoon, Mr. Hill. Please raise your right hand.

(Witness sworn.)

JUDGE WOODRUFF: You've also heard my statements about not elaborating on questions unless you're asked to do so and give us short answers and we'll be done sooner.

THE WITNESS: I'll do my very best.

JUDGE WOODRUFF: Thank you. You may inquire.

STEPHEN G. HILL testified as follows:

DIRECT EXAMINATION BY MR. DEARMONT:

Q. Good afternoon. Would you please state your name for the record.

A. My name is Stephen G Hill.

Q. And by whom are you employed, Mr. Hill, and in what capacity?

A. I'm self-employed as a cost of capital expert by Hill Associates.

Q. Did you prepare and cause to be filed any testimony in this matter?

A. Yes, I did.

Q. Specifically can you tell us what testimony?

A. I filed rebuttal testimony, which consists of 46 pages and one appendix and one schedule. I also filed surrebuttal testimony consisting of 24 pages and one appendix.

Q. Do you have any corrections to your rebuttal testimony that have not been addressed in subsequent filings?

A. Yes. I have a couple typographical changes. One is just errors on my part, and some others relate to the change in the company's capital structure.

On my direct -- I'm sorry. My rebuttal testimony, page 4, this is on line 15 of page 4, I've got parentheses in the wrong place. Right now the parentheses after the 9 percent number. That should be struck, and the parentheses should be moved to after the word equity, so that the phrase "i.e., the cost of common equity" is inside the parentheses.

The next group of changes are on page 6, and this has to do with the part of my testimony where I calculate the dollar amount of profit that would be allowed AmerenUE as a result of Staff's case, and there's probably half a dozen changes on this page. Beginning on -- and is, once again, due to the change in the common equity ratio of AmerenUE.

So beginning on line 8, that 47.39 is now 51.13 percent. And at the end of the line, I would insert the word updated, based on the updated capital structure requested by Ameren.

Line 10, the 267 million is now 288.75 million. Line 11, once again, 47.39 percent equity ratio is now 51.13. And again, the 267 million is 288.75 million.

Continuing with those same kind of changes, line 18, 267.63 is 288.75. Line 19, if you add tax in, that means ratepayers will be paying not $433.9 million a year, but $468.75 million a year with the Staff's 9.35 percent recommendation.

Line 20, once again, 267.63 must be changed to 288.75. And the final change, on 21, 433.9 million is now 468.75 million.

One other change I believe in this testimony is page 11, and for some strange reason on line

2 the word both in all caps. It should not be. It should be lower case.

And then I have one change in my surrebuttal testimony. Again, it's related to the change in the capital structure of AmerenUE. It's page 22, same sort of change we made before. It's in the footnote, 267.63 profit, annual profit is now, because of the increase in equity ratio, is now $288.75 million.

Those are the changes I have.

Q. Mr. Hill, is the testimony that you have filed, subject to those corrections, true and accurate to the best of your knowledge and belief?

A. Yes, it is.

Q. If you were asked the same questions today as was contained in that testimony, would your answers be the same?

A. Yes, they would.

MR. DEARMONT: At this time I would move for admission of premarked Exhibits 212 and 213, representing the rebuttal testimony and surrebuttal testimony of Staff witness Steve Hill.

JUDGE WOODRUFF: 212 and 213 have been offered. Any objections to their receipt?

(No response.)

JUDGE WOODRUFF: They will be received.

(EXHIBIT NOS. 212 AND 213 WERE RECEIVED INTO EVIDENCE.)

MR. DEARMONT: I tender the witness for cross.

JUDGE WOODRUFF: Thank you. Beginning with Public Counsel.

MR. MILLS: I have no questions.

JUDGE WOODRUFF: MIEC?

MS. ILES: Just a couple.

CROSS-EXAMINATION BY MS. ILES:

Q. Mr. Hill, I want to direct your attention to pages 22 and 23 of your rebuttal testimony, and there you talk about what you term problems in Dr. Morin's sample group selection process?

A. Yes.

Q. Now, when you talk about sample groups there, is that the same thing as we referred to earlier as proxy groups for the DCF analysis?

A. Yes.

Q. And did you examine Dr. Morin's DCF analysis?

A. Yes, I did.

Q. And he used four proxy groups, didn't he?

A. Four? I thought he used two proxy groups. He may have done two different kinds of analysis, one with one kind of growth rate and one with another kind of growth rate in order to get four results, but I believe he only used two proxy groups.

Q. You're correct. I stand corrected. It's four combinations, two groups?

A. He presented four DCF analyses, which is two different growth rates with each of his two groups.

Q. Now, when he made those recommendations in his analyses in his direct testimony, did he rely on the median of his DCF results in making his recommendations?

A. I can't recall.

Q. Could I show you his testimony?

A. I have a copy of it.

Q. You have a copy of it?

A. Yeah.

Q. We're in his direct testimony.

A. Do you want to direct me to a page?

Q. Yes. Pages 49 through 51.

A. He says at page 50, line 21, the median estimate is 11.9. I think the answer to your question is yes.

Q. Okay. Did you also look at his rebuttal testimony and his revised numbers?

A. Yes, I did.

Q. Do you know whether he relied on the median of his DCF analysis in his rebuttal testimony, of the proxy results again? When I refer to a median, I'm talking about the proxy group results.

A. I understand.

Q. Let me ask you this: Is it possible to tell from his rebuttal testimony whether he used the medians?

A. You mean in reporting his DCF results or in the overall assessment of --

Q. No. In reporting his DCF.

A. It's not possible to tell.

Q. Why is that?

A. Because we don't have the data. I mean, he doesn't supply his analyses in his testimony to show what his calculations were.

MS. ILES: All right. Thank you.

JUDGE WOODRUFF: All right. For Ameren, then.

CROSS-EXAMINATION BY MR. LOWERY:

Q. Good afternoon, Mr. Hill.

A. Good afternoon.

Q. Mr. Hill, am I correct that risk and return are directly related?

A. You are.

Q. And, therefore, the higher the risk, the higher the required return; is that right?

A. That's the fundamental paradigm of finance.

Q. And there are more risks for a company that owns generation than one that just owns wires, correct?

A. Somewhat. Integrated utilities are slightly less risky than T&D utilities. Because of their integrated nature, they are riskier, however.

Q. And these days you have to say that a regulated electric utility with more coal-fired plants than average is perhaps more risky than the average regulated electric utility, wouldn't you?

A. You'd have to say perhaps, and the risk really is not so much the fact that there's going to be coal legislation. I think that's pretty sure. The risk is whether or not they'll get to recover those costs.

Q. So the answer to my question was yes?

A. I don't think that was the answer to your question. You gave me a --

MR. LOWERY: Your Honor, I'd ask you to ask the witness to answer my questions, and if his counsel wants to redirect him, he can.

JUDGE WOODRUFF: I will so direct you. Keep that in mind.

THE WITNESS: Can I have the question again, please.

BY MR. LOWERY:

Q. That's fine. I think you answered it adequately.

As a general rule, if you have a gas local distribution company, a pipes-only gas company as I think you've referred to it, then it's probably true that such an LDC is lower risk than an integrated electric utility; is that fair?

A. That can be the case. I'm a little hesitant to say probably, but it certainly can be the case.

Q. Do you have your deposition that was taken with you, Mr. Hill?

A. I do not.

MR. LOWERY: May I approach the witness, your Honor?

JUDGE WOODRUFF: You certainly may.

BY MR. LOWERY:

Q. Mr. Hill, I'm handing you a copy of the transcript of your deposition taken a couple of weeks ago. Do you recognize -- you were deposed a couple of weeks ago, correct?

A. Yes.

Q. Would you turn to page 54 of your deposition, please.

A. I'm there.
Q. I'm going to direct your attention to line -- page 55 I should say, to line 8 on page 55. I'm going to ask you if you were asked the following questions and if you gave the following answers.
Question: Does it help lower it for gas if there's a straight fixed variable rate design?
Pardon me. I did mean page 54. Let me ask you -- direct your attention to line 20, the sentence that starts on line 20?
A. Of 54?
Q. Yes. My apologies. Page 54, the question, the sentence that starts "would you" on line 20.
A. I have that.
Q. Were you asked this question: Would you agree with me that gas distribution utilities have a lower risk than integrated electric utilities?
Answer: I think as a general rule, if it's just pipes companies, I think that's probably true.
Did I read that accurately?
A. You read it correctly.
Q. And if you have an LDC that has a straight fixed variable rate design, their risk is lower because they're able to recover more of their fixed costs that way; is that correct?

A. That would be correct.
Q. The reason that's correct is you're moving a variable cost to a fixed category, right?
A. The company's more likely to recover its cost if they're made to be fixed and recovered through regulation, yes.
Q. You can't argue against the proposition that shareholders of utilities that face greater regulatory lag are exposed to more risk than shareholders of utilities that face lower or less regulatory lag, can you?
A. It's a matter of degree, how much regulatory lag.
Q. Mr. Hill, can you argue against the proposition or not?
A. Yes, you can.
Q. Can you turn to page 24 of your deposition?
MR. LOWERY: Bear with me just a second, your Honor.
BY MR. LOWERY:
Q. Well, I can't find the reference right now, so we'll just move on.
A. It was page 24. I don't really want to help you out, but it is on page 24.
Q. Well, that's appreciated. Let me just ask

you the question again. Can you argue against the proposition that shareholders of utilities that face greater regulatory lag are exposed to more risk than shareholders of utilities that face lower or less regulatory lag?

A. Yes.

Q. Can you argue against that or not?

A. Yes, you can.

Q. You think you can?

A. For the reasons stated on page 24 in the second paragraph.

Q. Let me ask you if you were asked the following question and if you gave the following answer: How about regulated electric utilities that face greater regulatory lag, does that create a bigger financial risk for them than regulated electric utilities that face lower regulatory lag?

Answer: Well, I don't think that -- that you could argue against that, against what you said.

Did I read that accurately?

A. That's the first part of the answer and you read it correct.

Q. And that's the only part of the answer I asked you about, isn't it?

A. Yes, it is.

Q. All right. You endorse Staff witness Murray's 9.35 percent ROE recommendation in this case, correct?
A. I said that I thought it was reasonable, even conservative.
Q. So you don't endorse it, you just think it's reasonable?
A. Well, I don't know what quite the difference is. What do you mean by endorse?
Q. Did you take endorse and reasonable to be something different?
A. No.
Q. So if I define endorse as reasonable, then you'd agree with my question; is that correct?
A. Yes.
Q. In a recent Washington state case you were involved in that involved Puget Sound Energy, am I correct that you eliminated a number of companies from your sample group of companies? For example, you eliminated Progress Energy because its bond rating was too high?
A. That's correct.
Q. Is the reason that you did that because you were trying to develop a proxy group with risk that's comparable to the risk of the utility for which you were estimating the cost of capital in that case?

A. Yes.

Q. So for Puget Sound, when you looked at the companies you could use in your proxy group, you tended to eliminate those that had a notch or two higher bond rating than Puget Sound Energy; is that fair?

A. Yes.

Q. You're not aware of any commission around the country that has recently adopted a return on equity below 9.35 percent for an integrated electric utility, are you?

A. No, I'm not.

Q. You're not aware of any that's adopted a 9.35 percent for an integrated electric utility recently either, are you?

A. Not for an integrated electric utility, no.

Q. You believe that the DCF is the most commonly used method across the country; is that right?

A. That's right.

Q. In fact, you tend to rely on the DCF and have always relied on it more heavily than the other ROE estimation methods; is that right?

A. Not entirely.

Q. I'm going to ask you the question again. Do you tend to rely on the DCF analysis -- first of all, do you tend to rely on it?

A. Yes, I do.

Q. And have you always relied on it more heavily than other ROE estimation methods?

A. No.

Q. Would you turn to page 66 of your deposition. Starting on line 2, okay. Ask you if this is -- I'm reading the question and answer correctly.

Question: Okay. And again, looking back at your past deposition, I can show you where you said this, but at that point you said you thought the DCF was the most accurate model.

Answer: I tend to rely on it and have always -- and always have more heavily.

Then you go on to say you've used other methodologies. Did I read that accurately?

A. Yes, you did.

Q. You agree that projected growth rates are influential, aren't they?

A. Yes.

Q. The growth rate in the DCF, the growth rate that is used is the most important component, it's basically everything in the DCF; is that right?

A. No. It's the most important component. It's not everything.

Q. Mr. Hill, I just handed you a copy of the transcript from when you testified before this Commission in the last rate case. You did testify before the Commission in the company's last rate case; is that correct?

A. That's correct.

Q. Ask you to turn to page 500 of that transcript.

A. I have it.

Q. Starting on line 21, I want you to confirm if I'm reading this correctly.

Question: And my understanding is the growth rate, the growth rate you put into that formula is a pretty important component, is it not?

Answer: It's everything in the DCF.

Did I read that correctly?

A. You did read that correctly.

Q. In fact, a ten basis point change up or down in the growth rate used in the DCF model will move the DCF results up or down by ten basis points; isn't that right?

A. If you're doing a standard one, standard DCF, that's right.

Q. Standard meaning constant growth, is that what you mean?

A. Constant growth.

Q. Fair enough. Am I correct that the market to book analysis is just an algebraic rearrangement of the DCF?
A. You are correct.
Q. Is it important that recent data be used to determine the risk-free rate used in the CAPM model when you're using that model to estimate cost of equity?
A. Can you repeat the question?
Q. Is it important that recent data be used to determine the risk-free rate used in the CAPM model?
A. Yes.
Q. Now, you may not know whether it does so, but could reducing the return on equity allowed for a utility from what the ROE allowed now is, reducing it below that, could that diminish the utility's financial incentive to make discretionary investments in its system?
A. I don't know. I don't think I can answer that without more information. It's possible.
Q. It could, right?
A. It could.
Q. Mr. Hill, Hill & Associates, is that a proprietorship? Is it a corporation?
A. Hill Associates, there's no "and" in there, is a single -- is a sole proprietorship.
Q. You started that in the early '80s after

you began to meet people around the country that had a need for a cost of capital witness because, I think to use your description of how the business started, there are not too many folks that do it on the consumer side, right?

A. Except for the dates, I think that's a correct statement. It was the late '80s.

Q. It was the late '80s, wasn't it?

A. That's right.

Q. And when you said -- when you say do it, you mean not too many folks that provide cost of capital testimony for consumers in rate cases, right?

A. There are only a few witnesses that testify on cost of capital, period. That's true for both sides, I think.

Q. And you started your business part-time while working for the Consumer Advocate Division of the West Virginia Public Service Commission; is that right?

A. That's right.

Q. You operate your consulting business out of your home; is that right?

A. That's right.

Q. And right now, I don't think -- you don't have any employees at this time; is that correct?

A. That's correct.

MR. LOWERY: Your Honor, I need to mark an exhibit. It will be 173.

(EXHIBIT NO. 173 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. LOWERY:

Q. Mr. Hill, you've been handed what's been marked for identification Exhibit 173. You recognize that document, do you not?

A. Yes.

Q. Can you identify it for the record, please?

A. It's a list of my testimony since the year 2000.

Q. It doesn't cover the -- and I know -- I know you may not know the exact number. It doesn't cover the roughly 250 cases you've testified in, but it does cover all of them from 2000, right?

A. That's right.

Q. Am I correct that you've represented a utility one time, and that was Trigen here in Missouri a few years ago?

A. That's correct.

MR. LOWERY: Your Honor, I'd move for the admission of Exhibit 173, and I don't have any further questions.

JUDGE WOODRUFF: 173 has been offered. Any objections to its receipt?

(No response.)

JUDGE WOODRUFF: Hearing none, it will be received.

(EXHIBIT NO. 173 WAS RECEIVED INTO EVIDENCE.)

JUDGE WOODRUFF: We'll come up for questions from the Bench. Commissioner Davis.

QUESTIONS BY COMMISSIONER DAVIS:

Q. Good afternoon, Mr. Hill.

A. Commissioner.

Q. Going back to your surrebuttal testimony, page 14, you reference FERC and the, what I would refer to as the standard or constant growth DCF model; is that correct?

A. Yes.

Q. You haven't testified in a FERC case for a while, correct?

A. Not for a while.

Q. For a while. Are you aware, has the Federal Energy Regulatory Commission awarded a pipeline or any other entity that it regulates and sets ROE for that I might not be aware of an ROE of less than 10, to your knowledge?

A. Not to my knowledge, but I haven't followed FERC allowed returns in a while.

Q. In terms of the FERC allowed returns that you have followed, do you ever recall them going below 10?

A. No, sir. When I was involved in the FERC generic ROE proceedings in the '80s and '90s, the cost of capital was well above 10 percent. It was about 11 and a half percent, something in that range. So their numbers wouldn't have been that low at that time.

Q. And are you looking -- do you do anything with transmission companies at all?

A. I haven't testified on a FERC transmission case. I'm familiar with what they're doing with transmission, though.

Q. Right. And you're aware that they're giving out adders or FERC candy to incent transmission?

A. I'm aware of that.

Q. And that's on top of ROEs that can be 11 or more?

A. That's right.

Q. You spend a lot of time in your, I believe it's your surrebuttal testimony, talking about the appropriateness of the geometric mean, too, correct?

A. No. Actually, my appendix in my surrebuttal testimony shows that there's support for both the arithmetic and geometric mean.

Q. Here's a -- here's a mental impression that

I have, and you're probably going to disagree with me, but I want you to tell me where I -- where I'm going wrong here. And that is, my impression is that if you are using the geometric mean, then wouldn't that also imply some sort of quarterly or semiannual dividend incorporation?

A. I don't believe so. First of all, you're talking about two different methods, one CAPM, one DCF. But I think what you're getting at is wouldn't the compounding aspect of the geometric mean be similar to a dividend compound? That's the gist of your question.

Q. Yes.

A. Well, first let me say that it's not really arguable, just like Mr. Gorman said, that an investor can take a periodic cash flow and invest it if he wants to and make a higher return through that methodology. I mean, that's -- compound returns and compound interest have been with us in society for thousands of years. So that's a fact.

The question is, with regard to allowing a compound return in the DCF analysis, whether you should compound the dividend. The question is, is that -- is that fair for investors and ratepayers? And I believe the answer to that question is no. There's no -- I have no argument, I think we're on the same page when it comes to is it a fundamental -- the time value of money fundamental in finance? Yes, it is. Are you able to reinvest periodic cash flows? You certainly are.

The question is, what's the proper regulatory response? And I don't believe the proper regulatory response is to have a DCF based on quarterly compounding. I have a numerical example in my testimony that shows that, if you do that, the company will overearn.

It's akin to the logic that Mr. Gorman used, but it's a different analysis. It looks at specifically, if you have a DCF model with certain assumptions, if you com-- if you allow a compounded return, in other words a DCF with a compounded quarterly dividend, the company will overearn the expected return, and what you will wind up with is a growth rate that's higher than the basis for your expectation.

So -- and FERC, we were talking about FERC a minute ago when you referred to my testimony, they looked at this issue in great detail, and their analysis was even different. Their analysis was, okay, we'll buy the company's argument and we'll look at how investors can earn more money, but we feel we also have to look at how the utility can earn more money by taking its monthly payments from investors and then reinvesting those monies to earn a higher return.

So they felt through a really complex algebraic analysis that the ability of the investor to earn an extra return was counterbalanced by the ability of the utility to earn an extra return for its reinvesting ability. So that worked out to that one plus one-half G that they use in the generic ROE. So that was their analysis.

Q. Okay. I'm a little -- I'm still a little murky on -- you know, I heard Mr. Murray when I was asking him questions, and he's like he's concerned with investor returns. That was my impression of his comments. You heard his testimony. So he is concerned with the returns that investors expect. Is that fair?

A. That's the definition of cost of capital.

Q. Okay. And investors -- if you're an investor in AmerenUE, you expect a quarterly dividend, do you not?

A. That's the norm, and that's what investors expect.

Q. And tell me again why it is inappropriate to rely on the quarterly DCF model.

A. Well --

Q. I've read your -- I've read your testimony.

A. All right. I'm not going to go through the mathematics of it.

Q. No. Because you would agree with me that there -- I mean, you've cited examples that say the quarterly DCF over-earns. Well, I'm sorry. Just go ahead.

A. Once again, I don't disagree with you that investors are able to take that quarterly dividend and reinvest it in whatever and make more money. They may go out and buy a six-pack, but effectively they're getting their required return. It's the same thing. It's enjoyment. It's not money, but you get the same return.

But what my concern comes down, is do you require ratepayers to pay them that return when they can get it themselves by reinvesting? FERC said no, that would be recovering -- that they would get the return twice, once when ratepayers provide it in rates and another time when they reinvest the money themselves. That's kind of the crux of what Mr. Gorman was saying, I believe.

Q. Now, it's not your position that Mr. Murray is applying the DCF model in the same way that FERC staff applies it, is it, I mean, in terms of the assumptions they make and the variables that they plug into the -- to the same formula?

A. No. The most recent multistage DCF that I've seen by FERC staff was a pretty I would call standard method where they used -- I don't know what they used, earnings growth rates or dividend growth rates for the first stage, but generally the long-term stage is GDP growth, expected GDP growth. And I have problems with that because I believe that seriously overstates what's likely to be the long-term growth for utilities because it has in the past. But I think that's FERC's standard methodology.

Q. Right. So you would agree with me that their standard methodology as they -- they apply the variables to the same formulas, it's different than Mr. Murray applies them?

A. They choose different variables to apply to the same formula, and the main difference is Mr. Murray used electric utility consumption, electric consumption, and FERC uses GDP growth.

Q. Okay.

A. That's the main difference.

Q. Last question, and that is, Mr. Hill -- I apologize. I did not offer this opportunity to Mr. Murray. I should have. That is, is there anything else that you want to add that you haven't gotten a chance to say? And I'll even give you ten minutes because I didn't give Mr. Murray five, if you want to take it.

A. Well, I appreciate the opportunity,

Mr. Commissioner, to comment. I would say a couple things. I think that Ameren has hit the regulatory lag issue pretty hard here. Seems to be a flagship issue for them. And I would -- I would ask you to look at the most recent 10K, the AmerenUE portion of their most recent 10K. It's the last three years' income statements, balance sheets and cash flow statements. One second. I've got those here.

But my point is, is that we really haven't seen evidence that shows that the company's inability to earn its return is a regulatory problem. We would agree that with a historical test year, even one that allows a true-up to January of this year, there will be six months before they're able to start recovering those monies, and they won't be able to recover the investment they make in those six months -- for six months.

But it's also -- if you simply look at the income statements for Union Electric over the past three years, you'll see that one of the reasons that they're not earning their return is they're simply not selling as much electricity right now. Electric sales are down. Their expenses really are about the same over those three years, but the revenues are lower. They're just not selling as much electricity. The economy is down. People are conserving. They've had some issues with their industrial customers.

And so you're not going to make the revenues if you don't sell the electricity. That's not a regulatory problem. That's simply a market problem, you know. It's a monopoly, and no one in their service territory can buy electricity from anybody else. That doesn't mean that everybody has to buy electricity when they don't need it.

So that's a factor that's affecting net income, and you can't put it all on the shoulders of regulation. I think that's kind of the impression that's being sort of bandied about here.

The other thing I would mention is something that I actually found just the other day. Edison Electric Institute publishes on its website some information called Rate Case Summary. It's only about a six-page document. It's very interesting. It has all the RRA allowed return data.

One thing it has is an average regulatory lag calculation, and it shows the average regulatory lag from 1990 through the most recent quarter, and the average regulatory lag for 67 utilities that belong to EEI is between 9 and 11 months. 9 and 11 months. So that's just about what they've got here in Missouri.

So I would just like to, you know, put that in your mind a little bit, that the company's inability to earn its allowed return is not all due to bad regulation as Ameren would have you believe. I believe it's also due to the fact that this economy is in a recession and they're not selling as much power as they were. I mean, their rates were lower three years ago and their revenues were much higher. They were just selling more power.

And the other thing is that regulatory lag, in other words, the time between when rates go into effect and when the rate case is determined -- I mean the rate base is determined, it averages 9 to 11 months. I think that's important to know.

Q. Okay. And then -- I'm sorry. I had something that I was going to ask you. It's just escaping me at the present. That's all right. Mr. Hill, it's good to see you. Glad you're doing okay.

A. Thank you.

COMMISSIONER DAVIS: Thank you.

JUDGE WOODRUFF: Commissioner Kenney.

QUESTIONS BY COMMISSIONER KENNEY:

Q. Mr. Hill, I think you might have just answered my question. I was going to ask you what the argument is against greater regulatory lag leading necessarily to greater risk. Is there anything else other than what you just articulated that you'd like to add that might answer that question?

A. Well, I think you touched on it earlier, Commissioner, when you talked about isn't there some use to regulatory lag, and I think -- I think that there is a use for regulatory lag. And traditionally it's been said here in this hearing already that regulation is supposed to be a substitute for competition where competition doesn't exist.

Well, I don't know of any big company -- let's take Ford Motor, for example. They don't make a dime on a new product line until that first car rolls off and they sell it. They don't get to charge people any more money for the current cars that they're producing. They don't get any allowance for construction work in progress from any of their customers because there is competition to hold those prices down. So they have to build those plants without any kind of, quote/unquote, CWIP in rate base or anything like that.

So that's why regulation traditionally has followed that model. That began to change in the 1980s with huge nuclear construction programs. Companies were building plants that were ten times the size of their rate base. They needed help. They needed monetary help. That's where this whole idea of CWIP came from. Let's give them a return on the monies they're using for construction. That helped out the companies.

Now there's a move afoot to shorten regulatory lag, get more rate base that's automatically included. And certainly that helps finances for the utilities, but it lowers their risk, and it prevents that regulatory lag from acting as a regulator or governor, if you will, on the ability -- on the company's ability to spend. If everybody is guaranteed, then why should they worry about what they spend on anything? You know, why should they be prudent about their spending? If it's all covered by ratepayers, hey, we'll buy that, it'll be covered.

So I think without that, with some measure of regulatory lag, then the company has to be a little more cautious about its spending. I don't think that's a bad thing.

Q. One other question. There was the assertion that integrated utilities that are dependent upon coal are relatively riskier than those that are not. It sounded like your position is that the increased risk is not because of the uncertainty of legislation but because of whether, I guess, increased costs will be recoverable.

Are you referring to the cost of retrofitting or retiring the plants, or what costs are you referring to?

A. Well, I think -- I think the impression is that we've got these sort of onerous pollution compliance costs out there, and I don't think anybody would disagree with that. But the real risk doesn't lie in the fact in whether or not those are going to come down, if you will, on utilities. I think any thinking person would realize that, yes, they're going to be there. There is going to be CO_2 legislation come out of this Congress probably in the next couple of years.

The risk occurs at the regulatory level. Are regulators going to allow these companies to rate base these facilities, earn a return on these facilities? And I believe the answer is pretty clearly yes, they are, and so the risk is relatively low. It's a huge amount of money, there's no question. They've got to go to the capital markets. They have access to capital. That's all true.

But the real risk comes in whether or not regulators are going to pass those costs on to consumers, and historically regulators have been very good for the utilities about passing pollution control costs on to consumers. It's something that's required to be done, it's positive for society, and it's a cost that the ratepayers need to bear.

COMMISSIONER KENNY: I don't have any other questions. Thanks for your time.

THE WITNESS: Yes, sir.

COMMISSIONER DAVIS: Judge, can I --

FURTHER QUESTIONS BY COMMISSIONER DAVIS:

Q. I've got two more questions for you, Mr. Hill. Going back to your customer growth, it doesn't appear that in the next year or two that there's going to be a lot of customer growth to offset rising expenses. Is that a fair statement based on --

A. I would say generally across the board in this country, we're going to be looking at a weak economy for another couple of years at least.

Q. In past Commission proceedings, there has been discussion over customer growth and what, you know, what financial benefits that would have for a utility; is that a fair characterization?

A. Yes. If it's not enough, it's not good. If it's too much, it's not good. It's got to be kind of the right bowl of porridge for it to be good for the utility.

Q. And then in questioning from Commissioner Kenney, you were talking about regulatory lag, and I don't even know -- I think you may have gone on to cost recovery. Let me see if I got this right. Who cares -- I seem to remember you saying something to the effect of, who cares what you spend if you know you're going to get your costs recovered no matter what?

A. That's right.

Q. Now, I'm going off the reservation here, so just indulge me. Are you familiar with RTOs at all?

A. Somewhat.

Q. So if a transmission company can go to an RTO and get 100 percent of their costs for their new transmission line, do you think that's a good idea?

A. Well, if it was set up to incentivize people to build transmission where transmission is needed and it's not being built, then it serves a greater purpose. I think that probably is a reasonable idea.

However, as a regulatory sort of model, I'd be very cautious about that sort of thing because it would lead to overbuilding. I mean, how do utilities make money? They build plant, because they make a return on the plant they build. So the more plant they build, the more money they make.

And if you let them build plant without any sort of redress or whether it's prudent or not, then I think that's problematic for ratepayers. Ratepayers will be paying very, very high rates very soon.

Q. And if you had -- if you had a group of states that were in an RTO and you were bundling the projects together such that, you know, everybody had to get a piece of the pie, so to speak, would that -- would that concern you that, you know, that could also lead to overbuilding?

A. I'd have had to know more of the details. If it's set up with a carte blanche, whatever you build we'll base rates on, I would be concerned about that, but I don't know specifically what the details are.

COMMISSIONER DAVIS: All right. Thank you, Mr. Hill.

JUDGE WOODRUFF: We'll go to recross based on questions from the Bench. Public Counsel?

MR. MILLS: Just a few.

RECROSS-EXAMINATION BY MR. MILLS:

Q. Mr. Hill, I'd like to return to that topic about declining revenues and constant expenses. Is that essentially the observation you made off of the last few years with AmerenUE?

A. I haven't really made an observation over the last two years. I was speaking earlier about my review of Union Electric's annual report that was just published in the 10K.

Q. So just for the last year that's been the case?

A. Well, there's three years reported there.
Q. Okay. You run a business; is that correct?
A. That's right.
Q. Is it a sustainable business model to have declining revenues and flat expenses?
A. No, not over the long term certainly.
Q. And if that -- if the situation of declining revenues were to hit your business, would you do everything you can to decrease expenses within reason?
A. Certainly.
Q. And wouldn't that be a prudent thing for any business to do?
A. I believe so.
Q. Is there less incentive for a regulated business to react that way than there is for an unregulated business?
A. Well, certainly in the situation that the Commissioner was talking about a minute ago, if whatever you want to build is approved and becomes rate base, that would certainly exacerbate that problem. I think for utilities that are used to cost plus business, then it could be problematic.
MR. MILLS: Thank you. That's all I have.
JUDGE WOODRUFF: MIEC?
MS. ILES: No questions.

JUDGE WOODRUFF: Ameren?

RECROSS-EXAMINATION BY MR. LOWERY:

Q. Mr. Hill, you were discussing this issue of whether there's a greater risk facing a heavily coal-fired electric utility versus one that depends less on coal-fired generation. Do you recall that?

A. I do recall that.

Q. And I believe your testimony to Commissioner Kenney was that that risk is not because of the -- of the pending -- the risk of pending CO2 legislation; is that right?

A. Well, if I said it was not because of that, of course it's related to that. I mean, it arises from that, but --

Q. First of all, isn't it a fact that a minute ago you told Commissioner Kenney that it wasn't related to the pending CO2 legislation, but rather it was related to the risk that a state commission won't allow recovery of the capital investments in those environmental improvements? Isn't that what you told him?

A. That is a -- your summary of what I said. I don't agree that that's exactly what I said.

Q. Did you mention the risk? Did you mention the fact that pending legislation was part of the greater risk faced by heavily coal-fired utilities? Did you mention that to him?

A. I think it was obvious that the risk of having to build scrubbers or other pollution control equipment to deal with CO_2 arises from the broader environmental need that we have as a planet. Part of that is the CO_2 legislation. I think it's obvious that the need to build those facilities arises from that legislation.

The risk, sort of where the rubber hits the road is whether or not the Commission is going to allow the company to recover those costs. My -- what I -- the point of my testimony was that it's not as onerous a risk as it seems because regulators have been very good about approving environmental expenditures.

Q. So is it your risk that a utility -- excuse me. Not is it your risk.

Is it your testimony that a utility that has greater percentage of coal-fired generation on average, are they more risky or not relative to other utilities that have less heavy dependence on coal-fired utilities -- or coal-fired generation?

A. They're probably slightly riskier.

Q. And is the reason that they're more risky because of the risk of regulatory disallowances on the capital investments or is the reason that they're more risky because they may face a high level of capital expenditures because of CO_2 legislation? Which is it?

A.   It's because of the level of capital expenditures.

Q.   Is it because of the -- it's because of the risk that the legislation may require them to spend more on capital expenditures relative to less heavily dependent utilities?

A.   No. The legislation will require them to spend those monies. The risk comes about with regard to whether or not regulators are going to allow the company to earn a return on those expenditures, and I believe that that risk is relatively small.

Q.   So it's regulatory risk, is that your testimony? You believe it's relatively small, but the risk is related to regulation; is that right?

A.   That's right.

Q.   Do you have your deposition?

A.   Yes, I do.

Q.   Could you turn to page 20?

A.   I'm there.

Q.   Were you asked the following questions, did you give the following answers, starting on line 2.

Question: How about regulated electric utilities with more coal-fired power plants than average,

are they riskier than average or not in your opinion?
Answer: These days you have to say perhaps, and I think you know why. The pending CO2 legislation is a concern.
Were you asked that question and did you give that answer?
A. That's part of the answer and you read that correctly.
Q. You were talking with Commissioner Davis about Ford Motor Company. Do you recall those questions, or at least that discussion? I think you used Ford as an example.
A. I was talking with the Commission about that, yes.
Q. Is Ford subject to rate of return regulation?
A. No. That was my point.
Q. I want you to assume for me that 1.2 million people wanted to buy Ford cars in 2008 and Ford sold cars to 1.2 million people in 2008. Do you have that assumption in mind?
A. Yes.
Q. If Ford's cost to produce cars go up in 2009, Ford isn't obligated to sell cars to 1.2 million people in 2009 if it isn't satisfied with the profit level

associated with doing so, is it?

A. You mean can it close its doors and go away? Is that your question?

Q. Can you answer my question? I asked you a yes or no question.

A. I don't understand your question.

Q. If Ford -- if Ford's costs in 2009 goes up to produce cars, Ford is not obligated to sell cars to 1.2 million people in 2009 if it's not satisfied with the profit margin, is it?

A. That's right, it's not.

Q. If Ford can make more money by selling 900,000 cars because -- let's say it has a high cost plant that makes 300,000. If Ford can make more money by shutting down that plant and only selling 900,000 cars in 2009, it has the right to do so, doesn't it?

A. I don't believe that the competition in the market would let them do that, but if you want to make that assumption in your question, then yes, they have the right to do that.

Q. If UE had 1.2 million customers in 2008 and also 1.2 million customers in 2009, UE is obligated by law to serve all 1.2 million customers in 2009 even if it would prefer not to do so because its costs have gone up and it is not making as much margin on those customers;

isn't that true?

MR. DEARMONT: I'm going to object to the compound nature of that question. I think there was a few strung together there.

JUDGE WOODRUFF: I'll overrule the objection. You can answer.

THE WITNESS: Because they are allowed to be a monopoly, the answer to your question is yes.

BY MR. LOWERY:

Q. I want you to assume for me that the true-up cutoff date in this case, and I think this is actually even true, is January 31st, 2010. All right?

A. I think that is true.

Q. If the company invests $50 million, capital investment of $50 million in 2010, if it -- and so would you agree if it invests $50 million capital investment in 2010, that's not going to be picked up in this case, right, because it's after January 31st?

A. Right.

Q. If the company does so, turns around and files another rate case in July of this year, and if it takes the normal 11 months to process and complete that rate case, the new rates from that rate case could go into effect in June 2011, right?

A. I'll take that representation.

Q. When does the $50 million invested in February 2010, when does that go into rate base under those set of hypothetical circumstances?
A. When the rate case is decided.
Q. In June 2011, right?
A. Right.
Q. So when you testified earlier that there might be only five or six months of lag because there's a January 31st true-up, true-up date in this case, that only applies to the rate base -- or to the capital investment placed into service by January 31st, 2010, right?
A. That's correct.
Q. Doesn't apply to capital investment made between, in my hypothetical, February 2010 and June 2011, does it?
A. No, but compared to a strictly strict test year --
Q. Mr. Hill, does it apply to the capital investment made between February 2010 and June 2011 or not?
A. It does not.
Q. You had a fairly long discussion with Commissioner Davis about quarterly dividends and how that should be handled in the cost of equity in a rate case, right? Do you remember that?

A. Yes.
Q. If the company pays $200 million of dividends annually but pays $50 million on March 31st, $50 million on June 30th, 50 million on September 30th and 50 million on December 31st, isn't it true that there's an opportunity cost to the utility company itself of not having use of the first $50 million payment that it made from April 1 to 12/31? Isn't there an opportunity cost associated with that?
A. Yes.
Q. And there's an opportunity cost associated with the next 50 million between July 1 and 12/31, isn't there?
A. Yes. That's always been the case with utilities that pay quarterly.
Q. And that opportunity cost is equal to the utility's weighted average cost of capital during the subject period, isn't it?
A. You could calculate it that way.
MR. LOWERY: I have no further questions, your Honor.
JUDGE WOODRUFF: Redirect?
REDIRECT EXAMINATION BY MR. DEARMONT:
Q. Will you please turn to page 24 of your deposition.

A. I'm there.

Q. Okay. Will you please read lines 8 to 19 out loud.

A. Page 24?

Q. Yes, sir.

A. Well, I don't think that -- that you could argue that against what you said, that less regulatory lag would be better for the investors than more regulatory lag, but regulatory lag has -- has a place, and it's been -- we've -- utilities once again have lived with it for -- for a very, very long time and have done, you know --

MR. LOWERY: Your Honor, I'm going to object at this time. Move to strike that answer. That answer was completely nonresponsive to the question. If Mr. Dearmont thinks that the portion of the deposition I read to impeach Mr. Hill wasn't -- wasn't representative and left something out to put it in context, then Mr. Hill can explain -- he was asked to read a very limited number of lines. That's not what he's doing. He's making a speech that apparently he wants to make. It's nonresponsive.

THE WITNESS: I haven't finished.

JUDGE WOODRUFF: Was he reading from --

MR. DEARMONT: He was reading verbatim from the deposition, your Honor. He started at line 8. He made it to approximately line 14. I asked him to go to line 19.

MR. LOWERY: If that's the case, I apologize.

MR. DEARMONT: This portion of the deposition represents the entire answer that was asked in the deposition.

MR. LOWERY: If that's the case, I apologize. I thought it was something else.

MR. DEARMONT: It's the other half of the first half of an answer given previously.

JUDGE WOODRUFF: All right. Well, apparently the objection's been withdrawn.

MR. LOWERY: I'll withdraw the objection.

JUDGE WOODRUFF: You can continue from the point where you left off.

THE WITNESS: I'm take it from --

BY MR. DEARMONT:

Q. I'll withdraw the question. If you just want to start on line 11 and read to line 19, that would be even better.

A. Okay. But regulatory lag has a place, and it's been -- we've -- utilities once again have lived with it for -- for a very, very long time, have done -- you know, managed to provide the necessary power to their customers, and it's something that without utilities might be incented to overbuild or not be as cautious about building something otherwise.

Q. That overbuilding, what is that, A. Rich?

A. I referred in the deposition to something called the A. Rich Johnson effect, which is a study that showed that if a utility company is allowed returns that continually exceed their cost of capital, that there will be a tendency to overbuild, build unnecessary plant.

Q. Will you please turn to page 20 of your deposition.

A. I'm there.

Q. Do you see the answer that begins on line 5 of page 20?

A. Yes.

Q. Will you please read that answer in its entirety?

A. These days you have to say perhaps, and I think you know why. The pending CO2 legislation is a concern. However, it's important to remember that that is a -- the potential cost of building plant to fulfill those pollution requirements is a -- would be a financial impact to the company. But then again, those -- those plants are going to be rate based, and those operations are going to be rate based, and they're going to eventually earn a return on those -- on those plants.

Q. Thank you. Will you entertain a hypothetical with me?

A. Certainly.

Q. What if Staff filed an overearnings complaint against the company on January 31st of a year? With me so far?

A. Yes.

Q. Okay. And after a process that the Commission, a commission decided that this company was, in fact, overearning. With me so far?

A. Yes.

Q. How long after January 31st will it take for the company to return those overearnings to its customers?

A. Well, my assumption would be it would be a similar time period between the time the company files a rate case and when the rates go into effect.

Q. And you're not an attorney, correct?

A. That's correct.

Q. Could it be longer?

A. I don't know the answer to that question.

Q. Okay. Is the cost of capital determined by the party you represent?

A. Absolutely not.

Q. Is your cost of capital recommendation determined by the party you represent?

A. No. My testimony is the same no matter who I'm testifying for.

MR. DEARMONT: No further questions.

JUDGE WOODRUFF: Mr. Hill, you can step down.

THE WITNESS: Thank you.

JUDGE WOODRUFF: And looks like we're done for the night. We will start tomorrow with Mr. Lawton.

MR. BYRNE: Your Honor, I do have copies of this exhibit.

MR. MILLS: We can do this off the record, too, but I think we have three different things that we were going to do first thing tomorrow. One was Mr. Lawton. Two was an argument about AARP's motion to take administrative notice, and then there was a third thing that came up this afternoon that I don't remember what it was.

JUDGE WOODRUFF: I think that was talking about these exhibits.

MR. DEARMONT: That was another thing that did come up, though.

JUDGE WOODRUFF: Maybe there's four things.

MR. MILLS: And I just --

MR. BYRNE: It's the Goldman exhibits, that was the third thing.

MR. MILLS: The one that I'm most, not concerned about, but trying to get a handle on is whether we're going to do Mr. Lawton first or the argument over administrative notice first, because it makes a difference about when he needs to be here and be ready to take the stand.

MR. LOWERY: And all I would say, I don't think we care that much, but I did tell Mr. Coffman that we were doing the argument on the motion first because that's what we decided first thing this morning.

JUDGE WOODRUFF: I don't anticipate a long argument.

MR. BYRNE: I've got no more than an hour of oral argument on that point.

JUDGE WOODRUFF: We'll deal with Mr. Coffman first.

MR. MILLS: That's fine.

JUDGE WOODRUFF: That will be brief, and then we'll do Mr. Lawton.

MR. BYRNE: Your Honor, I've got copies of this exhibit that I -- that was on the board. It's Exhibit 172.

JUDGE WOODRUFF: And with that, then, we are adjourned.

WHEREUPON, the hearing of this case was adjourned until March 19, 2010.

I N D E X

RETURN ON EQUITY, CAPITAL STRUCTURE, FLOATATION COSTS

AMERENUE'S EVIDENCE:

ROGER MORIN

MICHAEL G. O'BRYAN

MIEC'S EVIDENCE:

MICHAEL GORMAN

STAFF'S EVIDENCE:

EXHIBITS INDEX

*Marked at the conclusion of the hearing.

C E R T I F I C A T E

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

I, Kellene K. Feddersen, Certified Shorthand Reporter with the firm of Midwest Litigation Services, do hereby certify that I was personally present at the proceedings had in the above-entitled cause at the time and place set forth in the caption sheet thereof; that I then and there took down in Stenotype the proceedings had; and that the foregoing is a full, true and correct transcript of such Stenotype notes so made at such time and place.

Given at my office in the City of Jefferson, County of Cole, State of Missouri.

____

Kellene K. Feddersen, RPR, CSR, CCR