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STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

TRANSCRIPT OF PROCEEDINGS
Evidentiary Hearing
March 2, 2015
Jefferson City, Missouri
Volume 21

In the Matter of Union)
Electric Company d/b/a)
Ameren Missouri's Tariff) File No. ER-2014-0258
to Increase Its Revenues)
for Electric Service)

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

ROBERT S. KENNEY, Chairman
WILLIAM P. KENNEY,
DANIEL Y. HALL,
SCOTT T. RUPP,
COMMISSIONERS.

REPORTED BY:
KELLENE K. FEDDERSEN, CSR, RPR, CCR NO. 838
MIDWEST LITIGATION SERVICES

1 APPEARANCES:

2 WENDY K. TATRO, Attorney at Law

MATTHEW TOMC, Attorney at Law

3 Union Electric Company

P.O. Box 66149

4 1901 Chouteau Avenue

St. Louis, MO 63103

5 (314)554-2237

tbyrne@ameren.com

6

FOR: Union Electric Company,

7

d/b/a AmerenUE.

8 DIANA VUYLSTEKE, Attorney at Law

KEN MALLIN, Attorney at Law

9 CAROLE ILES, Attorney at Law

Bryan Cave, LLP

10 211 North Broadway, Suite 3600

St. Louis, MO 63102

11 (314)259-2543

brent.roam@bryancave.com

12

FOR: Missouri Industrial

13

Energy Consumers.

Noranda Aluminum.

14

DAVID WOODSMALL, Attorney at Law

15

Woodsmall Law Office

807 Winston Court

16

Jefferson City, MO 65101

(573)797-0005

17

david.woodsmall@woodsmallllaw.com

18

FOR: MECG.

19

JOHN COFFMAN, Attorney at Law

871 Tuxedo Boulevard

20

St. Louis, MO 63119

(573)424-6779

21

FOR: Consumers Council of Missouri.

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DUSTIN ALLISON, Public Counsel
CHRISTINA BAKER, Assistant Public Counsel
MARC D. POSTON, Senior Public Counsel
TIMOTHY OPITZ, assistant Public Counsel
Office of the Public Counsel
P.O. Box 2230
200 Madison Street, Suite 650
Jefferson City, MO 65102-2230
(573)751-4857

FOR: Office of the Public Counsel
and the Public.

KEVIN A. THOMPSON, Chief Staff Counsel
NATHAN WILLIAMS, Deputy Counsel/Electric
CULLY DALE, Senior Counsel
JOHN BORGMEYER, Deputy Counsel/Gas
JEFF KEEVIL, Senior Counsel
ALEXANDER ANTAL, Legal Counsel
MARCELLA MUETH, Legal Counsel
WHITNEY PAYNE, Legal Counsel

Missouri Public Service Commission
P.O. Box 360
200 Madison Street
Jefferson City, MO 65102
(573)751-3234

FOR: Staff of the Missouri Public
Service Commission.

1 P R O C E E D I N G S

2 (WHEREUPON, the hearing began at
3 10:00 a.m.)

4 (AMERENUE EXHIBIT NOS. 16, 17 AND 18
5 AND OPC EXHIBIT NOS. 409, 409HC, 410 AND 411 WERE
6 MARKED FOR IDENTIFICATION BY THE REPORTER.)

7 JUDGE WOODRUFF: We're back for
8 another week of the Ameren rate case hearing,
9 ER-2014-0258. Today we're going to take up ROE
10 issues. Before we get started with mini openings
11 on that, I did note that there was a motion filed
12 on Friday by Wal-Mart indicating that their witness
13 Mr. Chris would not be available until Wednesday.
14 I'm assuming everyone's had a chance to see that.
15 Does that create problems for anyone?

16 MR. TOMC: No objection, your Honor,
17 from the company.

18 JUDGE WOODRUFF: I'll go ahead and
19 grant that, and we'll proceed from there.
20 Mr. Thompson?

21 MR. THOMPSON: Staff has another
22 matter we'd like to raise. Natelle Dietrich is
23 here. During last week, the Chairman was asking
24 about collaboratives, and there was a homework
25 assignment basically given to Staff with respect to

1 some collaboratives. And so we wanted to inquire
2 for guidance as to how we should report those
3 results to the Commission. Should it be filed in
4 this case or --

5 JUDGE WOODRUFF: Clarify for me, or
6 refresh my memory. What was it that they were
7 asking for?

8 MS. DIETRICH: The Chairman asked for
9 Staff to do an analysis of the effectiveness of all
10 the various collaboratives, and since they meet
11 quarterly, that will take some time. It's not like
12 we can have it by the end of this hearing.

13 We do have a docket that's open,
14 AO-2011-0035, which is In the Matter of the
15 Chairman's Request for a Status Report Regarding
16 Energy Efficiency Advisory Groups and
17 Collaboratives, and it was opened a few years ago
18 at the request of then Chairman Clayton to look at
19 collaboratives, but it was more like the numbers
20 and what the programs are doing and that type of
21 thing.

22 So we didn't know if that would be a
23 place to file a report as to what we think and our
24 findings related to observing the various
25 collaboratives.

1 JUDGE WOODRUFF: Well, that sounds
2 appropriate to me, but I've not discussed this with
3 the Chairman. For the moment, go ahead and plan on
4 giving it as you propose. When I have a chance to
5 talk with the Chairman, if he has other ideas, I'll
6 let you know.

7 MS. DIETRICH: Okay. Thank you.

8 JUDGE WOODRUFF: Thank you.

9 MR. THOMPSON: Thank you, Judge.

10 JUDGE WOODRUFF: Okay. Anything else
11 before we begin with opening statements?

12 All right. For mini openings on the
13 ROE issues, then, we begin with Ameren Missouri.

14 MR. TOMC: Thank you, your Honor.

15 May it please the Commission. My name is Matt
16 Tomc. I'm corporate counsel for Ameren Missouri.

17 The issue today before you is return
18 on equity. A competitive return on equity is
19 critical to the ratemaking process, essential to
20 the ratemaking and the regulatory compact itself.
21 The rate of return must be sufficient to compensate
22 investors for capital invested in public service,
23 and it must be sufficient to ensure that capital
24 will be available at reasonable rates going
25 forward.

1 Maintaining the financial integrity
2 of Ameren Missouri is important to not only
3 shareholders but to consumers as well. As you are
4 aware, Ameren Missouri is the largest
5 investor-owned utility in the state of Missouri
6 with a service territory that includes St. Louis
7 and surrounding communities. It also serves many
8 other municipalities and rural areas across the
9 state.

10 Reliable electric service is
11 essential to our communities. The electric utility
12 infrastructure that Ameren Missouri constructs and
13 maintains is foundational to our economy.
14 Unquestionably today it could be said that we live
15 in an electronic age. Our customers, from
16 residential to large industrial, rely upon
17 electricity every day of every hour -- every hour
18 of every day. Sorry.

19 Across the U.S., utilities are
20 actively replacing aging infrastructure. This case
21 is demonstrative of that point. By way of example,
22 consider the reactor head installed at our Callaway
23 nuclear facility. The Callaway plant was completed
24 in the early 1980s. Capital investment is required
25 to keep that plant operational and safe.

1 Additionally, as this case
2 demonstrates, environmental mandates and
3 regulations also require compliance by Ameren
4 Missouri, and that necessitates capital investment.
5 Investment and maintenance of energy infrastructure
6 is not without cost. It requires capital, capital
7 investment. The utility business is a capital-
8 intensive business. Capital markets are
9 competitive markets.

10 Ameren Missouri is an investor-owned
11 utility and must compete for the capital it
12 requires for its operations. Because of this,
13 Ameren Missouri must offer a competitive return
14 opportunity to investors.

15 The law with respect to the cost of
16 capital is clear, including the return on equity.
17 Two principal cases on point for their Supreme
18 Court decisions, Bluefield Waterworks and Hope
19 Natural Gas.

20 Pursuant to those cases, a fair rate
21 of return must do three things: One, the return
22 must be comparable to returns investors expect to
23 earn on other investments with similar risk. Two,
24 it must be sufficient to ensure confidence in the
25 company's financial integrity. And three, it must

1 be adequate to maintain and support the company's
2 credit and attract capital.

3 A rate of return that is set below
4 returns for other investments of comparable risk is
5 therefore unconstitutional confiscatory. To be
6 clear, the rate of return that is authorized is not
7 a right or entitlement. It is an opportunity.

8 In the context of this case, there is
9 no question substantial capital investment has been
10 made in the state of Missouri by Ameren Missouri
11 for public use. Ameren Missouri investors have a
12 constitutional right to reasonable opportunity to
13 earn a return on their investment, a return on rate
14 base that is commensurate with similar investments
15 with corresponding risk.

16 When it comes to return, too often
17 parties become distracted by a rhetorical us versus
18 them debate, shareholders versus ratepayers. What
19 these parties often forget is the very relevant and
20 salient consideration that we all benefit from
21 ensuring that the utility is financially sound and
22 worthy of investment.

23 We must recognize the operations of
24 Ameren Missouri are of long-term consequence to its
25 customers and to the state. A return must be

1 sufficient to ensure continued investment in the
2 capital-intensive operations of the company.

3 Earlier in this case you heard
4 opening argument from the other parties and Staff.
5 Counsel for Staff in his opening statement relayed
6 a story about Commissioner Davis asking witness
7 Mr. Murray, are all the other analysts wrong?

8 Well, I looked over the last few
9 orders for Ameren Missouri and also some
10 transcripts from those proceedings. I did not find
11 that particular question and answer referenced by
12 counsel, but I did find where the Commission noted
13 that Mr. Murray believes mainstream rate of return
14 analysts are getting it wrong.

15 The reference I found was not with
16 regard to the other cost of capital witnesses at
17 bar, but the entire industry of rate of return
18 experts generally. The Case No. ER-2011-0028, the
19 Commission stated as follows: Mr. Murray's clear
20 implication is that, aside from him, all other rate
21 of return witnesses are getting it wrong.

22 Nonetheless, as counsel suggests,
23 please do ask Mr. Hevert why his recommendation is
24 appropriate and why the other positions offered in
25 this proceeding are unsupported. Please also ask

1 him about cost recovery mechanisms that other
2 utilities have available today across the country,
3 and ask him how those utilities compare to Ameren
4 Missouri.

5 I would also suggest that you ask
6 Mr. Murray, Mr. Gorman and Mr. Schafer why their
7 recommendations are so far below the average recent
8 returns approved for vertically integrated electric
9 utilities.

10 That is a fact. The record's not
11 disputed in this respect. While all four experts
12 have different calculations and interpretations of
13 the data, all agree that when it comes to recently
14 approved return on equity, the average return
15 approved for vertically integrated electric
16 utilities is about 10 percent.

17 Counsel for Staff suggested that
18 Mr. Hevert is an outlier. However, Mr. Hevert's
19 recommendation is based on sound methods. It's
20 clearly a reasonable approach and appropriate in
21 light of recently authorized returns.

22 Consider this Commission's recent
23 decision in a gas case a few months ago, December
24 of 2014. The company's name was Liberty. The
25 approved ROE that was authorized was 10 percent.

1 The case is GR-2014-0152. In that case the
2 Commission specifically found each methodology --
3 each of the methodologies used by the ROE expert in
4 that case were reasonable, including that
5 particular witness' constant growth DCF, multistage
6 DCF, CAPM and bond plus risk premium. All of these
7 were determined to be reasonable. That witness was
8 Mr. Hevert.

9 His analysis in this case is based on
10 those same methods. Far from an outlier position,
11 Mr. Hevert offers credible evidence in this case to
12 support his position.

13 On behalf of the Office of Public
14 Counsel, Mr. Allison spoke to you of slow economic
15 growth in the state and at the county level in
16 Missouri. He spoke of these issues in the context
17 of the proposed return on equity in this case.

18 The inference is both troubling and
19 illogical. Capital markets are competitive.
20 Energy infrastructure is foundational to our
21 economy. Capital investments by utilities are
22 fundamentally important.

23 This specific case concerns the
24 electric utility infrastructure that serves the
25 state's biggest city, St. Louis. Authorizing a

1 below market return is clearly at odds with the
2 long-term interests of consumers and the state in
3 general.

4 Consider, for example, the solar
5 facility that is included in Ameren Missouri's rate
6 base in this proceeding. It is the largest
7 investor-owned solar-generating facility in the
8 state of Missouri. It is located in O'Fallon, and
9 it will provide a source of power for decades to
10 come to the benefit of customers.

11 The capitalized labor that is
12 included in that investment is representative of
13 wages paid to workers who built the facility. If
14 we are concerned about the economic viability of
15 our communities as a long-term proposition, we
16 should support investment in our infrastructure and
17 support investments like the O'Fallon Energy
18 Center.

19 Investors have choices with regard to
20 where they put their money, and it's our benefit
21 that Missouri utilities be a choice that investors
22 consider.

23 I mention the statements of attorneys
24 in this case with respect to the return on equity,
25 but this is an evidentiary hearing, and it is the

1 testimony of the expert witnesses that is
2 important. On behalf of Ameren Missouri,
3 Mr. Hevert provides competent testimony with
4 respect to the measurement of capital costs,
5 specifically the return on equities.

6 As I noted in -- as I noted, his
7 methods are reasonable and have been accepted by
8 this Commission as recently as December of last
9 year. In measuring the cost of equity, Mr. Hevert
10 is a firm believer that there is not one single
11 method or approach that is best. Returns should be
12 measured using several methods.

13 It can be said that the measurement
14 of the cost of equity is both quantitative and
15 qualitative. Mr. Hevert prepared several
16 quantitative analyses designed to model the cost of
17 equity.

18 Mr. Hevert has testified in
19 commissions throughout the United States for many
20 years. He has hands-on experience having worked in
21 a utility treasury department. He's advised
22 corporate boards regarding dividend policy. He has
23 real world experience in what it actually means to
24 acquire, manage and invest capital, capital for a
25 utility company.

1 None of the other witnesses on ROE in
2 this case have anything close to that type of real
3 world experience. In this regard, their
4 perspectives are academic in nature.

5 One thing that Mr. Hevert does that I
6 find to be helpful is he shows his work. He
7 provides us with an array of results together with
8 an informed opinion interpreting that data.
9 Mr. Hevert's prepared constant growth DCF, the
10 constant growth DCF analysis, and provided an array
11 of results based on different stock price
12 measurement periods.

13 He also models the three-stage DCF.
14 That model demonstrates a transition from present
15 analyst three-to-five-year anticipated rates of
16 growth to a long-term growth rate that incorporates
17 investor long-term expectations.

18 He again provides an array of data
19 based upon the varying measurement periods of the
20 stock price. He prepared an ex-ante or
21 forward-looking CAPM, capital asset pricing model.
22 That provides a range of results using both
23 Bloomberg and ValueLine derived risk premium as
24 well as Bloomberg and ValueLine average beta
25 coefficients.

1 The CAPM model estimates required
2 returns the diversified investor would consider in
3 making a choice based upon the overall market
4 return and the risk relationship of the target
5 investment, in this case Ameren Missouri, to the
6 market as a whole.

7 Mr. Hevert also prepared a bond plus
8 risk premium that charts the relationship between
9 bond rates and commission-authorized rates of
10 return. He also assessed generally ROEs authorized
11 in other jurisdictions. Finally, Mr. Hevert
12 addressed financial metrics specific to the
13 company.

14 He also examined the conditions of
15 capital markets to arrive at his recommended range
16 point estimate for the cost of equity. Based on
17 his analysis, Mr. Hevert recommends a 10.4 percent
18 return on equity used to set rates in this case.

19 With respect to the other parties'
20 recommendations, these recommendations are closely
21 aligned to one another and very low in the context
22 of authorized returns in other jurisdictions.

23 As was the case in the last Ameren
24 Missouri rate case, Mr. Gorman and Mr. Murray take
25 a pessimistic view of the investor expectations for

1 investment growth. As our economy moves farther
2 from the recession, Staff and intervenors want you
3 to believe this is as good as it gets. They assume
4 perpetual growth will fall well below current
5 analysis consensus estimates.

6 Mr. Schafer, a new witness on behalf
7 of the Office of the Public Counsel, now joins
8 Mr. Murray and Mr. Gorman in this approach.

9 These witnesses do not report varying
10 measurement periods of stock price like Mr. Hevert,
11 instead relying on 13-week average. All three
12 witnesses also rely upon very low yields,
13 inconsistent with both history and analyst
14 forecasts.

15 With respect to their CAPM analyses,
16 Staff and intervenors also take a very similar
17 approach to one another. Unlike Mr. Hevert's
18 forward-looking approach, Staff and intervenors use
19 a historic market risk premium covering a period of
20 much higher interest rates than exist today and
21 dividend yields that are higher than -- they also
22 on much higher -- let me start over on that point.

23 Staff and intervenors use a historic
24 market risk premium covering a period of much
25 higher interest rates and dividend yields than

1 those that exist today. That market risk premium
2 relies upon about 90 years of historic data
3 starting in 1926. But they apply that market risk
4 premium to five years of interest rate forecasts
5 and use current beta coefficients.

6 This mismatch of data explains why
7 Staff and intervenor CAPM results are so
8 unreasonably low.

9 The evidence will also show that
10 while Staff and intervenor witnesses will readily
11 admit that investors are aware of authorized
12 returns in making investment choices, the witnesses
13 nonetheless choose to ignore them, and they ask you
14 to ignore them as well.

15 In conclusion, as the evidence will
16 show, the rate of return to fairly compensates
17 investors and ensure the financial integrity of the
18 utility and attract investment is between 10.2 and
19 10.6 percent with the point estimate of
20 10.4 percent.

21 By approving a fair return, the
22 Commission can be assured that Ameren Missouri has
23 the tools it needs to compete for capital it
24 requires to support the essential services it
25 provides to consumers in this state. Thank you.

1 JUDGE WOODRUFF: Questions?

2 CHAIRMAN KENNEY: No, thanks.

3 COMMISSIONER HALL: I have one. Has
4 there ever been a case in Missouri where an
5 Article 3 corp determined that the ROE set by this
6 Commission was confiscatory?

7 MR. TOMC: I am not aware of any such
8 case in this state.

9 COMMISSIONER HALL: Is there a
10 leading case from outside the state on that issue?

11 MR. TOMC: There are two cases that
12 are cited as the seminal court cases, Bluefield and
13 Hope Gas.

14 COMMISSIONER HALL: Right. And in
15 those cases, which I've read -- I've not read the
16 full cases. Are they -- is the holding that a
17 particular ROE was confiscatory?

18 MR. TOMC: Yes. With respect to the
19 Bluefield case, in that particular example
20 Bluefield Waterworks Company, a water utility I
21 believe in West -- state of West Virginia, had
22 proposed a rate increase in that proceeding. The
23 facts in that case, as I recall, those costs that
24 they actually invested in service providing
25 facilities in that state were high, I think, I

1 believe due to high commodity costs during a -- I
2 think it might have been World War I in the period
3 after that. And the Commission chose to ignore
4 those particular economic conditions and set a rate
5 that was very low, and the rate of return in that
6 case that was authorized was 8 percent, but
7 depreciation was included in that return, so the
8 return was actually about 6 percent, and the
9 Commission found that to be confiscatory and
10 unlawful, and in doing so set forth the standards.

11 And those standards are both with
12 respect to what's fair to the investors that made
13 their investments in the capital, but the holding
14 also indicates that the financial integrity of the
15 utility and its ability to attract capital going
16 forward are also equally important considerations.

17 COMMISSIONER HALL: Second question.
18 Do you think that it is appropriate for the
19 Commission to take into account the ability of
20 ratepayers to pay for rate increases when making an
21 ROE determination?

22 MR. TOMC: Well, I think it's a
23 consideration that does factor into the ratemaking
24 process, and in particular my experience in rate
25 cases is that it's assessed in the rate impact

1 analysis of the varying rate designs.

2 With respect to the cost of capital,
3 the law is pretty clear, and also the salient facts
4 are clear that capital markets are competitive.
5 Ameren Missouri must compete for capital it
6 requires to fund its operations, and in that sense
7 Ameren Missouri is a price taker when it comes to
8 the cost that it must pay capital.

9 So the markets, those financial
10 markets do not change based upon the
11 recommendation, recommendations with respect to the
12 authorized rate of return and what's approved by
13 the Commission.

14 I think really in terms of what the
15 law provides for, I think that the Commission
16 should pay close attention to the facts in the
17 case, the market conditions, the output of the
18 models, the recommendations of the parties and
19 approve a rate of return that is consistent with
20 what the market dictates.

21 COMMISSIONER HALL: Thank you.

22 JUDGE WOODRUFF: Commissioner Rupp?

23 COMMISSIONER RUPP: Not at this time.

24 JUDGE WOODRUFF: Thank you. Opening
25 for Staff.

1 MR. THOMPSON: Thank you, Judge. I
2 have a visual aid. I have it projected, and I also
3 have copies to hand out.

4 May it please the Commission? We're
5 here for return on equity. You've already heard
6 about that from Mr. Tomc. This issue is worth
7 nearly \$70 million. It's the largest single issue
8 that you'll decide in this case, and it's the one
9 where you have perhaps the most discretion. But
10 discretion is never untrammelled, and so what I want
11 to talk about are the boundaries that should guide
12 your discretion.

13 You heard from Mr. Tomc about the
14 Hope case and the Bluefield case, the leading
15 United States Supreme Court cases that guide
16 commissions in setting a return on common equity,
17 and the principles that those cases set out, the
18 principle of capital attraction, financial
19 integrity and commensurate return.

20 And he was absolutely right when he
21 said that the rate you set must be sufficient for
22 the utility to obtain the capital that it needs
23 going forward, and he was absolutely right when he
24 told you that the rate that you set must be
25 sufficient to maintain the creditworthiness of the

1 utility.

2 He also talked about the sort of
3 returns that other utilities are receiving that
4 have been set by other commissions. I want to
5 focus on that for a moment. The principle of
6 commensurate returns says that the return that you
7 set must be commensurate, equivalent to the return
8 that the investor would receive in another
9 investment of similar risk. In another investment
10 of similar risk.

11 Well, in calculating their
12 recommendations, the four experts that you're going
13 to hear from today have largely examined, in fact
14 have entirely examined other integrated electric
15 utilities. Why? Because those are businesses that
16 face the exact same business risks as Ameren
17 Missouri. Okay. So if you're looking for
18 similarity in risk, then you look to companies that
19 are in the same line of business because the risks
20 are the same.

21 But there is a danger that you have
22 to be aware of in doing that, and the danger is
23 circular reasoning. If all of those utilities have
24 a return that has been set by another state
25 Commission, then in looking at the returns they've

1 received, you're looking at the actions that other
2 state commissions have taken. In other words, it's
3 not set by the market. It's set by a commission.
4 And if all the commissions are looking at other
5 commissions and saying, what are they doing,
6 there's a danger of circularity. There's a danger
7 that commissions will essentially copy each other
8 in assigning returns.

9 So I urge you to think about the
10 market-driven evidence that you're getting from
11 David Murray and from the other analysts.

12 You're vested with the State's police
13 power to set just and reasonable rates. I spoke
14 about that at my general opening when this case
15 began last week. A just and reasonable rate is one
16 that is fair to the utility and fair to the
17 ratepayer, fair on both sides. It's a balancing.
18 It is no more than is sufficient to keep public
19 utility plants in proper repair for effective
20 public service and to ensure to the investors a
21 reasonable return upon the funds invested.

22 The Commission's guiding purpose in
23 setting rates is to protect the consumer against
24 the natural monopoly of the public utility, which
25 is the sole provider of a public necessity.

1 The utility has a constitutional
2 right to a return. There is no argument but that
3 the company and its stockholders have a
4 constitutional right to a fair and reasonable
5 return upon their investment or at least an
6 opportunity to earn such.

7 It's important to remember that
8 you're not bound to the use of any single formula
9 or combination of formulas. Instead, it is the
10 results of your order, it is the result that would
11 be weighed by a reviewing court, not the method
12 that you choose to use.

13 In the same way, perhaps you
14 shouldn't be overly concerned with the methods used
15 by any particular analyst.

16 Now, the chart that I've handed out
17 and that I have projected up there shows you the
18 four recommendations, and they are ranked from the
19 highest to the lowest in the chart at the top of
20 the page. Mr. Hevert on behalf of Ameren Missouri
21 has recommended 10.4, within a range of 10.2 to
22 10.6. Mr. Gorman has recommended 9.3, within a
23 range of 9 to 9.6. Mr. Murray has recommended
24 9.25, within the range 9 to 9.5. And Mr. Schafer
25 has recommended 9.01, within a range of 8.74 to

1 9.22.

2 At the bottom I constructed a visual.
3 I apologize for its crude nature, but it's intended
4 to show how the recommendations cluster. And
5 you'll see that three of them cluster between 9 and
6 9.5, and the other one is way off to the right
7 there, close to 10.5.

8 This talk about outliers, I find that
9 a little bit amusing because, of course, in several
10 of the cases that we've done here Mr. Murray has
11 been accused of being an outlier because his
12 recommendation was often the lowest of several that
13 were presented to the Commission.

14 Well, in this case, Mr. Murray is not
15 an outlier, unless you agree with Ameren that
16 everybody except Mr. Hevert is an outlier. Perhaps
17 that's possible.

18 Another thing that should guide your
19 consideration is a very fundamental one, which is
20 that equity by its nature is more risky than debt.
21 Right? The holder of debt knows from a contract,
22 an indenture, what he or she is going to get.
23 That's the nature of debt.

24 With equity, you have a residual
25 claim. You only get paid after all the other

1 creditors are paid. The cost of Ameren Missouri's
2 long-term debt is 5.59 percent. So that sets an
3 absolute floor. You can't set ROE lower or even at
4 5.59 because it's got to be higher than the cost of
5 debt because equity is more risky than debt.

6 Mr. Murray explains in his testimony
7 that capital market activity demonstrates that the
8 cost of equity for Ameren Missouri and other
9 utilities has fallen, and this is demonstrated by
10 the fact that the price of utility stock has risen.

11 For the 12 months ending December 31,
12 2014, the total return on the Dow Jones Industrial
13 Average was 7.52 percent. The total return on the
14 Standard & Poor's 500 was 14.69 percent. The total
15 return of companies classified as regulated
16 utilities by the Edison Electric Institute was a
17 staggering 32.86 percent.

18 This indicates, as Mr. Murray has
19 explained to you and will be happy to explain when
20 he's on the stand, that the cost of equity, the
21 cost of equity for Ameren Missouri and other
22 electric utilities has fallen precipitously. It is
23 cheap.

24 You've also heard evidence, or should
25 I say evidence has been tendered to you in Staff's

1 report about the general economic condition of this
2 state. Missouri has not yet recovered from the
3 great recession in 2008. The gross domestic product
4 growth of Missouri has been smaller than that of
5 the United States as a whole. It was negative for
6 the year 2011. Unemployment in Missouri is still
7 higher than it was before the recession.

8 From 2007 to 2013, the counties in
9 Ameren Missouri's service area collectively
10 experienced a 10.51 percent increase in average
11 weekly wages. This is lower than the overall
12 Missouri compounded increase in average weekly
13 wages of 11.56 percent.

14 The Consumer Price Index during the
15 same period increased by 12.35 percent, putting
16 pressure on those consumers. Electric rates for
17 Ameren Missouri, not counting this request,
18 increased by 43.16 percent.

19 Now, the reality is, it is expensive
20 to generate and distribute electricity. It is an
21 expensive proposition. There's a lot of money
22 involved in creating and maintaining the
23 instruments of doing so. Electric service costs
24 money. It must be paid for. Those are all
25 reality.

1 But in this one area of return on
2 equity, you have the most discretion that you have
3 anywhere in this case. This is different from many
4 other issues where you're looking at an amount of
5 money that the company has spent and figuring out
6 how to give it back to them, how they should
7 recover it.

8 When they build a capital project,
9 that goes into rate base, unless it was imprudent.
10 When they spend money on O&M expenses like storm
11 restoration, personnel, they get that money back.
12 They get it in rates, unless it was imprudently
13 spent, unless it was spent on something that didn't
14 benefit the ratepayers.

15 Here, with return on equity, you're
16 not guided by that kind of accounting. Here it is
17 your discretion what is a fair return to this
18 company, taking all relevant factors into
19 consideration, and those would include factors such
20 as the state of capital markets and whether the
21 ratepayers can afford the increase. Those are
22 relevant factors.

23 Finally, let me close by telling you
24 that the United States Supreme Court in Market
25 Street Railway Company versus Railway Commission of

1 the State of California stated that Hope Natural
2 Gas does not assure that the regulated business
3 make a profit. All it holds is that the company
4 cannot complain if the return that is allowed is
5 sufficient for the company to continue to operate.

6 Thank you very much.

7 JUDGE WOODRUFF: Questions?

8 CHAIRMAN KENNEY: No, no questions.

9 Thanks.

10 JUDGE WOODRUFF: Commissioner Rupp?

11 COMMISSIONER RUPP: I understand that
12 all relevant factors must be taken into
13 consideration, and you can say that about anything,
14 anything we talk about. This is the only time I've
15 heard the argument about the growth in Missouri and
16 the state of the Missouri economy.

17 So if we're supposed to set the rate
18 so that it's sufficient for the company to attract
19 capital and to maintain a good credit rating and it
20 has to be similar within investments of similar
21 risk, then why should -- beyond just all relevant
22 factors, why should the growth rate of Missouri,
23 the climate in Missouri, the county wages, why
24 should that be brought to our attention during this
25 piece than any other part of the rate case?

1 MR. THOMPSON: Because this is the
2 part where you have the most discretion, and so
3 this is the part where you can think about those
4 things and factor them into the decision that you
5 make.

6 If you think only about attracting
7 capital, for example, then you're going to want to
8 give Ameren Missouri a healthy ROE, maybe higher
9 than the natural average to make it a more
10 attractive investment because that, after all, is
11 what we're talking about when we talk about
12 attracting capital.

13 But that's only one of the whole
14 myriad of things that you need to think about as
15 you make this decision.

16 COMMISSIONER RUPP: That's all.
17 Thank you.

18 MR. THOMPSON: Thank you.

19 JUDGE WOODRUFF: Opening for Public
20 Counsel.

21 MS. BAKER: Thank you. I do
22 apologize for my voice today. It was worse
23 yesterday than it is today.

24 May it please the Commission? The
25 charge of the Commission is to set rates that are

1 just and reasonable, and part of determining a just
2 and reasonable rate is to make rates as affordable
3 as possible without causing detriment to the
4 utility.

5 An important part of a just and
6 reasonable rate is an authorized return on equity
7 that is neither excessive nor confiscatory. A
8 reasonable return on equity as developed by the
9 United States Supreme Court decisions in the
10 Bluefield and Hope cases is, one, adequate to
11 attract capital at reasonable terms, thereby
12 enabling the utility to provide safe and
13 adequate -- safe and reliable electric service;
14 two, that is sufficient to ensure the company's
15 financial integrity; and three, that is
16 commensurate with returns on investment in
17 enterprises having corresponding risks.

18 It is important to note -- for the
19 Commission to note that three of the four experts
20 that are testifying today have return on equity
21 recommendations in the low 9 percent area.

22 Mr. Schafer recommends 9.01. Mr. Murray recommends
23 9.25. Mr. Gorman recommends 9.3.

24 However, company witness Mr. Hevert
25 somehow recommends 10.4 percent, which is higher

1 than what Ameren was awarded in its last rate case.
2 And this is surprising because capital markets are
3 lower now than at Ameren's last rate case. The
4 cost of equity has gone down. As a result of the
5 capital market decline, average ROE awards for
6 electric companies similarly situated to Ameren
7 Missouri throughout the country have also declined.
8 But still Ameren requests an ROE that exceeds the
9 ROE it was awarded in its last rate case.

10 The company's recommendation does not
11 reflect the market realities of today. Ameren
12 would have the Commission believe that it would
13 somehow be seen as riskier and less able to attract
14 capital at more favorable rates if the ROE it
15 receives is not the same or greater than it
16 received in its previous rate case or if its ROE
17 didn't exceed what other electric companies
18 receive.

19 What Ameren seems to overlook is that
20 Bluefield and Hope indicate that market-based
21 factors must be taken into account in order to
22 ensure that a return on equity award is just and
23 reasonable. What Ameren's last authorized return
24 on equity was or what returns other commissions
25 have awarded to other companies may help inform the

1 Commission in its decision, but they are not the
2 deciding factors.

3 What is most relevant in this case is
4 what the current market cost of equity is for
5 Ameren given the market today and how affordable
6 rates can be set with that in mind.

7 Part of determining a reasonable rate
8 is to make rates as affordable as possible without
9 causing a detriment to the utility. Public Counsel
10 urges the Commission to decide discretionary issues
11 such as return on equity in a manner that
12 recognizes the economic challenges faced by the
13 households in Ameren's service areas and reasonably
14 minimizes the rate impact on consumers.

15 Customers testifying in public
16 hearings and customers submitting comments to the
17 Commission have regularly voiced frustration and
18 concern about the burden of additional rate
19 increases given the state of the economy. The
20 reality is that customers have seen their wages
21 decrease. They cannot get a decent rate of return
22 on their own savings accounts, and their retirement
23 funds are at risk.

24 Public Counsel asks the Commission to
25 focus on ensuring rate affordability and fairness

1 for the customers. There is no denying that the
2 lower the approved ROE, the more affordable the
3 rates are to the customers.

4 According to Staff's reconciliation,
5 the total revenue requirement as of February 20th,
6 2015, just before the hearing began, as expressed
7 by the company at its recommended 10.4 ROE was
8 about \$200.5 million.

9 According to that same
10 reconciliation, if the Commission approves Public
11 Counsel's recommended 9.01 percent ROE, customers
12 would save more than \$82 million per year,
13 approximately 41 percent. If the Commission
14 approves Staff's 9.2 percent recommended ROE or
15 even MIEC's recommended 9.3 percent ROE, Staff's
16 reconciliation shows that the revenue requirement
17 would be cut by nearly one-third, saving customers
18 more than \$65 million per year.

19 These dollar figures show that the
20 effect of ROE on the customers and the
21 affordability of rates in this case is staggering.
22 Public Counsel asks the Commission not to lose
23 sight of this fact.

24 Mr. Hevert, Mr. Schafer, Mr. Gorman
25 and Mr. Murray all utilize traditional tools,

1 including discounted cash flow, DCF models, risk
2 premium, RP studies and the capital pricing --
3 capital asset pricing model, CAPM, to determine the
4 reasonable range of return on equity in these cases
5 given market forces.

6 The ROEs recommended by Public
7 Counsel, MIEC and Staff, which are reflected in
8 Staff's reconciliation, all have expert testimony
9 behind them, proving that they satisfy the
10 Bluefield and Hope standards that have been set by
11 the U.S. Supreme Court for a reasonable ROE.

12 Customers have the right to expect
13 the Commission to decrease the return on equity in
14 a rate case if the evidence suggests it is the fair
15 and equitable thing to do. Therefore, Public
16 Counsel asks that the Commission reject the
17 company's requested ROE and approve Public
18 Counsel's recommended return on common equity of
19 9.01 percent as a just and reasonable balance
20 between Ameren and its customers.

21 Thank you.

22 JUDGE WOODRUFF: Questions?

23 CHAIRMAN KENNEY: Just a couple. And
24 I appreciate your voice, so I won't ask too many
25 questions. And these, I think, are legal

1 questions. The low of Mr. Schafer's recommendation
2 is 8.74?

3 MS. BAKER: Yes.

4 CHAIRMAN KENNEY: And the high of
5 Mr. Hevert's is 10.60. And I think what you just
6 said is that they're all supported by the DCF, CAPM
7 and the risk premium models, all supported by
8 expert testimony, right?

9 MS. BAKER: They were developed with
10 those in mind, yes.

11 CHAIRMAN KENNEY: So legally, would
12 you agree with me that we could set the ROE at 8.74
13 or 10.60 and be sustained by the courts either way?

14 MS. BAKER: Legally, you can set the
15 ROE at any place that you feel that you have
16 sufficient testimony and evidence in front of you,
17 yes.

18 CHAIRMAN KENNEY: So you would agree
19 with me that there's sufficient evidence and
20 testimony in front of us to support either of those
21 ROEs?

22 MS. BAKER: I believe that you have
23 testimony in front of you up to 10.6. I'm not sure
24 that I agree that it -- how it was developed is
25 sufficient, but that is your decision to make, yes.

1 CHAIRMAN KENNEY: Okay.

2 JUDGE WOODRUFF: Thank you.

3 MS. BAKER: Thank you.

4 JUDGE WOODRUFF: Then opening for
5 MIEC.

6 MS. ILES: I have a PowerPoint, and I
7 have a handout to go along it. It's just a few
8 slides.

9 Good morning. May it please the
10 Commission? My name is Carole Iles. I'm here on
11 behalf of the MIEC, the Missouri Industrial Energy
12 Consumers. And our evidence in this case on ROE is
13 the testimony of Michael Gorman. His
14 recommendation, as you've already heard in all the
15 other opening statements of course, is 9.3 percent,
16 which is the midpoint of his recommended range of
17 9.0 to 9.60.

18 And what I want to share with you
19 right now is a little excerpt from Mr. Gorman's
20 testimony, which I think is a nice summary of the
21 key factors that we would like this Commission to
22 consider in deciding this issue. And again, I'm
23 going to be echoing some of the openings that have
24 just gone before me here, but this is what I wanted
25 to share with you.

1 Ameren Missouri's -- this is
2 Mr. Gorman's testimony. Ameren Missouri's and
3 other electric utilities' capital costs are at
4 historically low levels. These low capital market
5 costs help offset increases in electric utility
6 rates caused by commodity prices and increased rate
7 base investment.

8 In my judgment, a balanced regulatory
9 decision reflects the increase in utility's cost of
10 capital and decreases in their cost of capital.
11 The current market environment has offered a
12 significant decline in the utility's cost of
13 capital that should be considered in setting Ameren
14 Missouri's revenue requirement and determining fair
15 and reasonable return on equity.

16 So what we're saying, what we're
17 asking the Commission to do in this case -- and
18 this is in response somewhat to what Commissioner
19 Rupp asked earlier -- we're simply asking that
20 ratepayers be given the benefit of these
21 historically low capital market costs, that it
22 shouldn't be a one-way switch. It shouldn't just
23 go up when -- the ROE shouldn't just go up when
24 capital costs go up, but they should also reflect
25 the decline in the capital markets.

1 As in past cases, Mr. Gorman's
2 testimony, as you've also heard this morning, uses
3 the same market-based analyses that Ameren's expert
4 uses, and yet they arrive at different conclusions,
5 and that, as Mr. Tomc explained to you, is due to
6 their different inputs.

7 In evaluating these recommendations,
8 you've already been versed this morning on the key
9 principles that apply here from the Hope and
10 Bluefield case, so I went go through those again.

11 But what we want you to focus on is
12 that the information provided by the markets is
13 what shows you what the commensurate return should
14 be. It shows you what investments with comparable
15 risk would provide. And we're asking that you pay
16 particular attention to current interest rate and
17 capital market environments.

18 Now, Mr. Tomc accused Mr. Gorman of
19 being a pessimistic economist, having a pessimistic
20 outlook on where things are going. I would term
21 him realistic. We are at historic lows in the
22 capital markets. Might they go up in the future?
23 Of course they might. But have they gone up? I'm
24 sure everyone was saying the same thing when we
25 were here in 2000-- for the 2012 rate case, and

1 capital costs have not gone up since then. They've
2 gone down, and they continue to go down even since
3 surrebuttal testimony's been filed in this case.

4 Since Ameren Missouri's last rate
5 case, interest rates have declined by approximately
6 37 basis points, utility stock prices have
7 increased, and Mr. Thompson explained that quite
8 thoroughly, and utility stock dividend yields have
9 gone down by 50 basis points. All of these
10 factors point to one conclusion: Lower cost of
11 capital for AmerenUE.

12 As Mr. Thompson also pointed out and
13 Mr. Gorman states in his testimony, higher stock
14 prices mean lower cost of capital, and we've got
15 higher stock prices now. With higher stock prices,
16 companies have to sell fewer shares to generate the
17 capital they need. It's real simple.

18 All of those things, lower interest
19 rates, higher stock prices, lower dividends, they
20 are verifiable, they're objective, they're
21 observable market factors. And all of these
22 factors have gone down since this Commission set
23 Ameren's return on equity at 9.8 percent in the
24 last rate case.

25 Now, not surprisingly, Ameren

1 Missouri is not asking you to focus on these facts.
2 Instead, in our view they are placing undue
3 emphasis on their view of average returns on equity
4 authorized by other regulatory commissions around
5 the country in cases involving other vertically
6 integrated electric utilities.

7 We agree and Mr. -- Mr. Gorman's
8 testimony agrees that average authorized returns
9 provide some measure of reasonableness, but his
10 testimony also asks you to consider this data
11 carefully, and he drills down in that data a little
12 more, a lot more than Ameren does.

13 As he points out, the number that
14 Ameren wants you to look at is vertically -- do I
15 have a typo on this? I think that should be 9.96
16 for the first number. They want you to look at
17 vertically integrated company -- oh, no. It is
18 9.94. The difference in the two numbers is
19 Mr. Gorman looked at all of 2014, and I think when
20 Mr. Hevert's testimony was provided, it was just
21 through November.

22 So these are some things to think
23 about when you're talking about authorized returns
24 on equity. If you look just at vertically
25 integrated companies, the average for 2014 would be

1 9.94. If, however, you look at more than just
2 vertically integrated -- now, Mr. Thompson
3 mentioned to you that vertically integrated
4 companies share certain business risks, have
5 certain business risk that as a class distribution
6 companies may not have. And that's why Ameren says
7 just look at the vertically integrated ones.

8 But as Mr. Gorman has pointed out in
9 his testimony, if you look at credit ratings, which
10 tell you investment risk, which take into account
11 both business and financial risk, you can find
12 distribution companies that are similar, have
13 similar investment risks as integrated companies as
14 well.

15 So it is not unreasonable to look at
16 some of the distribution companies when you're
17 looking at what's going on in other commissions to
18 see what returns are being authorized.

19 If you add the distribution
20 companies, you have more data points. So that kind
21 of smooths out any anomalous results. And when you
22 do that, it also lowers the average authorized
23 return for 2014. It drops down to 9.76.

24 Now, there's another issue that we
25 think needs to be considered when you're looking at

1 those authorized returns, and that is that not all
2 of the authorized returns, not all of the decisions
3 that we look at coming out of other commissions
4 necessarily represent a thorough vetting of the ROE
5 issue. Some cases, as you know, are settled. In
6 some cases the Commission uses the same ROE as in
7 the most recent case without really examining
8 what's going on in the market environment.

9 So Mr. Gorman looked at these things,
10 and this is all from his testimony. It's in his
11 Schedule MPG-SR-1. And if you take out the settled
12 cases where -- and also the cases where the
13 Commission just continued the previous ROE, the
14 average authorized return for 2014 drops down to
15 9.63 percent.

16 So what Ameren wants to tell you is
17 that an informed investor is going to look at these
18 things to see what to expect is going to come out
19 of this Commission in this case, and we would say
20 that an informed investor is going to look
21 carefully and drill down into these numbers, and
22 that these numbers should actually tell them
23 that -- to expect something around 9.63 percent,
24 not 10 percent like Mr. Tomc said.

25 How does that compare to where we

1 were in the last rate case? Well, in 2012, I don't
2 have this on the slide, but the authorized -- the
3 average authorized return for all electric
4 companies was at that level. So there's definitely
5 been a decline of about 26 basis points since then.

6 Now, we recognize that Mr. Gorman's,
7 the average, the 9.63 that he ends up with here is
8 approximately at the high end of his recommended
9 range, and that's why the Commission needs to look
10 at more than just this number, and that's why his
11 analysis that's in his testimony has been provided
12 to you.

13 As the Commission has stated in
14 nearly all of its recent cases for Ameren, that
15 although you're -- you look at the average
16 authorized returns from other commissions, you will
17 not slavishly follow the national average in
18 awarding an ROE to Ameren.

19 I think the other thing that's really
20 important is what Mr. Thompson pointed out, is this
21 circular reasoning idea. If previously authorized
22 returns are some kind of limit on the Commission's
23 discretion, then authorized ROEs can never be
24 adjusted to reflect the true market cost of
25 capital, which is what we're asking you to do in

1 this case.

2 The record in this case in our view
3 supports a finding that Ameren's current cost of
4 common equity is 9.3 percent. This is reasonable
5 and will allow Ameren Missouri to maintain its
6 financial integrity and its credit rating, and
7 Mr. Gorman includes that analysis in his testimony.

8 But more importantly, we think that
9 the 9.3 percent ROE, a decline in the ROE from the
10 2012 case, balances the interests of the company
11 and ratepayers and allows rates to reflect today's
12 historically low capital costs and gives ratepayers
13 the benefit of that savings.

14 Thank you.

15 JUDGE WOODRUFF: Questions?

16 CHAIRMAN KENNEY: Not for me. Thank
17 you.

18 COMMISSIONER W. KENNEY: None for me.

19 JUDGE WOODRUFF: Thank you. Then
20 opening for Consumers Council.

21 MR. COFFMAN: I'll be very brief.

22 Good morning. I concur in the opening statements
23 of the Staff and of the Office of Public Counsel.

24 I would commend to you that the --
25 that there is likely going to be a zone of

1 reasonableness in this case between at least the
2 recommended amounts of 9.01 to 10.40. And within
3 that -- I mean, that is what I believe the law
4 considers the zone of reasonableness to be, which
5 is supported by the evidence. Assuming that at the
6 end of the day that you consider that to be
7 competent evidence, that's what you have to work
8 with.

9 And this issue obviously gives you
10 the broadest range of discretion about any issue
11 that I think the Public Service Commission ever
12 gets to decide. If you refer again to the
13 reconciliation, you'll see that the difference
14 between 10.4 and 9.01 is \$82 million.

15 And so the decision before you is
16 to -- what happens to that \$82 million. That
17 \$82 million a year is now money that is in the
18 hands of families, small businesses, big
19 businesses, all customers of Ameren Missouri. And
20 the question is, how much of that \$82 million do
21 you want to transfer to the utility?

22 And I would urge that you not
23 transfer any more, not one dollar more than what
24 you believe is necessary and sufficient to attract
25 capital and do the things that we've talked about

1 the Bluefield and Hope test requires.

2 I believe that Missouri law requires you in
3 making this decision to consider both the impact on
4 the utility as well as on the consumers. You have
5 evidence, I believe, sufficient evidence in the
6 record as to what the current economic conditions
7 are and what the impact of rate increases would do
8 to various customers.

9 And I would ask that you also
10 recognize the impact that this decision has both on
11 the historical overearnings that this utility has
12 enjoyed under the current regulatory scheme and
13 also the various mechanisms and surcharges that
14 shift risk already from the utility to consumers.

15 That's all I have.

16 JUDGE WOODRUFF: Questions?

17 CHAIRMAN KENNEY: No questions.

18 Thank you.

19 JUDGE WOODRUFF: Thank you. For
20 MECG.

21 MR. WOODSMALL: Good morning. Dave
22 Woodsmall for Midwest Energy Consumers Group.

23 I'm not going to stand before you
24 today and delve into the various court holdings,
25 methodologies, growth rates, data, flaws in certain

1 methodologies or outcomes. Instead, what I'm going
2 to try to do today is put this issue in context,
3 show you this Commission's recent thoughts on the
4 various witnesses, and demonstrate that
5 Mr. Hevert's recommendations are historically as
6 found by all commissions to be inflated.

7 Now, let's look at recent cases. As
8 I pointed out in my original opening statement,
9 with this rate increase Ameren's rates will have
10 gone up 57 percent. That doesn't include
11 \$657 million that they've collected in fuel
12 adjustment clauses. And here you can see
13 graphically how their rates are going up with their
14 rate increase here.

15 Now, since 2006, how does that
16 compare? 57 percent of rate increases while
17 average weekly rates have gone -- wages have gone
18 up 10.51 percent and the Consumer Price Index has
19 gone up 12.35 percent. As you can see, Ameren's
20 shareholders are doing much better than the
21 ratepayers.

22 Now, why do I bring that up? And the
23 Commissioners have asked many questions about that,
24 and I would echo what Mr. Thompson said, because
25 this is the issue in which the Commission has the

1 most discretion. But I'll take it one step
2 further. Not only is this where the Commission
3 exercises the most discretion, this is the biggest
4 issue in the case. 10 basis points here equals
5 \$6.2 million.

6 So if you take the difference between
7 Mr. Hevert's 10.4 percent ROE and take that down to
8 just 9.5 percent, you're talking about \$56 million.
9 Over 28 percent of Ameren's request is buried here
10 in an issue that is discretionary to you.

11 Now, so you see the four
12 recommendations here, and as Mr. Thompson said, it
13 kind of reminds me of Sesame Street. One of these
14 things is not like the others. Three of these are
15 in the low 9s, and you have Mr. Hevert with his
16 routinely inflated ROE.

17 Interestingly, Mr. Tomc sang the
18 praises of Mr. Hevert's experience and his
19 methodology and his data and everything, but
20 noticeably what he failed to provide for you was
21 your previous findings in other cases about
22 Mr. Hevert.

23 For instance, in the 2011 case this
24 Commission said, Hevert's recommended return on
25 equity is higher than the other recommendations in

1 large part because he overestimates future
2 long-term growth in his various DCF analyses,
3 making them too high to be reasonable estimates of
4 long-term sustainable growth.

5 That wasn't an isolated incident. In
6 the last case: However, Hevert's estimation of the
7 appropriate ROE is, quote, too high. MIEC's
8 witness Michael Gorman explains that Mr. Hevert
9 relied on long-term sustainable growth rate
10 estimates in his DCF models that are higher than
11 the growth rate outlooks of the economy as a whole.

12 Now, why is that problematic? As
13 Mr. Gorman says, Mr. Hevert has continued that into
14 this case. Here's Mr. Gorman's rebuttal where he
15 talks again about this continuing string of
16 Mr. Hevert overinflating his growth rates.

17 From his rebuttal, Mr. Gorman's
18 rebuttal: Most of Hevert's DCF return estimates
19 are based on growth rates that are too high to be
20 reasonable estimates of long-term sustainable
21 growth. How does he come about with that
22 conclusion? How does he say they're too high?
23 Because Mr. Hevert's growth rates are greater than
24 any estimates of the gross domestic product.

25 You see here a chart from

1 Mr. Gorman's surrebuttal testimony, and what this
2 shows you is that the middle line, the green line
3 is electricity use, and it lags -- while it
4 follows, it lags slightly behind the growth in the
5 GDP, but it doesn't exceed it.

6 So how do you get growth rates in
7 Mr. Hevert's testimony that exceed any projected
8 growth in the DGP? You don't, and that's what the
9 Commission has previously said. His growth rates
10 are inflated. They exceed that of the GDP.

11 And as Mr. Gorman says in his
12 testimony, utility sales growth has lagged behind
13 GDP growth for more than a decade. As a result,
14 nominal GDP growth is a very conservative proxy for
15 a utility sales growth, rate base growth and
16 earnings growth. Therefore, the U.S. GDP nominal
17 growth rate is a conservative proxy for the highest
18 sustainable long-term growth rate of a utility.

19 So I'd remind you, when you look into
20 this and you do delve that the growth rates,
21 consider how do these compare to the GDP growth?
22 Do they exceed it? Are they unrealistic?

23 Now, you've -- I've pointed out to
24 you that this Commission has previously said that
25 Mr. Hevert's recommendations are, quote, too high.

1 You're not the only commission that thinks so.
2 Every commission thinks so. I went back and I
3 asked a data request, and you'll hear later today,
4 for Mr. Hevert's recommendation in every case since
5 2013. And if you compared his recommendation to
6 what the Commission authorized, you see an 83 basis
7 points difference. His average recommendation was
8 10.53. Commissions awarded 9.70. He is always
9 high. In this case, average is 83 points higher
10 than any commission authorizes. And that arranges
11 all the way up to recommendation that was 150 basis
12 points high.

13 So interestingly, while Mr. Tomc
14 wanted to talk about the Commission's decision in
15 the Liberty case in which Mr. Hevert was 50 points
16 high, he is routinely high. And I'd welcome you to
17 ask him questions about that.

18 Now, in this case, MECG supports the
19 position of MIEC witness Gorman. So I thought it
20 would be interesting to compare for you what this
21 Commission has said about Mr. Gorman. Here's a
22 previous Ameren case: Quote, in particular, the
23 Commission accepts as credible the testimony of
24 MIEC's witness Michael Gorman. Of the witness who
25 testified in this case, Michael Gorman, the witness

1 for MIEC, does the best job of presenting the
2 balanced analysis that the Commission seeks.

3 It didn't stop there. In another
4 case, Michael Gorman, the witness for SIEUA, AGP
5 and FEA, did the best job of presenting the
6 balanced analysis the Commission seeks.

7 And in the last Ameren case: The
8 Commission finds Michael Gorman to be the most
9 credible and most understandable of the three ROE
10 witnesses who testified in this case. Previous
11 Commission decisions are pretty clear on this fact.

12 So let's put this all in context for
13 you. As you can see here, taken from Schedule
14 MPG-12 of Mr. Gorman's direct, capital costs are
15 decreasing. This is since 1986. You can see a
16 definite decline. Now, what I'd like to point to
17 you more importantly is look out here at the tail
18 end and you can see how they declined since 2012,
19 the point of your last decision.

20 In 2012 this Commission authorized a
21 return of 9.8 percent, and what's happened since
22 then? As you can see, the authorized return since
23 you issued your decision have gone down
24 approximately 25, 30 basis points. So naturally,
25 then, your decision in this case should be lower

1 than your decision in the last case.

2 And Mr. Hevert really doesn't argue
3 with that. Mr. Hevert's recommendation is that
4 capital costs have gone down, too. In fact, his
5 recommendation in this case is lower than his
6 recommendation in the last case. Capital is
7 cheaper.

8 So naturally given his
9 recommendation, given the returns of other
10 commissions, your return should go down from the
11 9.8 previously.

12 That was all I had, but I wanted to
13 address a couple questions that were asked earlier,
14 if I may. Commissioner Hall, you had the question
15 about whether a Commission ROE has ever been found
16 to be confiscatory.

17 In the 25 years that I've been
18 watching this, I've never seen a Commission
19 decision found to be confiscatory. Every ROE
20 decision that I've ever seen overturned, it was
21 always on the basis of findings of fact.

22 That kind of goes to one of the
23 questions that the Chairman asked. Within the
24 range of 9.01 to 10.4, can we pick a point anywhere
25 in there? And I would agree you can, but I would

1 caution. If you pick a number like 9.8 that is not
2 a particular point in anybody's testimony, you have
3 to have findings of fact about how you got there.
4 You can't just throw a dart and say 9.8, it's in
5 the range. You have to have findings of fact. But
6 I've never seen a Commission decision deemed
7 confiscatory.

8 We were asked about why do we
9 consider this? Why do we consider the impact on
10 customers? And Mr. Tomc said there's really not
11 much you can do about this because Ameren is a,
12 quote, price taker in the capital market. It has
13 to get capital. It's a price taker. So you have
14 to give us this return.

15 I found it interesting that he
16 mentions that Ameren is a price taker. Who is the
17 real price taker here? Ratepayers. Ameren is a
18 price taker only when it accesses the capital
19 markets, only when it tries to get equity, only
20 when it needs debt.

21 Ratepayers on the other hand are
22 price takers every hour of every day. So I'd ask
23 you to consider that. And I think that was all I
24 had.

25 JUDGE WOODRUFF: Questions?

1 CHAIRMAN KENNEY: Mr. Woodsmall,
2 thank you. Regarding the other cases, the other
3 19 reported cases in which Mr. Hevert's
4 recommendation was deemed too high, do you have --
5 is that in somebody's testimony somewhere?

6 MR. WOODSMALL: It will be in a data
7 request that I'll make an exhibit later.

8 CHAIRMAN KENNEY: Okay. Thank you.

9 JUDGE WOODRUFF: Commissioner Kenney?

10 COMMISSIONER W. KENNEY: No.

11 MR. WOODSMALL: Thank you.

12 JUDGE WOODRUFF: Thank you. I
13 believe that's all the parties who are here today
14 who wish to make opening statements. So we'll go
15 into at this point the testimony, and the first
16 witness then would be Mr. Hevert for Ameren.

17 (Witness sworn.)

18 JUDGE WOODRUFF: You may inquire.

19 MR. TOMC: Your Honor, before we
20 begin, if I may turn off the projector.

21 ROBERT B. HEVERT testified as follows:

22 DIRECT EXAMINATION BY MR. TOMC:

23 Q. Good morning, Mr. Hevert.

24 A. Good morning.

25 Q. Would you please state your name and

1 **business address for the record.**

2 A. My name is Robert Hevert, last name
3 spelled H-e-v-e-r-t. My business address is
4 161 Worcester Road, Suite 503 in Framingham,
5 Massachusetts.

6 **Q. Mr. Hevert, are you -- are you the**
7 **same Robert B. Hevert that caused to be filed**
8 **direct, rebuttal and surrebuttal testimony in this**
9 **proceeding?**

10 A. Yes, I am.

11 **Q. And those aforementioned pieces of**
12 **testimony have been marked Ameren Missouri**
13 **Exhibits 16, 17 and 18. Mr. Hevert, do you have**
14 **any additions or corrections to your testimony at**
15 **this time?**

16 A. I have three. The first is on my
17 direct testimony, which I believe is Exhibit 16,
18 and that's page 33, line 19. The phrase 2014 to
19 2015, that should read 2014 to 2018.

20 The next is also on my direct
21 testimony, page 42, and I'll save Mr. Thompson the
22 trouble by noting that on page 11, natural gas
23 utilities should be vertically integrated electric
24 utilities.

25 And lastly, there seemed to have been

1 a numbering issue on my rebuttal schedule, which
2 should be Schedule 12. It originally had been
3 labeled as Rebuttal Schedule R-9 but should be
4 labeled R-12. I'm not entirely sure how that
5 happened. Those are the only corrections that I
6 have.

7 Q. Mr. Hevert, just so the record is
8 clear, in your testimony, your rebuttal testimony,
9 the schedule that's marked RBH-R-9, this is part of
10 your bond yield plus risk premium; is that right?

11 A. Yes, that's correct.

12 Q. And it is found in place in our
13 organization of schedules where Schedule RBH-R-12
14 should be found; is that correct?

15 A. That is correct.

16 Q. Any other additions or corrections to
17 testimony?

18 A. No, I do not.

19 Q. With those corrections noted, if I
20 were to ask you the same questions today that are
21 in your testimony, would your answers remain the
22 same?

23 A. Yes, they would.

24 MR. TOMC: With that, your Honor, I
25 would move for admission of Ameren Missouri

1 Exhibits 16, 17 and 18 and tender the witness for
2 cross-examination.

3 JUDGE WOODRUFF: 16, 17 and 18 have
4 been offered. Any objections to their receipt?

5 (No response.)

6 JUDGE WOODRUFF: Hearing none, they
7 will be received.

8 (AMERENUE EXHIBIT NOS. 16, 17 AND 18
9 WERE RECEIVED INTO EVIDENCE.)

10 JUDGE WOODRUFF: Cross-examination,
11 MECG?

12 MR. WOODSMALL: Thank you, your
13 Honor. I'd like to mark an exhibit. I believe
14 mine is 970.

15 (MECG EXHIBIT NO. 970 WAS MARKED FOR
16 IDENTIFICATION BY THE REPORTER.)

17 CROSS-EXAMINATION BY MR. WOODSMALL:

18 Q. And I just marked it now, but we'll
19 get to that later.

20 Good morning, Mr. Hevert. My name is
21 David Woodsmall representing some industrial
22 customers in this case. This is your third Ameren
23 Missouri case in which you've testified; is that
24 correct?

25 A. That is correct.

1 Q. And do you recall you testified in
2 Ameren's 2011 rate case; is that correct?

3 A. Yes.

4 Q. Do you recall what your recommended
5 ROE was in that case?

6 A. I do not offhand, no.

7 MR. WOODSMALL: May I approach the
8 witness, your Honor?

9 BY MR. WOODSMALL:

10 Q. This is the Report and Order from the
11 2015 case. Would you agree that your
12 recommendation was 10.7 in that case?

13 A. It was indeed 10.7.

14 Q. And you recall you testified in the
15 2012 case, too; is that correct?

16 A. That is correct.

17 Q. And can you tell me what your
18 recommendation was in that case?

19 A. 10.5.

20 Q. And your recommendation in this case
21 is 10.4 percent; is that correct?

22 A. That is correct. Within a range of
23 10.2 to 10.6.

24 Q. So would you agree that, your
25 quantification that Ameren's cost of equity has

1 **declined since the last case?**

2 A. I would agree that the results of the
3 models that I looked at had me -- had me develop a
4 recommendation that was somewhat lower in this
5 case. I do think, though, that the range is
6 relevant, and I do think that a range that goes up
7 to 10.6, which encompasses the 10.5, is something
8 to consider. But I agree that the spot -- excuse
9 me -- the point estimate of 10.4 is ten basis
10 below.

11 **Q. Turning to Exhibit 970, do you have**
12 **that in front of you?**

13 A. I do.

14 **Q. Do you recall responding to this data**
15 **request?**

16 A. I do.

17 **Q. And would you agree that this data**
18 **request is a list of cases in which you have**
19 **testified and includes your recommended ROE, as**
20 **well as the decision of the various public service**
21 **commissions; is that correct?**

22 A. Yes. And when you say recommended
23 ROE, it does include the range as well as the final
24 recommendation.

25 **Q. And to try to avoid having to go**

1 through each of these point by point, would you
2 agree that, on average, that your recommendation is
3 83 points higher than the return authorized by the
4 commission?

5 A. I have not gone through the math.
6 I've not found that to be a necessarily meaningful
7 calculation, but -- but I don't -- I have no reason
8 to doubt your math.

9 Q. Okay. And would you agree that the
10 minimum difference between your recommendation and
11 the authorized return by a commission was 44 basis
12 points?

13 A. I would agree that if you were to
14 look at the range, the minimum is zero, but if you
15 were to look at the point estimate, what did you
16 say 44 basis points?

17 Q. 44.

18 A. And can you point me to which case
19 that was? It is a Delmarva case. Looks like
20 Delmarva, Maryland.

21 JUDGE WOODRUFF: Mr. Woodsmall, you
22 need to use your microphone.

23 MR. WOODSMALL: I'm sorry.

24 THE WITNESS: I'm sorry. So
25 Delmarva, that would be Case 9317?

1 BY MR. WOODSMALL:

2 Q. Yes. You would agree that the
3 difference there was 44 basis points?

4 A. Yes, I agree with that.

5 Q. And would you agree that the maximum
6 difference between your recommendation and the
7 authorized return by the Commission was 150 basis
8 points in a Virginia Electric and Power Company
9 case?

10 A. I would not fully agree with that.
11 The final recommendation in that case took into
12 account the additional 50 basis points that the
13 company made for what it considered to be its
14 performance. So the 11.5 percent recommendation
15 included my estimate, as well as the company's
16 50 basis point request for operational performance.

17 Q. Okay. And Mr. Tomc referenced a
18 Liberty Gas case in Missouri in which you
19 testified. Do you recall that?

20 A. I do.

21 Q. And would you agree that in this case
22 you recommended a return of 10.50 percent?

23 A. Let me just pull that one up. Yes.
24 As I recall, that was again within a range of
25 10 to 10.5. So as I'd mentioned earlier, if you

1 were to look within the context of range, the
2 minimum is -- would be zero basis points.

3 MR. WOODSMALL: No further questions.

4 I'd move for the exhibit of Exhibit 970 -- entrance
5 of Exhibit 970.

6 JUDGE WOODRUFF: 970 has been
7 offered. Any objections to its receipt?

8 MR. TOMC: No objection.

9 JUDGE WOODRUFF: It will be received.

10 (MECG EXHIBIT NO. 970 WAS RECEIVED
11 INTO EVIDENCE.)

12 JUDGE WOODRUFF: And for further
13 cross-examination, we move to Consumers Council.

14 MR. COFFMAN: No questions.

15 JUDGE WOODRUFF: Public Counsel?

16 CROSS-EXAMINATION BY MS. BAKER:

17 Q. Good morning, Mr. Hevert. I'm sorry.
18 My voice is still pretty bad.

19 A. I was going to say, it sounds like
20 you had a more fun weekend than I did.

21 Q. I did not. I can guarantee you I did
22 not.

23 Are you aware that during the local
24 public hearings, there's been a lot of customer
25 concern over the affordability of rates?

1 A. I am. And I will tell you that --

2 **Q. Just yes or no, please. Thank you.**

3 A. I am, based on my review of the
4 transcripts, because I do make it a practice to
5 read many of those transcripts.

6 **Q. And you would agree that the goal for
7 the Commission is to set rates that are just and
8 reasonable, yes?**

9 A. As with all commissions, yes.

10 **Q. And you would agree that part of
11 determining a reasonable rate is to make rates as
12 affordable as possible without causing a detriment
13 to the utility, yes?**

14 A. I guess I use a slightly different
15 term. And it may come out the same way, but when I
16 look at it, I look at it as the role of the
17 Commission is balancing the interests of ratepayers
18 and investors.

19 **Q. All right. And in your testimony,
20 you state that you calculate a reasonable range for
21 ROE for Ameren to be that anywhere between 10.20 to
22 10.60 percent; is that correct?**

23 A. That is correct.

24 **Q. And based on that range, your
25 recommendation is 10.4, correct?**

1 A. That is correct.

2 Q. And to develop that recommendation,
3 you utilize the constant growth DCF model, the
4 multistage DCF model and the CAPM model; is that
5 correct?

6 A. And the bond yield plus risk premium
7 model and, of course, as discussed throughout my
8 testimony, as a consequence of some of the market
9 conditions that were talked about in various
10 opening statements this morning, some of those
11 models and in particular the constant growth DCF
12 model in my view are less applicable.

13 Q. Okay. But you did use them in your
14 analysis, yes?

15 A. When you say use them, I looked at
16 them. I agree with that.

17 Q. All right. And these models were
18 also used or looked at by the other ROE witnesses,
19 Mr. Schafer, Mr. Gorman and Mr. Murray; is that
20 correct?

21 A. Not all. I think we all used some
22 form or looked at some form of the constant growth
23 DCF model. We all looked at some form of the
24 multistage DCF model, as well as the capital asset
25 pricing model. Mr. Gorman and I also considered a

1 bond yield plus risk premium approach, although our
2 approaches differ.

3 **Q. And then I assume that you would**
4 **agree that a reasonable return on equity for Ameren**
5 **is one that is, one, adequate to attract capital at**
6 **reasonable terms, two, sufficient to ensure**
7 **Ameren's financial integrity and, three,**
8 **commensurate with returns on investments in**
9 **enterprises having corresponding risks as stated by**
10 **the Bluefield and Hope cases?**

11 A. Yes. I think it's quite common for
12 rate of return witnesses to cite to Hope and
13 Bluefield. And I think as to the first standard,
14 the capital attraction standard, you're right that
15 the notion or the term of reasonable costs is an
16 important element of that standard.

17 **Q. Okay. And so a return on equity that**
18 **meets those requirements or those standards of**
19 **Bluefield and Hope would be a reasonable -- would**
20 **be reasonable and not detrimental to Ameren?**

21 A. To the extent that the company is
22 able to attract capital at reasonable terms, that
23 the return is commensurate of enterprises of
24 corresponding risk and it does maintain the
25 company's financial integrity, then it would meet

1 those three standards on over -- excuse me -- with
2 respect to Hope and Bluefield, and by that measure
3 most people would consider it to be reasonable.

4 **Q. And not detrimental to Ameren?**

5 A. Well, correct. If it can -- if the
6 company can attract capital at reasonable terms and
7 it can maintain its financial integrity; in other,
8 words, it has the cash flow needed to fund capital
9 expenditures, it has the cash flow needed to -- to
10 maintain its liquidity, it's able to maintain its
11 credit ratings, it's able to maintain the
12 confidence of investors, if those things happen and
13 it's able to attract capital, then yes, I would
14 agree.

15 MS. BAKER: No further questions.

16 Thank you.

17 JUDGE WOODRUFF: Then we move to
18 MIEC.

19 CROSS-EXAMINATION BY MS. ILES:

20 **Q. Good morning, Mr. Hevert.**

21 A. There you are.

22 **Q. I'm way back here. Is this okay?**

23 **Just a few questions.**

24 **Now, you performed your analysis to**
25 **determine a fair return on common equity, and as**

1 part of your analysis you selected a proxy group;
2 is that correct?

3 A. Yes, that is correct.

4 Q. And the basis of making -- or the
5 proxy group was intended to reasonably reflect
6 Ameren Missouri's investment risk; is that correct?

7 A. I think that's a fair summary. It's
8 meant to come as close as possible to Ameren
9 Missouri's risk profile, yes. So I would agree
10 with that.

11 Q. Well, you use the term risk profile,
12 and I use the term investment risk. Is there a
13 difference in those two things?

14 A. Well, when you say investment risk,
15 I'm not entirely sure what you mean. So I thought
16 I'd let you know what I mean.

17 Q. Okay. When I say investment risk,
18 I'm including business risk as well as financial.

19 A. Fair enough. Then I think we would
20 agree.

21 Q. Thank you. So it's your assumption
22 that the market cost of equity for your proxy group
23 can be used to estimate a fair and reasonable
24 return on equity for Ameren?

25 A. I'm sorry. Can you repeat your

1 question?

2 Q. The assumption in using a proxy group
3 is that the market conditions of equity that you
4 determine for the proxy group can be used to
5 estimate a fair and reasonable return on equity for
6 Ameren Missouri?

7 A. Yes, I agree with that.

8 Q. Okay. Now, you also state on page 8
9 of your direct testimony that the use of a proxy
10 group has a significant benefit because it serves
11 to moderate the effects of anomalous temporary
12 effects associated with any one company; is that
13 correct?

14 A. That's right.

15 Q. Can't anomalous -- can an anomalous
16 event result in a return estimate that is
17 unreasonably low? Is that what you're trying to
18 avoid?

19 A. Unreasonably low or unreasonably
20 high.

21 Q. It could be either way?

22 A. It could be either way.

23 Q. And so those are the -- those are the
24 results you're trying to avoid by using the proxy
25 group, correct?

1 A. Right. The idea is that because of
2 the Hope and Bluefield risk comparability standard,
3 you have to look to companies of comparable risk.
4 And also because the cost of equity is born of the
5 concept of opportunity cost, you also have to look
6 at investments of comparable risk.

7 And so by using a proxy group, you're
8 able to mitigate the potential risk of any one
9 company having anomalous results but, more
10 importantly, you cannot use the subject company for
11 that purpose.

12 **Q. Okay. Great. You just answered my**
13 **next question, which was, did you identify any**
14 **other benefits of using the proxy group? And I**
15 **think you summed that up quite well.**

16 **So basically, if you had a proxy**
17 **group that was not a reasonable risk proxy to**
18 **Ameren, that wouldn't be helpful in your analysis,**
19 **correct?**

20 A. That is correct. And I think that's
21 why all analysts develop a series of screens that
22 we think --

23 **Q. Okay. I'm going to ask you about**
24 **those in a second, so you don't need to get into**
25 **those yet.**

1 A. Very good.

2 Q. And page 9 of your direct testimony,
3 you go over your selection criteria, which I think
4 you just started to talk about there, so I know
5 you're anxious to tell us about those. So is it
6 true that you started with, I think you state on
7 page 9, line 7 to 8 of your direct testimony, that
8 you began your analysis with all electric utility
9 companies, followed by the Value Line Investment
10 Survey; is that correct?

11 A. I began with the universe of
12 companies that Value Line classifies as electric
13 utilities, that's right.

14 Q. That would include distribution
15 companies as well as vertically integrated, right?

16 A. It does, yes.

17 Q. Now, in your work papers, did you
18 provide a list of all those companies? I don't
19 think you did.

20 A. I can't -- I can't say offhand.

21 Q. If I showed you the list, would you
22 be able to identify it as the list you started
23 with?

24 A. Perhaps. I'll give it my best try.
25 I will tell you the list does change from time to

1 time.

2 **Q. Okay.**

3 A. So sure. Why don't you go ahead and
4 give me the list.

5 (MIEC EXHIBIT NO. 517 WAS MARKED FOR
6 IDENTIFICATION BY THE REPORTER.)

7 BY MS. ILES:

8 **Q. All right. I'm handing you what's**
9 **been marked as Exhibit 517. Does this look like**
10 **the right list?**

11 A. Can you tell me when this was
12 downloaded?

13 **Q. Last week.**

14 A. Last week? Okay.

15 **Q. Do you think there have been changes**
16 **since last week?**

17 A. Well, I don't know. If you don't
18 mind, I'm just going to take a quick look

19 **Q. Let me just ask you this question:**
20 **Have there been significant changes in the**
21 **companies that Value Line follows over the time**
22 **since you submitted your testimony and today?**

23 A. I don't think so.

24 **Q. Okay. So this may not be exactly it,**
25 **but it's probably close?**

1 A. I would say it's probably close.

2 Q. That's good enough for our purpose
3 today. Thank you.

4 MS. ILES: I'd like to move for the
5 admission of 517.

6 JUDGE WOODRUFF: 517 has been
7 offered. Any objections to its receipt?

8 MR. TOMC: I object, your Honor. I
9 don't think the witness established sufficient
10 familiarity with this document. It appears to be a
11 document that was printed off of the Internet last
12 week. I don't believe it meets the evidentiary
13 criteria for foundation and should not be admitted.

14 JUDGE WOODRUFF: Ms. Iles, can you
15 establish further foundation on this? What is this
16 document?

17 MS. ILES: Basically, your Honor, the
18 reason we're submitting this is because he states
19 in his testimony that he started with this full
20 universe of Value Line companies, but he did not
21 provide that in his work papers. So this is to
22 supplement the information that Mr. Hevert
23 provided.

24 JUDGE WOODRUFF: Can you ask the
25 witness about that? Have him explain more what the

1 document is.

2 BY MS. ILES:

3 Q. I'm sorry. Let me do a better job of
4 being a lawyer here. Could you explain, does this
5 appear to you to be the type of document that if
6 you went to Value Line's website and looked for a
7 list of the companies, is it consistent with what
8 you'd find there?

9 A. It is. And I'll tell you the one
10 that has been sort of tickling at me a little bit
11 is on the first page, Wilmington Capital
12 Management. I just don't recall whether or not
13 that was in the initial group that we looked at.

14 But generally speaking, the way
15 you've got this document arranged, Value Line
16 covers companies according to three regions,
17 central, east and west. And these companies are
18 downloaded according to those regions. So this
19 would strike me as the type of document that you
20 would expect to get out of Value Line.

21 Q. Are you familiar with Value Line's
22 website?

23 A. I am, yes.

24 Q. And have you looked at a list of
25 companies similar to this one when you've gone on

1 the website?

2 A. Yes, I have.

3 Q. And so does this appear to be the
4 kind of information that one would download from
5 that website, consistent with that?

6 A. It would be the type of information
7 available from that website.

8 JUDGE WOODRUFF: Still object?

9 MR. TOMC: No, your Honor. I
10 withdraw the objection.

11 JUDGE WOODRUFF: Exhibit 517 will be
12 received.

13 (MIEC EXHIBIT NO. 517 WAS RECEIVED
14 INTO EVIDENCE.)

15 BY MS. ILES:

16 Q. So let's go through those screens
17 that you mentioned in your testimony. I believe
18 you state these are described on pages 9 and 10 of
19 your direct testimony?

20 A. That's right.

21 Q. And the first one is consistent
22 payment of quarterly cash dividends; is that
23 correct?

24 A. Correct.

25 Q. And then at least two industry

1 analysts have to be following the company; is that
2 correct?

3 A. That is correct.

4 Q. And then you look for
5 investment-grade bond ratings or corporate credit
6 ratings from Standard & Poor's; is that correct?

7 A. That's right.

8 Q. And then you look to see whether less
9 than 60 percent of the operating -- well, I guess
10 you would eliminate any company that has less than
11 60 percent of its operating income from regulated
12 operations, correct?

13 A. That is correct.

14 Q. Have I stated that correctly?

15 A. That's right.

16 Q. And then you also look at merger and
17 acquisition activity, correct?

18 A. Correct. There was one other.

19 Q. Okay. What was one other?

20 A. So on page 9, beginning at line 19,
21 there's a requirement that electric operating
22 income -- excuse me -- regulated electric operating
23 income had to represent at least 90 percent of
24 total regulated operating income.

25 Q. Okay. Thank you. And then in

1 addition to those screens on page 11 of your direct
2 testimony, you removed Edison International from
3 the proxy group due to recent writeoffs related to
4 a failed merchant generation subsidiary of that
5 company, correct?

6 A. That's right.

7 Q. Let's see. And is it true that
8 Edison International stock price may have been
9 negatively impacted by its ownership of that
10 merchant generator subsidiary that was having
11 financial difficulties?

12 A. Well, I think during the time, during
13 the time of the impairment, during the time of the
14 bankruptcy of the entity that held those entities,
15 it could well have negatively affected the stock
16 price. It also may have affected analysts' views
17 of growth going forward.

18 In my view, it was -- there was
19 sufficient uncertainty in there that it just - -it
20 seemed to me that there could be great uncertainty
21 in how the investment community would look at the
22 company prospectively. So I eliminated it on that
23 basis.

24 Q. So really when you say the
25 investment, how the investment community was going

1 to look at it, you were thinking about how -- tell
2 me if this is correct -- the market price and other
3 DCF parameters might have been impacted by that
4 situation?

5 A. Well, I think if you look at page 11,
6 lines 13 through 16, I think I sum it up there
7 saying, given the significant nature of the result,
8 it's difficult to assess the degree to which
9 regulated utility operations would be expected to
10 contribute to the company's consolidated financial
11 performance in the future.

12 Q. Okay. So that has to do with other
13 subsidiaries having to make up the difference from
14 the financial problems associated with this failing
15 subsidiary, correct?

16 A. I'm not sure I would put it that way.
17 I think I would put it the way I put it in my
18 testimony.

19 Q. Okay. All right. Now, in Ameren
20 Missouri's last rate case, which was decided and
21 the Order was issued in December of 2012, Ameren
22 Corporation also had a merchant generating
23 facility, did it not?

24 A. Yes, it did.

25 Q. And isn't it true that it sold that

1 **merchant generation after March 14th of 2013?**

2 A. That's right.

3 **Q. And isn't it also true that Ameren**
4 **Missouri's credit rating was positively impacted by**
5 **that?**

6 A. I think the -- from a corporate
7 perspective, the -- the loss of the merchant
8 generation risk was seen as a benefit, and to the
9 extent that companies such as Standard & Poor's
10 look at creating -- excuse me -- look at ratings
11 from a top-down perspective, yes, it was affected
12 by that.

13 **Q. And that's Ameren Missouri in**
14 **addition to Ameren Corporation?**

15 A. Yes, that's what I meant.

16 **Q. I just want to make it clear. And**
17 **just so also to be clear, that sale of that**
18 **subsidiary occurred after the last rate case was**
19 **decided, correct?**

20 A. Correct. And again, just to be
21 clear, we're here setting the rate of return for
22 Ameren Missouri, the regulated electric operations,
23 and that's the purpose of developing the proxy
24 group. So to the extent that there's a potential
25 proxy company that would be affected by merchant

1 operations, we want to eliminate that. Because
2 we're looking at the company as a standalone
3 company with respect to its regulated utility
4 risks.

5 **Q. Okay. Thank you. Now, can you**
6 **explain why you use the S&P bond rating as a**
7 **screening criterion in identifying companies of**
8 **comparable investment risk?**

9 A. We use it because it's generally
10 available. We want to be sure that there is a bond
11 rating that's generally used by companies. If a
12 company does not have a credit rating from
13 Standard & Poor's, we'll use Moody's. Typically a
14 company will have either one of those two.

15 And again, for our purposes, for my
16 purposes, the distinction is investment versus
17 non-investment grade. So whether you use Moody's
18 or whether you use Standard & Poor's for that
19 purpose, I don't think it really matters.

20 **Q. And what's that investment grade --**
21 **what's that investment grade bond rating really**
22 **tell you?**

23 A. Oh, it tells you a lot.

24 **Q. Is it telling you something about**
25 **predictable cash flows?**

1 A. What it's telling you is, it's
2 telling you a couple of things, some of which are
3 technical in nature, some of which are fundamental
4 in nature. Let me speak to the first issue, those
5 that are technical in nature.

6 In my experience, Mr. Tomc mentioned
7 I spent quite a lot of years working at a utility,
8 and I know from my experience that institutional
9 investors often have prohibitions against investing
10 in non-investment grade companies. So simply that
11 prohibition is important.

12 You consider the fact that
13 utilities typically are approximately 65 percent
14 institutionally owned. A prohibition against
15 non-investment grade companies could have quite an
16 effect on the trading value or the price of a
17 company. If that were the only reason, in my view
18 that would be sufficient to have a cutoff at
19 noninvestment grade.

20 Now, as you move up from investment
21 grade with notches, of course, what that
22 corresponds to are changes in business risk,
23 changes in financial risk.

24 **Q. You're talking about changes in**
25 **business risk and financial risk, and that would**

1 explain why there are some institutional investors
2 who avoid those low credit rated investments,
3 correct? I mean, there's a connection between the
4 two things you just explained to us?

5 A. There's a connection. I think
6 sometimes the question is where that connection
7 falls, whether -- what the increments or decrements
8 of required equity returns are relative to
9 increments or decrements of credit rating notches.

10 Q. Okay. Thank you. In your
11 experience, is it generally normal within the
12 industry practice for rate of return witnesses to
13 use bond ratings as an investment risk selection
14 criterion in identifying proxy group companies of
15 comparable risk?

16 A. I think it's -- it's certainly not
17 uncommon for that purpose.

18 MS. ILES: No further questions.

19 JUDGE WOODRUFF: All right. Cross
20 for Staff?

21 MR. THOMPSON: No questions. Thank
22 you.

23 JUDGE WOODRUFF: Come up to questions
24 from the Bench. Mr. Chairman?

25 QUESTIONS BY CHAIRMAN KENNEY:

1 Q. Mr. Hevert.

2 A. Good morning.

3 Q. Good morning. Good to see you again.

4 A. Nice to see you as well.

5 Q. I searched high and low and I
6 couldn't find Attachment A to your direct testimony
7 that listed your prior testimony.

8 A. Uh-oh.

9 Q. And it could be my fault. So I'm
10 just going to ask my questions without the benefit
11 of that attachment. Have you -- do you typically
12 testify for utilities?

13 A. I do, yes.

14 Q. Have you testified for a consumer
15 group in the last, I don't know, ten cases in which
16 you've testified?

17 A. Let me sort of back up on my first
18 answer. I took your question to mean with respect
19 to rate of return issues. I have testified, for
20 example, on behalf of the Maine Public Utility
21 Commission on an issue regarding the incremental
22 value of pipeline capacity into the New England
23 region.

24 Q. My question was poorly worded, and
25 you're correct, I wanted you to limit this to ROE

1 **issues.**

2 A. Then I have not testified on behalf
3 of consumer groups. My clients are utilities.

4 **Q. Solely?**

5 A. On rate of return issues, I've only
6 testified for utilities, that's correct.

7 **Q. Okay. And I'm going to ask everybody**
8 **this, so don't be offended.**

9 A. None taken.

10 **Q. How much are you making for your**
11 **testimony here today?**

12 A. My billing rate is \$350 an hour.
13 The -- because we have a number of people at our
14 firm with lower billing rates that work on
15 testimony, the average, I refer to it as the
16 blended rate, so if you were to look at the cost
17 divided by the number of hours, it's about 230 to
18 \$240 an hour.

19 **Q. Is that rate the same for your**
20 **prepared testimony, the three rounds of testimony**
21 **that you filed?**

22 A. It is, yes.

23 **Q. Same rate?**

24 A. It is.

25 **Q. So you charge the same whether you're**

1 **testifying on paper versus actually appearing here?**

2 A. That's a great question. I do not
3 charge a premium for live testimony. I know some
4 witnesses do.

5 Q. Okay. Thank you for those answers.
6 **So the main purpose in constructing a proxy group**
7 **is essentially to try to as closely as possible**
8 **approximate the profile of Ameren Missouri, right?**

9 A. Yes.

10 Q. **And each of the four witnesses who**
11 **have testified as to these issues construct proxy**
12 **groups?**

13 A. That's right.

14 Q. **And I think all four of you start**
15 **with Value Line and then you limit off or exclude**
16 **companies on different criteria?**

17 A. That's right.

18 Q. **Are any of the three's methodologies**
19 **for constructing their proxy groups patently out of**
20 **line?**

21 A. I don't think so, and that's why in
22 my rebuttal testimony I developed what I refer to
23 as a combined group. So it includes any of the
24 companies that any of us used.

25 Q. Okay. So let me just ask a question.

1 **Generally speaking, when we're setting the ROE, the**
2 **value of that number is ultimately a statement**
3 **about the risk of the company, right?**

4 A. I would agree with that, yes.

5 **Q. It's both the business and the**
6 **financial risk of the company?**

7 A. I would agree.

8 **Q. So investors are going to look at**
9 **what the Commission sets as the allowed ROE as a**
10 **statement of our assessment of the relative or**
11 **comparative risk of Ameren?**

12 A. I think two things happen. One is
13 that investors look -- as you said, investors look
14 at it as your perception of the company's risk, and
15 then in certain jurisdictions, in most
16 jurisdictions, investors also will look at the
17 outcome and -- from that and for a level of risk.
18 So I think the perspective goes both ways.

19 **Q. So there's multiple things they look**
20 **at. They're also going to look at credit ratings**
21 **from three major agencies?**

22 A. On the equity side?

23 **Q. Yeah.**

24 A. I think that's right.

25 **Q. As a measure of risk?**

1 A. As a measure of risk. And I think
2 part of the issue on the measure of risk, as I
3 said, is in my view, the principal threshold is
4 above or below investment grade. I think if you
5 were to look at, for example, Ameren Missouri's
6 credit ratings from the three major rating
7 agencies, they're not far off from the rest of the
8 companies. And I say that looking at it at the
9 operating company level.

10 **Q. So when we look at -- let me back up.
11 You said it from the investors' perspective, and we
12 had a discussion earlier with one of the attorneys
13 about the threshold for institutional investors.**

14 A. Right.

15 **Q. When we talk about institutional
16 investors, we're talking about like pension funds?**

17 A. Correct.

18 **Q. State pension funds, private pension
19 funds, teachers' pension funds?**

20 A. Correct. As well as institutions
21 that manage money on behalf of individual clients,
22 right.

23 **Q. And they have criteria that they look
24 at when they're deciding to where to place their
25 capital?**

1 A. They have criteria and some have
2 policy guidelines to which they have to adhere.

3 **Q. And that prohibits them from**
4 **investing in any company that's below investment**
5 **grade?**

6 A. Right. And again, based on my
7 experience in dealing with institutional investors,
8 I -- I understand that -- I know that that was a
9 threshold that some institutions have.

10 **Q. So at the end of the day, though,**
11 **whether you're looking at the three credit rating**
12 **agencies or you're looking at the allowed ROE that**
13 **we set, it's all a measure of business and**
14 **financial risk, correct?**

15 A. It's a -- it's a measure of business
16 and financial risk, and it's a measure of relative
17 business and financial risk.

18 **Q. Relative to other similarly situated**
19 **entities?**

20 A. That's correct. And I think another
21 point that's possibly especially important now in
22 this environment is relative to other market
23 sectors. So, for example, if you have a situation
24 in which a sector is trading at relatively high
25 levels, at some point the market will see that the

1 relationship between that sector and other sectors
2 is out of line and it will correct itself. I think
3 that's what we've been seeing recently.

4 **Q. That's interesting. I wasn't going**
5 **to ask these questions, but that triggers another.**
6 **Relative to other market sectors, why not construct**
7 **a proxy group that considers those other sectors?**

8 A. In a sense -- in a sense we -- the
9 issue of relative risk is taken into account
10 through the capital asset pricing model, where the
11 beta coefficient actually measures the risk of the
12 proxy group, the risk of the subject company
13 relative to other sectors. So that model which is
14 commonly used does take into account that relative
15 risk.

16 There are -- I have seen witnesses
17 use comparable earnings types of approaches using
18 sectors that have equivalent risk parameters and
19 perhaps measured by beta coefficients, perhaps
20 measured by stock -- excuse me -- credit ratings,
21 but I don't think too many witnesses use that
22 approach.

23 **Q. So the other three witnesses have**
24 **indicated that, as a general proposition, since**
25 **Ameren's last rate case, the cost of capital has**

1 **declined. Do you agree with that statement as a**
2 **general proposition?**

3 A. I do not.

4 **Q. Okay. Because that's a really**
5 **fundamental disagreement, isn't it?**

6 A. It is. I think there are a couple of
7 fundamental disagreements. That's certainly one of
8 them.

9 **Q. That's a big one, right?**

10 A. It is. And when I look at it, well,
11 we can look at a couple of very visible measures.
12 If you were to look at, for example the 30-year
13 treasury yield from July 2014, about when this case
14 started, through now, it's about 2.97 percent. If
15 you were to look at it through calendar year 2012,
16 it was about 2.9 percent. There's not a
17 fundamental difference there. We've had some
18 differences of opinion regarding how you should
19 look at authorized returns.

20 But when I look at it, I see over the
21 course of 2012 to 2014, the end of 2014, it being
22 at about 10 percent. It's pretty close. It may be
23 you're in -- within 5 to 7 basis points of that
24 going from 2012 to 2013, 2013 to 2014, but to me
25 that's well within just this variation. So I don't

1 see authorized returns as having decreased.

2 Q. I got you there. But let me stop you
3 there for a second. You started with the
4 2.9 percent of the treasury yield?

5 A. Right.

6 Q. You basically said they stayed
7 constant from 2012 through 2014?

8 A. From July 2014 through February 27th,
9 2015.

10 Q. They have stayed at that
11 2.9 percent?

12 A. The average over that period.

13 Q. So they're not -- the treasury
14 yields, if we look at these 30-year treasury
15 yields, they're not increasing?

16 A. Slightly, but they've certainly
17 remained constant.

18 Q. And, well, isn't that a good measure
19 of whether capital costs as a general proposition
20 are increasing or not?

21 A. I think it's a starting point. You
22 can look at a lot of reasons why treasury yields
23 bounce around. Sometimes it's the flight to safety
24 issue, which would mean actually as treasury yields
25 go down, risk aversion is going up. The required

1 return on equity is going up. So there are, I
2 think, a lot of interactions to be considered. But
3 as a broad measure, it's probably a good starting
4 point.

5 Q. Okay. I want to talk about three
6 measures that were mentioned earlier, and I can't
7 remember whose opening it was, but there was
8 mention that the stock prices are increasing,
9 dividend yields are decreasing and interest rates
10 have declined. Do you agree with those three
11 statements or measures?

12 A. Well, I've got some thoughts on each
13 of them.

14 Q. Would you agree with them first, not
15 necessarily what they actually mean?

16 A. Not entirely, no.

17 Q. Let's start with stock prices
18 increasing. I think what somebody said was that as
19 stock prices increase, ROEs are inversely related
20 and decrease.

21 A. Right. I think --

22 Q. First, do you agree with the
23 statement that stock prices are increasing?
24 Secondly, do you agree with what we should read
25 from that?

1 A. I disagree that stock prices are
2 increasing. If you look at what happened from
3 January 29th through last Friday, February 27th,
4 the sector is down 10 percent. As of this morning
5 before I got on the stand, it's down another two
6 and a half percent, even while the Dow was up. I
7 know it's just a spot operation today, but it's
8 continuing a trend.

9 So what that means is if someone
10 bought the utility sector on January 29th because
11 they wanted a 3 and a half to 4 percent yield, they
12 lost two and a half that amount, because the sector
13 traded off so much so quickly.

14 So I think when we look at the fall
15 in utility prices, it's been fairly dramatic. It's
16 been fairly quick. Over that time, treasury yields
17 increased by about 50 basis points. Utility
18 dividend yields increased by about 40 basis points.
19 So over the past month, if we're going to talk
20 about more current information, I think things have
21 changed actually quite a bit.

22 The other thing that I would say is
23 that when we talk about treasury yields, if you
24 look back in 2012, that was right about when the
25 Federal Reserve was starting its quantitative

1 easing. It finished that in October of last year.
2 One thing that people often overlook is the
3 volatility of treasury rates. The volatility of
4 treasury rates now over the past few months is
5 about twice what it was in 2012, meaning that even
6 that market which typically is relatively stable
7 has been far more unstable now than it had been.

8 So to me, if you look at those couple
9 of things, the market has traded up at least
10 10 percent any month, treasury yields have moved up
11 and dividend yields have moved up. Treasuries are
12 more volatile. That tells me that I don't
13 disagree -- excuse me. I don't agree. I do
14 disagree with the statement that the cost of equity
15 has fallen.

16 **Q. That's helpful. So assuming that**
17 **stock prices are increasing, do you agree with the**
18 **notion that as stock prices increase, ROEs are**
19 **inversely proportional to that and decrease?**

20 A. No, not at all. And the
21 qualification that I believe was in that slide was
22 all else being equal. And the all else that's
23 typically not even is growth rate. Stock prices
24 will go up if growth rates go up. If you look at
25 the constant growth discounted cash flow method,

1 you'll see that the two tended to offset each
2 other. As growth rate goes up, the stock price
3 will go up, the dividend yield will go down.

4 So to say that stock prices are going
5 to go up, all else being equal, the cost of equity
6 goes down, that's fine. But at least under the
7 construct of that model and what we've seen between
8 growth rates now and in 2014, those growth rates
9 have gone up. So I would disagree with that
10 statement.

11 **Q. So what you're saying is, if I can**
12 **just paraphrase, is all else isn't usually equal?**

13 A. Correct.

14 **Q. Okay. So let me ask this: How do we**
15 **account for the fact that in 19 of these other**
16 **reported decisions, your recommended ROE is**
17 **83 basis points above what the Commission**
18 **ultimately authorized?**

19 A. Well, I --

20 **Q. What should we take from that, if**
21 **anything?**

22 A. First off, I find that when I testify
23 before commissions, there's a range of
24 recommendations. I would be interested to see
25 where the other witnesses sit in terms of their

1 recommendations and final decisions. I would not
2 be surprised if there was a similar difference.

3 One of the reasons -- one of the
4 issues that I talked about was looking at the rate
5 issue. I think if you were to look at the range of
6 my recommendations, quite often the difference is
7 not as stark as what's presented or suggested here
8 this morning.

9 I think if you were to look at the
10 fact that company witnesses typically have one
11 perspective and opposing witnesses typically have
12 another, and the fact that opposing witnesses tend
13 to cluster in an area is not usual.

14 I don't think this case in this
15 jurisdiction or any other jurisdiction is it
16 surprising to see that a company analysis and
17 recommendation is removed from the opposing
18 witnesses and typically to be clustered together.
19 I don't view that as an outlier.

20 One thing that I would say is that
21 when you look at my recommendations in this case,
22 it's 10.4 percent, we've talked a lot about
23 authorized return since 2012. If you were to look
24 at the average requested return since 2012, it's
25 10.65 percent.

1 So the notion that I'm an outlier by
2 reference to three people that typically you would
3 expect to be below my recommendation is to some
4 extent, if you broaden the perspective and if you
5 look at what companies typically request, my 10.6
6 is 25 basis points below, even the high end of my
7 recommended range is below the average since 2012.

8 **Q. That's the average that's requested**
9 **by utilities?**

10 A. Correct.

11 CHAIRMAN KENNEY: Okay. Fair enough.
12 Thanks for your time, Mr. Hevert.

13 THE WITNESS: Thank you very much.

14 COMMISSIONER W. KENNEY: I just have
15 one quick question, really.

16 QUESTIONS BY COMMISSIONER W. KENNEY:

17 **Q. What's the average ROE that's been**
18 **granted since 2012?**

19 A. It's -- if you look at vertically
20 integrated companies, it's right about 10 percent,
21 between 10.03, 10.96, depending on how you look at
22 it, but I'd say right around 10 percent.

23 **Q. That's a big difference, 10.03 to**
24 **10.96.**

25 A. I'm sorry. I'm not good with

1 numbers. Can you give me a second?

2 **Q. I don't believe that.**

3 A. No. No. Sorry about that. 9.96 to
4 10.03.

5 **Q. 9.96?**

6 A. Right.

7 **Q. To 10.03. And then one other**
8 **question. A company like Ameren, what's going to**
9 **affect their capital costs? What's the single most**
10 **effect on a capital cost?**

11 A. The thing that affects a company's
12 capital costs, and again, I'll take this from the
13 perspective of the studies we've done and from my
14 experience, is cash flow, is the ability to
15 maintain cash flow, because these are capital in
16 terms of companies. They're usually cash flow
17 negative companies, meaning that they have to
18 acquire capital. Internally generated cash is
19 typically not sufficient to fund capital
20 investments, so they have to have access to the
21 capital markets.

22 To the extent cash flow is diluted,
23 that is the biggest risk. And to the extent
24 there's a prospect of cash flow being diluted over
25 the long-term, that's a very big risk. And I'll

1 tell you that in 2008, what we saw were strong BBB
2 rated companies having to go out and issue debt at
3 9.75 percent, companies that wanted to go out 30
4 years but could only go out ten. We saw companies
5 with BBB+/A- ratings not able to draw down on their
6 lines of credit because the banks considered the
7 financial market to have undergone a material
8 adverse change, so they had to borrow two-year
9 debt.

10 **Q. When was that?**

11 A. 2008, 2009. That is a risk that
12 people ought not lose sight of. The capital
13 markets contracted, and they could contract again.
14 And when capital markets contract and utilities
15 have to invest, it becomes a major risk. One --
16 and this is the last thing. I don't want to --

17 **Q. You're fine. Keep going.**

18 A. One issue that I have often found
19 interesting is that utilities do not have options
20 that unregulated companies have. Utilities have
21 mandates. They have to invest. They have to
22 maintain reliable service. They have to extend
23 service. As a consequence, they have to access the
24 capital markets. Again, they're cash flow
25 negative, so they can't rely on internally

1 generated cash to fund those investments.

2 Unregulated companies have the option
3 to defer. They have the option to not invest.
4 They have the option to wait and see what the
5 markets are going to do. The loss of that option
6 has a cost, and when you don't have cash, when the
7 cash flow is so diluted and it looks like it's
8 going to be diluted going forward, that's a risk,
9 and it becomes amplified when there are other
10 companies out there that either have mechanisms in
11 place or have returns that are sufficient to allow
12 them to have the cash flow.

13 **Q. So you're saying to allow them -- the**
14 **higher ROE gives more incentive to investors to**
15 **invest in that company?**

16 **A.** I think a higher reasonable ROE gives
17 investors comfort that, from a regulatory
18 perspective, the company will be able to access the
19 cash that they need, yes. And the one thing you
20 want to avoid, you want to avoid is a situation in
21 which the company has to continue to go to the debt
22 markets. Equity becomes expensive. The share
23 price falls. You have to issue more shares. It
24 becomes more expensive. Therefore, you become more
25 leveraged and you just sort of enter into this

1 cycle that can be difficult to break.

2 **Q. How will that eventually affect the**
3 **ratepayers?**

4 A. The cost of capital will adversely
5 affect the ratepayers. A sound company, a company
6 with good, strong cash flow, a company with a
7 reasonable rate of return that's able to maintain
8 its financial integrity inures to the benefit of
9 ratepayers in the long run because capital cost --
10 cost of capital will be maintained. It will be
11 lower than it otherwise would be.

12 **Q. So the ratepayers won't have to take**
13 **on that expense in the future?**

14 A. Absolutely.

15 COMMISSIONER W. KENNEY: Thank you.

16 JUDGE WOODRUFF: Commissioner Hall?

17 COMMISSIONER HALL: Yes.

18 QUESTIONS BY COMMISSIONER HALL:

19 **Q. Good morning.**

20 A. Good morning, sir.

21 **Q. You've already been asked a couple of**
22 **questions about this, and I want to make sure I**
23 **understand this clearly. You've testified in**
24 **approximately 100 proceedings before state**
25 **regulatory agencies and FERC; is that correct?**

1 A. Somewhat more than that, yes, sir.

2 Q. How many of those were in -- were
3 before state commissions concerning ROE?

4 A. All of my ROE testimony has been on
5 behalf of utilities. So none on behalf of the
6 commissions or consumer groups.

7 Q. Well, I was interested in that, but
8 that wasn't really my question. My question was,
9 how many of those 100 proceedings were you
10 testifying on ROE before state commissions?

11 A. Oh, I'm sorry. All of them.

12 Q. All of them?

13 A. Yes, sir.

14 Q. Okay. In any of those
15 100 proceedings, did you ever support an ROE that
16 was the actual ROE that the commission adopted?

17 A. The closest I came was one basis
18 point, but I've never had the exact. My
19 recommendation was never adopted in its entirety,
20 but I think it's unusual for a specific point
21 estimate for a specific witness to be the eventual
22 decision.

23 Q. Do you agree with the general
24 proposition that regulated companies are a safer
25 investment than unregulated companies?

1 A. I do, and I think when we look at,
2 for example, the capital asset pricing model, we
3 all recognize that beta coefficient which measures
4 relative risk is less than one, and because it's
5 less than one, it means that utilities are less
6 risky than the overall market.

7 **Q. And you -- you talked about this a**
8 **little bit with Chairman Kenney. If an investor is**
9 **making an investment decision, why -- why does your**
10 **proxy group only include the regulated entities?**
11 **If the investor can invest in McDonald's or Ameren,**
12 **he, she, it will a make decision on what is the**
13 **safer investment and why is -- why focus on a**
14 **regulated utility proxy group?**

15 A. That's a great question. The --
16 there are really several reasons. One is going
17 back to the fundamental question of developing a
18 comparable group for the purpose of estimating the
19 cost of equity because we really can't use the
20 subject, the company. We have to use others as
21 proxy.

22 The first step is go to comparable
23 risk and comparable risk is -- the threshold
24 typically is in the same industry, in the same
25 sector.

1 Now, to the second part of your
2 question, I think, an individual investor certainly
3 can invest in a McDonald's or a utility. Typically
4 an investor will look at the various sectors and
5 they'll allocate their capital according to those
6 sectors and according to what they consider the
7 risk/reward relationship to be within that sector.

8 So You may have a biotechnology
9 sector where the expected returns are much higher,
10 but likewise, the risks are higher. And so an
11 investor will allocate the capital along that risk
12 return spectrum. And that's why we want to focus
13 on sectors that investors typically would look at
14 when they want to invest in utility companies.

15 Again, I have seen other witnesses
16 develop screening criteria for companies that are
17 not utilities but have, for example, the same beta
18 coefficients, same credit rating and use those as
19 proxies, but it's not common.

20 **Q. You mentioned a moment ago that**
21 **regulated utilities are less risky than**
22 **nonregulated publicly traded companies; is that**
23 **correct?**

24 A. I -- I think that's a fair statement,
25 yes.

1 **Q. Well, then shouldn't their -- the**
2 **return on equity of a regulated entity be lower?**

3 A. It is, and in this case my
4 recommendation, 10.4 percent, is below what I
5 estimate the market return to be, which is in the
6 12 and a half to 13 percent range. So you're
7 right, it should be lower, and my recommendation is
8 lower than my expected market return.

9 **Q. And market return is a function of**
10 **both growth in stock price and dividends?**

11 A. Yes, fundamentally, it would be the
12 dividends yield plus the growth in the price.
13 That's right.

14 COMMISSIONER HALL: Okay. No further
15 questions. Thank you.

16 JUDGE WOODRUFF: Commissioner Rupp?

17 COMMISSIONER RUPP: Yes, thank you.

18 QUESTIONS BY COMMISSIONER RUPP:

19 **Q. Good afternoon.**

20 A. Good afternoon.

21 **Q. Going back to the three statements**
22 **that the Chairman alluded to that was brought up**
23 **earlier, all things being equal, and also the**
24 **comment was made that, you know, stock prices are**
25 **up, dividends are down, walk me through -- do you**

1 **agree that dividends are down across the sector?**

2 A. When we see -- you mean dividend
3 yields?

4 **Q. Yes.**

5 A. I think dividend yields have been --
6 were moving down. They're moving up now, and
7 they're moving up now pretty steeply.

8 **Q. And why do you think they're moving
9 up steeply?**

10 A. Because I think as I -- I think
11 because what happened was we knew we were -- when
12 some of the analyses in this proceeding were done,
13 the market was valuing this sector, utilities, at a
14 very, very high price to earnings multiple. I said
15 in my testimony, at times the price to earnings
16 multiple was trading at about a 10 percent premium
17 to the market when historically utilities would
18 trade at a 10 percent discount to the market.

19 That, of course, is highly unusual
20 and so if were to be willing to pay that much more
21 money than the market, perhaps they were doing it
22 for that yield because they wanted the dividend
23 yield. But what we've seen very quickly is that
24 sentiment has changed, and we've seen the market
25 fall quite a bit. You sometimes hear the adage,

1 when you reach for a yield, you get what you
2 deserve. And perhaps that's what's happening now.
3 People were reaching for a yield. They wanted that
4 3 percent or so dividend yield. But now they've
5 lost two to three times that in the capital losses.

6 **Q. So is the -- is the desire for yield,**
7 **to reach for yield, is that because there is**
8 **limited opportunities to earn return with historic**
9 **low interest rates and the fed keeping interest**
10 **rates down so that the institutional investor is**
11 **trying to find yield? Does that drive that?**

12 **A.** I think what we saw in a lot of cases
13 were people looking for high-yielding sectors, and
14 I think in my testimony I noted that there's no
15 disagreement among the witnesses in this case that
16 for a period of time the sector was valued very
17 highly. We don't disagree about that.

18 The question is, should that be used
19 to set the return on equity prospectively? And so
20 when you saw a sector that was relatively highly
21 valued and you know that over time that
22 relationship comes back, I think that's what we're
23 seeing now. We're seeing that relationship come
24 back. So perhaps while people were looking for
25 yield, perhaps many of them got -- lost more than

1 the yield they were looking for.

2 Q. So in the test year and the years
3 you're looking at that, you don't think that is an
4 accurate estimate of their ability to attract
5 capital and the rate of return all being as of
6 today?

7 A. Those high price earnings ratios?

8 Q. Yeah.

9 A. No. In fact, not to get too
10 technical, but when I ran the multistage discounted
11 cash flow model, what I found was that the assumed
12 price in the model assumes that the stock will be
13 sold 10 or 15 years in the future depending on how
14 you structure the model. The assumed price at that
15 time was sometimes -- excuse me. The price
16 earnings multiple was about 16.5, down from about
17 20 to 21 now.

18 My analyses assumed that over time
19 that price earnings multiple would fall and it
20 happens at the growth rate that I used in the end,
21 which some people perhaps think is too high, is
22 borne out by the fact that it implies a price
23 earnings multiple of about 16.5, which is very much
24 in line with the historical average. So while I
25 certainly used market data, I think we have to be

1 careful about how we interpret that market data.

2 The only other thing I'll say is that
3 in my testimony I mentioned that we have to view
4 the constant growth discounted cash flow models
5 with considerable caution, because whereas in that
6 multistage model we were able to see the price
7 earnings multiple fall over time, the constant
8 growth model assumes it stays the same. So it
9 assumes that if you buy a utility at 21 times
10 earnings, you're going to be able to sell it at
11 21 times earnings.

12 What that would mean is that either
13 the market has stayed low or the market has so
14 exceeded the utility at 21 that there's a whole lot
15 of growth in the market or that investors
16 fundamentally changed the way they value utility
17 stock prices.

18 So my view is that those constant
19 growth discounted cash flow models, even though I
20 use it and I -- because I always have, we just have
21 to be very careful in terms of how we interpret
22 those results.

23 **Q. How long have you been doing**
24 **analyzing rates of return for utilities?**

25 A. Well, when I worked at a utility, I

1 did it. I haven't been a -- providing testimony on
2 this. I think I first did it in 2005. So about
3 ten years.

4 Q. And in that time, do you view that
5 the current economic climate, with everything that
6 is happening in the markets, in the fed, do you
7 view that as typical, atypical in your history of
8 doing this work, and where do you see things going
9 in the future?

10 A. I think the degree of market
11 intervention that we've seen over the last three to
12 five years was unusual. I think it's unusual in
13 the course of that span of ten years, and even a
14 longer span of history. We know that the Federal
15 Reserve now wants to, -- as they keep using the
16 term, normalize. They want to normalize rates.

17 And so what I think we're going to
18 see is the Federal Reserve to start bringing
19 interest rates back up. They'll increase as best
20 they can the federal funds rate, and they'll do
21 that for a couple of reasons.

22 One is at some point you have to let
23 the market be the market. You can't be constantly
24 interfering with the market. There are concerns
25 about federal intervention creating low interest

1 rates and, therefore, creating perhaps asset
2 bubbles from time to time. Federal intervention
3 can create some risks that people are identifying
4 and becoming concerned with.

5 The other issue's a very tactical
6 one, which is, if the fed ever needed to cut
7 interest rates again, they can't cut from zero. So
8 they're going to have to move them up at some point
9 so that they can again bring them down. I kind of
10 think about it as when people sell mattresses. You
11 increase the price and then you discount it. But
12 they're going to have to bring it up at some point
13 in order to have the ability to intervene in the
14 markets when they need to again.

15 **Q. And the increase in fed funds rates**
16 **in allowing the market rates to normalize, what**
17 **impact would that have on the utility sector?**

18 A. What that would do is it would
19 increase interest rates. As interest rates
20 increased, capital intensive companies, the stock
21 price tends to fall off.

22 Now, there's another interesting
23 aspect to this, though, which is, again, a function
24 of the fact that this is usual, this whole
25 situation is unusual, which is that if the fed is

1 going to continue to increase rates, they're going
2 to do it because they have confidence in the
3 overall economy.

4 In other words, they're confident
5 that growth will be sustainable, that growth will
6 be high, that growth will be strong. So you could
7 see interest rates going up, the dividend yields on
8 capital intensive companies such as utilities going
9 up, and for some period of time even expected
10 growth rates going up because the fed is increasing
11 rates in anticipation of stronger growth throughout
12 the whole economy.

13 **Q. The large -- one of the witnesses**
14 **said the utility sector had averaged 32.86 percent**
15 **compared to the S&P 500 of 14 and the Dow at 7.25**
16 **during whatever time frame that they had mentioned.**
17 **Did the impacts of the rising dollar in**
18 **institutional funds from overseas coming into a**
19 **sector with a possibility of a currency bump, would**
20 **that explain any of the -- of the rise of this**
21 **sector compared to the rest of the market?**

22 **A.** I think it could have. If you see
23 the European Central Bank cutting interest rates,
24 going through its own round of quantitative easing
25 bringing down interest rates in the euro zone, then

1 treasury yields in the United States, even if low,
2 would look comparatively attractive. So that
3 certainly could have an effect.

4 One of the things that we've seen
5 again over the past few days is perhaps some of the
6 debt problems in Greece being resolved between
7 Greece and the European Community Bank. We're
8 seeing people having a little bit more confidence
9 in growth within the European community.

10 So the question becomes whether or
11 not that difference in rates will persist over time
12 but for some period of time. I absolutely agree,
13 there are other things on a global scale that could
14 have affected rates as well. Geopolitical issues
15 in the Ukraine could make the United States look as
16 a comparatively more comfortable investment for
17 some people, and that could well have increased --
18 excuse me -- decreased treasury yields for a period
19 of time.

20 But when I said earlier the treasury
21 yields are about twice as volatile now as they had
22 been in 2012, I think all of those factors
23 contribute to that volatility.

24 **Q. And during periods of high**
25 **volatility, is the utility sector more sought out**

1 due to typically general feeling of higher dividend
2 rates and some stability?

3 A. I think that that's a really good
4 question. I think when there's higher volatility
5 in the market, what we saw in 2008-2009 when
6 volatility spiked, there was another saying in the
7 market, which was, all correlations went to one.
8 Which meant that every sector became correlated
9 with the market, utilities included.

10 So when the market became very
11 volatile, when there was a lot of financial risk in
12 the market and volatility spiked, the utilities
13 that often do not trade as highly correlated with
14 the market traded very highly correlated with the
15 market. There was no place to look for a sector
16 that was not correlated with the market at that
17 period in time.

18 And I think that took some people by
19 surprise, because utilities, because of the fact
20 that their beta coefficients are around .8,
21 typically would be less correlated, but when the
22 market became volatile that did not happen.

23 COMMISSIONER RUPP: I think that's
24 all I have. Thank you.

25 QUESTIONS BY JUDGE WOODRUFF:

1 Q. I just have one question to try and
2 clarify something.

3 A. Yes, sir.

4 Q. You offered a range of 10.2 to
5 10.6 with a recommended midpoint f 10.4?

6 A. That's correct.

7 Q. Does that mean that anything within
8 that range would be reasonable within your
9 professional opinion?

10 A. When I set ranges, that's right. I
11 think anything within the range is reasonable. If
12 you can envision sort of a bell curve, that's sort
13 of the way I look at it. At the bounds, I think
14 it's still reasonable, but the recommendation is
15 what I consider to be the most reasonable.

16 JUDGE WOODRUFF: Okay. Thank you.

17 THE WITNESS: Thank you.

18 JUDGE WOODRUFF: We've been going for
19 two hours and 20 minutes, which is longer than I
20 like to go. We'll take a break for lunch now
21 before we come back for recross, and we'll come
22 back at 1:30.

23 (A BREAK WAS TAKEN.)

24 JUDGE WOODRUFF: Let's come back to
25 order, please. We're back from our lunch break.

1 Mr. Hevert is still on the stand, and we're going
2 to begin with recross based on questions from the
3 Bench, beginning with MEGC.

4 MR. WOODSMALL: Yes, real briefly.

5 RECROSS-EXAMINATION BY MR. WOODSMALL:

6 Q. You were asked a question about your
7 previous testimony, lots of questions. You
8 indicated you worked for a utility. When you were
9 working for the utility, did you file and testify
10 on return on equity?

11 A. No, I did not.

12 Q. And you were asked a question about
13 your billing rate. You gave your rate on a
14 per-dollar basis. Do you have any idea, an
15 estimate of what your total costs for this case
16 will be?

17 A. I don't know, but I can find that.

18 Q. Okay. You were asked some questions
19 by Commissioner Kenney and you responded about the
20 importance of cash flow. Would you agree that cash
21 flow can be addressed by depreciation rates and not
22 just return on equity?

23 A. I agree that the two principal
24 components of cash flow are depreciation and net
25 income.

1 MR. WOODSMALL: Okay. Those are all
2 the questions I have.

3 JUDGE WOODRUFF: Public Counsel?

4 MS. BAKER: No questions, Judge.

5 Thank you.

6 JUDGE WOODRUFF: Consumers Council?

7 MR. COFFMAN: No questions.

8 JUDGE WOODRUFF: MIEC?

9 MS. ILES: Yes, your Honor.

10 RECROSS-EXAMINATION BY MS. ILES:

11 Q. Mr. Hevert, I want to show you an
12 exhibit.

13 (MIEC EXHIBIT NO. 518 WAS MARKED FOR
14 IDENTIFICATION BY THE REPORTER.)

15 BY MS. ILES:

16 Q. Mr. Hevert, I'm handing you what has
17 been marked as Exhibit 518, and this is the same as
18 the document that's been handed out to everyone
19 here. I'm also going to hand you a copy that I'm
20 going to represent to you is a copy of your direct
21 testimony from the last Ameren rate case.

22 A. Thank you.

23 Q. And I'm going to represent to you
24 that the pages that I handed you are the same ones
25 that are tabbed, and I'm going to ask you to

1 confirm that, please.

2 You agree that this is from your
3 direct testimony in the last Ameren rate case, as
4 one of your schedules, Schedule RBH-E-1?

5 A. From -- excuse me. Yes, that is
6 correct.

7 Q. Okay. And one of the values that's
8 shown on this schedule is the dividend yield?

9 A. Yes, that's right.

10 Q. Which is the dividend yield you used
11 in doing your determinations or your analyses in
12 the last rate case?

13 A. Correct.

14 Q. And there are three different values,
15 one on each page that you used. The first one is
16 your 30-day constant growth DCF, the second one is
17 your 90-day constant growth DCF, and the third one
18 is the 180-day constant growth DCF?

19 A. Yes, I see that.

20 Q. What are the values of the dividend
21 yields on those schedules?

22 A. So just to be clear, we're looking at
23 column 3, not column 4?

24 Q. Correct.

25 A. Column 3 for the 30-day yield is

1 4.29 percent, for the 90-day is 4.40 percent, and
2 for the 180-day is 4.42 percent.

3 **Q. Now, do you have similar -- did you**
4 **provide similar information in your schedules for**
5 **this case?**

6 A. Yes, I did.

7 **Q. Where would we find those in your**
8 **testimony?**

9 A. Those would be schedule -- well,
10 let's see. If we're comparing to -- did you want
11 to compare to the direct or the rebuttal testimony?

12 A. Whichever -- rebuttal would be more
13 recent. Let's do rebuttal.

14 A. Okay. Now, the second question is,
15 do you want to compare it to the combined proxy
16 group or to my original revised proxy group?

17 **Q. Let's do both.**

18 A. Okay. It's going to be six numbers.

19 **Q. Okay.**

20 A. Okay. Are we ready?

21 **Q. Tell us where you are, where you're**
22 **getting these.**

23 A. Sure. So this would be
24 Schedule RBH-R-7 to my rebuttal testimony.

25 **Q. Okay.**

1 A. Okay. And if you go to page 1
2 through page 3, that would be what is the combined
3 proxy group. So as I mentioned earlier, I created
4 one group which combined all of the companies that
5 any of the witnesses used in this case. So if we
6 are to look at the average yield for 30 days, it is
7 on page 1 of 6, 3.66 percent, median 3.77 percent.

8 **Q. And how about the 90-day?**

9 A. Okay. I'll just keep going 'til you
10 tell me.

11 **Q. Yes. That's great.**

12 A. The 90-day mean is 3.8, median 3.85.
13 180-day, mean 3.83, median 3.84. Now, as we move
14 to page 4, which is my original proxy group with --
15 based on my original proxy group for 30 days, the
16 mean and median are 3.68 and 3.79 respectively.
17 For 90 days, it is 3.83 and 3.90 respectively. And
18 for 180 days, it is 3.87 and 3.95 respectively.

19 **Q. So were the dividend yields for your
20 proxy group higher in the last case than they are
21 in the current case?**

22 A. Sure. And that's part of what we
23 talked about earlier this morning, drifting into
24 this afternoon. When you have a period during
25 which those price-to-earnings ratios were very

1 high, the consequence of that, of course, was a
2 relatively low dividend yield. What this model,
3 this exhibit that you gave me assumes is that the
4 dividend yield that created the -- excuse me -- the
5 price earnings ratios that created yields contained
6 in my Exhibit RBH-R-7 will stay in place forever.

7 **Q. Now, wait. I want to stop you there.**
8 **I don't want to do any assumptions about what's**
9 **going to happen.**

10 A. I'm not making any assumptions.

11 **Q. Okay. Right. But what I want to**
12 **make clear to the Commission, because I think it**
13 **was not clear when you were answering the**
14 **Commissioners' questions, if you look back to the**
15 **last rate case in 2012 with -- or actually before I**
16 **guess, when this testimony was prepared, we look at**
17 **the numbers in your current testimony, isn't it**
18 **true that utility stock dividend yields have**
19 **decreased based on the sampling that you did to**
20 **create your proxy companies? Yes or no, have they**
21 **decreased?**

22 A. They have decreased, and that's
23 exactly why we had the conversation earlier about
24 the price earnings ratios. That's exactly why it's
25 such an important concept.

1 Q. All right. But --

2 A. But, yes, I agree with you. They're
3 lower now than they were then.

4 Q. When Commissioner Kenney asked you
5 has the price -- when he asked you specifically
6 about utility stock prices and dividends, you
7 immediately jumped to a time period. What was the
8 time period that your response related to?

9 A. I spoke --

10 MR. TOMC: Objection, your Honor.
11 The question's argumentative.

12 JUDGE WOODRUFF: Overruled.

13 MS. ILES: I think it's --

14 JUDGE WOODRUFF: The objection's
15 overruled.

16 THE WITNESS: I'm sorry. So the time
17 period, and I think this is what you're asking, was
18 January 29th, 2--

19 BY MS. ILES:

20 Q. Of what year?

21 A. I was about to say, 2015.

22 Q. Right.

23 A. Through February 27th, 2015. And
24 that's what I said in my response.

25 Q. Okay. Right. But I just want to be

1 clear, because Commissioner -- or Chairman Kenney
2 did not state a time period. But I think he was
3 referring to Mr. Gorman's testimony, which was the
4 data that I had up on the slide during my opening.
5 I think that may have been what he was referring
6 to.

7 And that information, Mr. Gorman's
8 testimony, I'd represent to you, talks about the
9 change and what's happened since the last rate
10 case, not simply in a one-month period. Wouldn't
11 you agree?

12 MR. TOMC: Objection, argumentative.

13 JUDGE WOODRUFF: Again, overruled.

14 Ms. Iles, make sure your microphone is on. They're
15 having a hard time hearing you.

16 MS. ILES: I'm sorry.

17 THE WITNESS: I'm sorry, but I
18 just -- if you're asking me what my understanding
19 of the intent was, I can't answer that.

20 BY MS. ILES:

21 Q. Let me ask you about Mr. Gorman's
22 testimony, then, just to be clear.

23 A. Sure.

24 Q. The statements that -- from his
25 surrebuttal testimony on page 7 that I referred to

1 in my opening statement that stated that utility
2 stock dividend yields have decreased, he was
3 talking about between -- since the last Ameren rate
4 case; isn't that correct?

5 A. Yes, I believe that's correct.

6 Q. And that was also the same period
7 that he was talking about when he talked about
8 interest rates have declined, correct?

9 A. I'm sorry. Can you explain to me
10 again what the end date of what you believe that
11 analysis to have been?

12 Q. Well, the filing date of his
13 surrebuttal was in February.

14 A. Right. So -- so I guess what I'm --
15 and I really don't mean to be argumentative. The
16 answer that I gave spoke to market changes during
17 February.

18 Q. All right. So you were looking at a
19 one-month period this year?

20 A. Yeah, and I made that clear. That's
21 right.

22 Q. Okay. I'm not so sure it was clear
23 to everyone. That's why I'm reiterating it.

24 A. Well, I appreciate that.

25 Q. I may be wrong about that. I just

1 wanted to make that clear.

2 But this data that you just
3 identified shows us the change in dividend yields
4 between the time you filed your testimony in the
5 last rate case and the time you filed your
6 testimony in this rate case?

7 A. Correct.

8 Q. All right.

9 A. And -- well --

10 MS. ILES: Okay. That's all I wanted
11 to establish with this. And I would move for the
12 admission of Exhibit 518.

13 JUDGE WOODRUFF: 518 has been
14 offered. Any objections to its receipt?

15 (No response.)

16 JUDGE WOODRUFF: Hearing none, it
17 will be received.

18 (MIEC EXHIBIT NO. 518 WAS RECEIVED
19 INTO EVIDENCE.)

20 JUDGE WOODRUFF: And we'll move to
21 Staff for further recross.

22 MR. THOMPSON: No questions. Thank
23 you, Judge.

24 JUDGE WOODRUFF: Redirect?

25 MR. TOMC: Thank you, your Honor.

1 REDIRECT EXAMINATION BY MR. TOMC:

2 Q. Mr. Hevert.

3 A. Good afternoon.

4 Q. Good afternoon. Do you recall the
5 questions from counsel for Public Counsel
6 concerning the public hearing transcripts and the
7 topic of rate affordability?

8 A. I do.

9 Q. In one of your responses you began to
10 elaborate on your consideration of the public
11 hearing transcripts. I'd like to give you that
12 opportunity to explain, please, what is your
13 consideration of that public hearing testimony?

14 A. Yes. In this case, as in the cases I
15 testify in, it is my practice to read the
16 transcripts of the public hearings. Even though I
17 may not read all of them, I do read enough to
18 understand what the citizens are saying to you. I
19 think that's important to understand from my
20 perspective. So I realize what is being said, and
21 I'll bring one other perspective as well.

22 Again, when I worked at a utility, I
23 was part of the management team that decided when
24 or whether to seek rate relief. I also work with
25 many utilities in an advisory capacity on rate and

1 regulatory policy issues, and I can tell you that
2 the decision to seek rate relief is never taken
3 lightly. It is always taken with respect to the
4 effect on ratepayers, and that's precisely why I
5 read the transcripts, because I want to see it and
6 I want to understand it.

7 But as we also talked about a little
8 bit earlier, a safe, financially viable utility
9 that has the cash flow needed to maintain its
10 financial integrity inures to the benefit of
11 ratepayers in the long run because the company will
12 be able to access capital at the best available
13 rates.

14 So I always look at those
15 transcripts. I don't want you to think that I come
16 to these hearings without having considered the
17 perspective of the ratepayers, because in my
18 practice it's important to do so.

19 And I also understand your obligation
20 is to balance the interests of ratepayers and
21 shareholders and investors.

22 **Q. Mr. Hevert, there was some discussion**
23 **of the comparability of proxy companies. I believe**
24 **counsel for MIEC asked you several questions along**
25 **those lines, and as well there was a discussion of**

1 comparability in risk from the Bench. In your
2 response to Chair Kenney, I believe, you did make a
3 passing reference to rate mechanisms.

4 Can you comment on the fuel
5 adjustment clause that Ameren Missouri has in its
6 tariff book and how that compares to other
7 vertically integrated utilities?

8 A. Yes.

9 MR. WOODSMALL: Your Honor, I'm going
10 to object. I don't believe just because he
11 mentioned the word rate mechanisms that we've tied
12 it to any questions from the Bench. You know, if
13 he can tie it to a particular question, I think it
14 would be appropriate, but this is awful far off
15 course.

16 JUDGE WOODRUFF: Your response?

17 MR. TOMC: Your Honor, I believe it
18 is a relevant point. Comparability was a theme of
19 questioning, pretty substantial questioning.
20 During Mr. Hevert's response, he did make a mention
21 of rate mechanisms in his response. He did not
22 provide very much elaboration. I want to provide
23 that opportunity to him here on redirect. I think
24 the record would benefit from that discussion.

25 MR. THOMPSON: I was just going to

1 object to the narrative form of the response. I
2 think he gets to ask him questions, but I don't
3 think he gets to orate.

4 JUDGE WOODRUFF: All right. I'm
5 going to overrule the objection about -- I think it
6 is relevant to the questions that were from the
7 Bench. I'm not sure of Staff's objection here.
8 Are you talking about you're objecting to the
9 question itself or that it's calling for a
10 narrative?

11 MR. THOMPSON: I'm objecting that the
12 question is calling for a narrative. Thank you,
13 Judge.

14 JUDGE WOODRUFF: I think I'm going to
15 have to sustain that objection, in that a narrative
16 response doesn't give other parties any chance to
17 object to the testimony. You can ask similar
18 questions if you can narrow it down.

19 MR. TOMC: I will.

20 BY MR. TOMC:

21 Q. With respect to the proxy group of
22 vertically integrated electric utilities that you
23 used to measure the cost of equity, are those
24 companies representational of comparable investment
25 opportunities particularly with regard to a fuel

1 **adjustment clause or similar mechanism?**

2 A. Yes. It is very unusual for a
3 company not to have a fuel adjustment clause. I
4 have looked at the proportion of fuel costs
5 relative to total operating costs. They are
6 typically in the 50 to 60 percent range.
7 Therefore, they typically are subject to a clause
8 because they satisfy what I typically see as three
9 criteria. They're financially large, they are
10 exogenous and they're variable. And so I think
11 fuel adjustment clauses are very common.

12 **Q. All right. Now, Mr. Hevert, with**
13 **respect to other rate mechanisms, are there other**
14 **types of rate mechanisms aside from the fuel**
15 **adjustment clause represented within your proxy**
16 **group?**

17 A. There are. The -- here the company
18 has four or five trackers. We have other companies
19 within the proxy group that have current recovery
20 on investments for environmental investments --
21 excuse me -- environmental expenditures for new
22 generating plant development. You have recovery
23 clauses with current recovery for plant upgrades.
24 You have formula rate plans. You have multi-year
25 plans in which capital expenditures are included in

1 rate base in subsequent years.

2 Here you have, as I said in my
3 testimony, the inability to include CWIP in rate
4 base, very limited ability to implement interim
5 rates, a largely historical test year as opposed to
6 the fully or partially forecast test year in other
7 jurisdictions.

8 So I think many of the proxy
9 companies have mechanisms not available to the
10 company here.

11 **Q. Mr. Hevert, there was considerable**
12 **discussion from the Bench with respect to high**
13 **price to earnings ratios, as well as recent decline**
14 **in utility stock prices. Do you recall that**
15 **discussion?**

16 A. I do.

17 **Q. With respect to the specific 13-week**
18 **measurement periods used by the intervenor**
19 **witnesses, can you explain how their DCF models**
20 **were impacted by these price changes?**

21 A. Well, I think really any discounted
22 cash, any constant growth discounted cash flow
23 model that used data from that period used data
24 that violates one of the principal assumptions of
25 the model, which is that the PE ratio will stay

1 constant forever. At that time the PE ratio was
2 20 or 21. The long-term average is about 16.5.

3 To put that in perspective, it was
4 saying that the companies -- utilities would trade
5 forever at price-to-earnings ratios in excess of
6 Apple computer price-to-earnings ratios and not by
7 a small amount, by a considerable amount.

8 That is why I said in my testimony
9 even earlier this afternoon discussion that you
10 have to take -- you have to apply considerable
11 caution in looking at the results of those constant
12 growth DCF models.

13 One of the fundamental assumptions is
14 simply not likely to hold, and it is the reason
15 that those dividend yields were so low.
16 Because those price-to-earnings ratios were so
17 high, the dividend yields were low,
18 price-to-earnings ratios are not likely to persist
19 in perpetuity as the model assumes they will. And
20 that's what we started to see over the past month.

21 **Q. With respect to the calculation of**
22 **dividend yields, is it your understanding that**
23 **annualized dividends divided by stock price results**
24 **in the yield calculation?**

25 A. Yes.

1 **Q. So if dividends remain the same and**
2 **stock prices trade upwards, what happens to yield?**

3 A. The yield goes down.

4 MR. TOMC: I have no further
5 questions, your Honor.

6 JUDGE WOODRUFF: Then you can step
7 down.

8 THE WITNESS: Thank you, sir.

9 (Witness excused.)

10 JUDGE WOODRUFF: And the next witness
11 is Mr. Gorman.

12 (Witness sworn.)

13 JUDGE WOODRUFF: You may inquire.

14 MICHAEL GORMAN testified as follows:

15 DIRECT EXAMINATION BY MS. ILES:

16 **Q. Please state your name for the**
17 **record.**

18 A. My name is Michael Gorman.

19 **Q. And, Mr. Gorman, where are you**
20 **employed and what is your business address?**

21 A. I'm employed with Brubaker &
22 Associates at 16690 Swingley Ridge Road,
23 Chesterfield, Missouri.

24 **Q. And are you the same Michael Gorman**
25 **who prepared the testimony, the direct, rebuttal**

1 and surrebuttal testimony that's been prefiled in
2 this case and that has been marked as Exhibits 510,
3 511 and 512?

4 A. Yes.

5 Q. And, Mr. Gorman, if I asked you the
6 questions that are included in that testimony
7 today, would your answers be the same?

8 A. They would.

9 Q. Do you have any corrections?

10 A. No.

11 MS. ILES: I'd offer into evidence at
12 this time Exhibits 510, 511 and 512 and tender the
13 witness for cross-examination.

14 JUDGE WOODRUFF: 510, 511 and 512
15 have been offered. Any objection to their receipt?

16 Hearing none, they will be received.

17 (MIEC EXHIBIT NOS. 510, 511 AND 512
18 WERE MARKED AND RECEIVED INTO EVIDENCE.)

19 JUDGE WOODRUFF: And for
20 cross-examination, we begin with Public Counsel.

21 MS. BAKER: Thank you.

22 CROSS-EXAMINATION BY MS. BAKER:

23 Q. Good afternoon, Mr. Gorman.

24 A. Good afternoon.

25 Q. In your experience and in the

1 **research that you've done for this case, has the**
2 **cost of capital gone down in the past years?**

3 A. In the past two years?

4 Q. Uh-huh.

5 A. Yes.

6 Q. **Is there an expectation the economy**
7 **will rebound substantially within the next few**
8 **years?**

9 A. There's an expectation of an
10 improvement. I wouldn't call it an expectation of
11 substantial improvement. I'm sure there's a hope
12 of that.

13 Q. **And fluctuations in the economy are a**
14 **normal part of the business arena, aren't they?**

15 A. Yes. Movement in economic activity
16 does -- does have some volatility.

17 Q. **And in your experience, looking at**
18 **nonregulated business entities such as Fortune 500**
19 **companies, do you see that their returns have**
20 **lowered significantly under this economic downturn?**

21 A. It depends on the company you're
22 looking at. Many have done well and some have not
23 done quite as well.

24 Q. **Fortune 500 companies have much more**
25 **risk than a regulated monopoly; is that true?**

1 A. Yes.

2 Q. And when we're talking about risk for
3 a regulated utility, a risk can be alleviated or
4 lowered by the presence of some of the regulatory
5 mechanisms like an FAC, an approved tracking
6 mechanism, an environmental expenditure clause,
7 things like that?

8 A. Absolutely. Regulatory mechanisms
9 have an impact of reducing the utility or
10 investors' risk, but it doesn't make them go away.
11 The risk is transferred to customers, but risk from
12 the investors' standpoint goes down with the
13 implementation of regulatory mechanisms which
14 provide greater assurance of revenue and more
15 predictable and stable cash flow for the utility.

16 Q. And you would agree that a return on
17 equity should be a reflection of the risk that the
18 utility faces?

19 A. Yes.

20 Q. In your testimony, you calculate that
21 a reasonable range for return on equity is 9.00 to
22 9.6, and your recommended ROE is 9.3?

23 A. Correct.

24 Q. And this determination is based upon
25 your expert analysis of market-driven data using

1 traditional analytical tools like the DCF model,
2 the CAPM model, things like that?

3 A. Yes.

4 Q. And are these the same analytical
5 tools or similar ones that were utilized by the
6 other experts in this case?

7 A. Largely, yes. With different data
8 inputs, but the same models.

9 Q. And I assume that you agree that a
10 reasonable return on equity for Ameren is one that
11 is adequate to attract capital at reasonable terms,
12 that is sufficient to ensure Ameren Missouri's
13 financial integrity, and that is commensurate with
14 returns on investment in enterprises having
15 corresponding risks?

16 A. Yes, that is discussed in my
17 testimony. Those are the objectives of measuring a
18 fair and just return on equity.

19 Q. Therefore, in your opinion, at a
20 return on equity range of anywhere between 9.00 and
21 9.60, Ameren is adequately able to attract capital
22 at reasonable terms?

23 A. Yes.

24 Q. And anywhere within that range
25 Ameren's financial integrity is insured?

1 A. I believe it is, yes.

2 Q. And given your research, a return on
3 equity anywhere between 9.00 and 9.60 is
4 commensurate with returns on other similar
5 enterprises like Ameren who have similar risks?

6 A. That's my finding, yes.

7 Q. So Ameren would receive a reasonable
8 ROE anywhere between 9.00 and 9.60?

9 A. Generally, yes. I'm recommending the
10 midpoint because I believe it's the most balanced
11 point within that range, but anywhere within my
12 recommended range would reflect a just and
13 reasonable return on equity.

14 Q. And you are aware of Mr. Schafer's
15 recommended ROE of 9.01 percent?

16 A. Yes.

17 Q. And you would agree with me that his
18 9.01 percent does fall within your recommended
19 range?

20 A. Yes.

21 MS. BAKER: I have no further
22 questions.

23 JUDGE WOODRUFF: Consumers Council?

24 MR. COFFMAN: Yes.

25 CROSS-EXAMINATION BY MR. COFFMAN:

1 Q. Good afternoon, Mr. Gorman.

2 A. Good afternoon.

3 Q. Were you here earlier when Mr. Hevert
4 was asked questions regarding bond ratings and
5 lower interest rates that may be related to higher
6 bond ratings?

7 A. Yes.

8 Q. And did you hear him claim that those
9 higher bond ratings would benefit consumers into
10 the future with lowering borrowing rates?

11 A. Yes.

12 Q. But would that -- would it ever make
13 sense from a consumer perspective to increase the
14 authorized rate of return in order to realize those
15 savings from lower bond borrowing rates?

16 A. Well, I don't think that would be
17 fair and reasonable, and I'm not sure it would
18 accomplish the objective. Increasing authorized
19 return on equity will increase earnings of the
20 company, but it isn't clear whether or not those
21 increased earnings would actually stay in the
22 utility where they'd be paid up to the holding
23 company or ultimately paid out as larger dividends
24 to the shareholders, public shareholders.

25 Probably more specifically from a

1 cost of service perspective, it's not clear whether
2 or not customers will receive a more competitive
3 supply of utility service with a higher bond
4 rating. While a higher income level certainly
5 means greater revenue requirements for the utility
6 and that would be offset in part by lower debt
7 costs, the actual impact on customers would be the
8 net effect of both of those impacts, the higher
9 common equity cost and the lower debt cost.

10 Generally speaking, attempting to
11 inflate the utility's bond rating or to increase it
12 to a level that's higher than necessary to preserve
13 its access to capital under reasonable terms and
14 prices will mean customers will pay more to the
15 utility than they would under a more balanced
16 mechanism where an adequate bond rating, such as
17 what Ameren Missouri currently has, is preserved by
18 setting a rate of return which is adequate to
19 maintain that bond rating and to provide fair
20 compensation to the utility.

21 So it's a difficult, complicated
22 question, but generally speaking, inflating income
23 in order to improve credit rating likely will cost
24 customers more without necessarily improving access
25 to capital and certainly without reducing the cost

1 of service to customers.

2 **Q. And I understand it is complicated,**
3 **but wouldn't it be -- would it be fair to say that**
4 **the increased cost to consumers from increasing the**
5 **authorized rate of return on equity would far**
6 **eclipse the benefit of lower borrowing rates?**

7 A. You could make assumptions with that,
8 but generally, for example, increasing -- you have
9 to make some assumptions when you measure that, but
10 it's likely that it would.

11 **Q. So would that be -- would it be fair**
12 **to say that's a general rule that it would cost**
13 **consumers more?**

14 A. To really have a significant impact
15 on the improvement of a bond rating, I think it
16 would require a significant increase in regards to
17 the utility, and the offsetting reduction to the
18 interest income likely would be a real -- a small
19 fraction of what that increased earnings would be.

20 **Q. Great. Switching to another topic,**
21 **are you familiar with the practice of some**
22 **regulatory commissions of allowing regulatory**
23 **deferrals of certain expenses?**

24 A. Yeah. It's one of the mechanisms
25 that Mr. Hevert was referring to as a regulatory

1 mechanism. So it is common throughout the
2 industry, in my judgment, that deferred accounting
3 is one of those regulatory mechanisms.

4 **Q. You have -- have you reviewed any of**
5 **the issues relating to regulatory deferrals that**
6 **are being contested in this case?**

7 A. Not specifically. I'm generally
8 familiar with some positions taken by MIEC, but I
9 haven't looked at other parties' positions.

10 **Q. Well, let me ask you then generally,**
11 **based on your experience, do you believe investors**
12 **and analysts, how they would view these regulatory**
13 **deferrals? Would they view them as something that**
14 **reduces the risk of utilities --**

15 A. Well --

16 **Q. -- going forward?**

17 A. The entire structure of regulatory
18 mechanisms, rate structures, how you set the rate
19 structure, how often it can be structured and
20 accounting mechanisms that allow a utility to defer
21 expenses that would otherwise be expensed in the
22 period they were incurred are all types of
23 regulatory mechanisms which are designed to improve
24 the utility's ability to earn its authorized return
25 on equity, fuel adjustment clause, changes in rates

1 to track changes in commodity costs.

2 The deferral of the expense in the
3 event current rates aren't adequate to cover that
4 expense is a way of allowing the utility a better
5 opportunity of earning its authorized return on
6 equity.

7 So the regulatory mechanisms or these
8 deferrals are one of these mechanisms that are a
9 safety net, financial safety net to the utility
10 that allows them to defer the expense and record it
11 in rates in a different period if in that period
12 where those expenses were actually incurred would
13 have resulted in the utility earning less than its
14 authorized returns on equity.

15 So it's a regulatory mechanism to
16 enhance the likelihood that the utility could earn
17 its authorized return on equity during a period
18 where the commission or the chief accountant of the
19 regulatory commission finds it appropriate to allow
20 the deferral of expenses and then determine whether
21 or not those deferred expenses are appropriate for
22 including in the revenue requirement in a
23 subsequent rate case.

24 **Q. So given that explanation, would you**
25 **say it's fair that many investors would view**

1 **deferrals as something of an insurance policy that**
2 **earnings would not drop, that there would not be**
3 **underearnings as a result of those particular**
4 **expenses?**

5 A. It is. Regulatory mechanisms that
6 create a financial safety net for the utility to
7 improve its ability to earn its authorized return
8 on equity.

9 Q. And if, in fact, a utility commission
10 were to look back during the deferral period and
11 make adjustments to the amount that was allowed in
12 a rate case based on overearnings during that
13 period, would that -- how would that be viewed by
14 investors generally?

15 A. Well, my understanding of deferral
16 accounting and the ability to defer expense subject
17 to determination of whether or not it should be
18 recovered in a rate case is how it works. So if
19 the Commission follows through with the intent of
20 the regulatory mechanism, then I think that would
21 be reviewed as favorable by investors.

22 And the reason it would be favorable,
23 even if the deferral subsequently was determined to
24 not be allowed to be included in the development of
25 rates because the revenues at the time that the

1 deferrals were recorded were adequate to allow for
2 recovery of those expenses, it would still be
3 reviewed favorably, in my judgment, because the
4 Commission's actions would be predictable.

5 And one instance where deferral may
6 not be included in the development of forward rates
7 may -- may be negative for investors. In a
8 different situation where it actually is built into
9 future rates, that would be a positive aspect for
10 investors.

11 So if it's followed consistent with
12 how it's designed to work, I think that would be
13 viewed favorably by the investment community.

14 MR. COFFMAN: That's all I have.

15 JUDGE WOODRUFF: All right. Then for
16 Staff?

17 MR. THOMPSON: Thank you, Judge.

18 CROSS-EXAMINATION BY MR. THOMPSON:

19 **Q. Good afternoon, Mr. Gorman.**

20 A. Good afternoon.

21 **Q. Mr. Gorman, would you agree with me**
22 **that there is a point at which assigned return on**
23 **equity is so low as to be constitutionally**
24 **impermissible?**

25 A. Well, it wouldn't meet the standards

1 in my judgment. I'm not a lawyer, so I can't speak
2 from it. I can't answer that from a legal
3 standpoint.

4 But from my understanding of the
5 objectives and measuring a fair return on equity,
6 if it's so low it's not considered fair
7 compensation for the level of risk incurred or if
8 it's so low that it doesn't maintain the financial
9 integrity of the utility, then it's unreasonable.

10 **Q. Do you have an opinion as to what**
11 **that point is in this case?**

12 A. I do. I think low end of my range is
13 the point where below which I think it would be
14 unreasonable.

15 **Q. Okay.**

16 A. Something below 9 percent.

17 **Q. And on the other side of the scale,**
18 **do you agree that there's a point at which the**
19 **assigned return on equity is too high?**

20 A. I do.

21 **Q. And do you have an opinion where that**
22 **is in this case?**

23 A. Based on my analysis, I believe it's
24 at the high end of my range or 9.6 percent.

25 MR. THOMPSON: Thank you. No further

1 questions.

2 JUDGE WOODRUFF: MECG?

3 MR. WOODSMALL: Yes, very briefly.

4 CROSS-EXAMINATION BY MR. WOODSMALL:

5 Q. Working backwards, how do you
6 determine if an ROE granted to a utility maintains
7 financial integrity?

8 A. I perform credit metric evaluations
9 based on the cost of service for the utility in a
10 rate case and compare those credit metrics based on
11 that jurisdictional cost of service at my
12 recommended rate of return to benchmarks published
13 by Standard & Poors.

14 Q. And have you done that in this case?

15 A. I have.

16 Q. And your recommended ROE range all
17 leads you to the conclusion that the ROE would
18 maintain Ameren's financial integrity?

19 A. It would support its current
20 investment grade bond rating, yes.

21 Q. We've had a lot of talk about the
22 possibility of a higher ROE leading to future lower
23 debt cost. Can you tell me what would be the
24 effect of a higher ROE on the cost of capital for
25 industrial ratepayers?

1 A. Well, the impact really deals with
2 whether or not the practice of setting rates
3 results in the most competitive retail rates
4 available for the utility. It's important to
5 understand that the utility is not the only one
6 that has to go to the capital markets. Businesses
7 of utilities have to also.

8 Utility services are generally an
9 operating cost for businesses that do service
10 within the utility's service territory. Those
11 businesses also have to go to the capital markets
12 and show that they produce predictable and stable
13 cash flows that allows them to attract debt and
14 equity capital to fund capital improvements in
15 their own businesses.

16 So the idea of the need for capital
17 attraction doesn't just apply to utility investors,
18 but rather it also goes to whether or not the
19 utility's rates are competitive and supports ec--
20 investments by utility customers within the service
21 territory.

22 So in my judgment, it's imbalance to
23 give the utility a higher rate of return in order
24 to -- to support their access to capital because
25 that can erode the competitive position of the

1 utility's rates, which can detrimentally impact the
2 utility's customers' ability to make investments in
3 their own businesses or homes.

4 So the balance is to recognize that
5 it's not just utility investors that are impacted
6 by the decision, but the need for a balance is
7 there because utilities have investors, businesses
8 have investors, and even homeowners have to go to
9 banks in order to borrow money, and they need
10 disposable income adequate to support mortgages on
11 their homes and cars and other household items.

12 So I think the idea of fair and
13 balanced not only relates to utility investors but
14 also relates to utility customers and their need to
15 borrow money and to go to capital markets.

16 **Q. And there was some discussion in the**
17 **opening statements last Monday about the fuel**
18 **adjustment clause. Are you aware of any upgrades**
19 **that were provided to Ameren that explicitly tied**
20 **to the implementation of the fuel adjustment**
21 **clause?**

22 A. I'm not aware of an explicit upgrade
23 for that purpose, no.

24 MR. WOODSMALL: Okay. No further
25 questions. Thank you.

1 JUDGE WOODRUFF: Ameren?

2 MR. TOMC: Thank you, your Honor.

3 CROSS-EXAMINATION BY MR. TOMC:

4 Q. Mr. Gorman, good afternoon.

5 A. Good afternoon.

6 Q. Before we begin, let me ask you, do
7 you have a copy of your deposition that we took in
8 this case with you?

9 A. Yes.

10 Q. I may also ask you some questions
11 concerning past testimony and past recommendations
12 that you've made in Ameren Missouri rate cases
13 before this Commission. Do you have any copies of
14 that testimony with you today?

15 A. You gave me one at the deposition,
16 but I did not bring it up here with me.

17 Q. I do have that testimony with me, and
18 I will bring a copy of it for your reference should
19 you need to reference that to refresh your memory.

20 A. Thank you.

21 MR. TOMC: May I approach the
22 witness?

23 JUDGE WOODRUFF: You may.

24 MR. TOMC: So what I have handed
25 Mr. Gorman are copies of the complete direct

1 testimonies he has filed in past Commission rate
2 cases involving Ameren Missouri. To the extent we
3 need to reference those if the witness is unable to
4 remember, I provided the complete copies of
5 testimony to Mr. Gorman, but for the remainder of
6 us, I do have handouts to the specific pages that I
7 will be talking about.

8 BY MR. TOMC:

9 Q. Mr. Gorman, would you agree that an
10 electric utility is a capital intensive business?

11 A. Yes.

12 Q. You testified in jurisdictions across
13 the country on behalf of industrial consumers and
14 other intervenors; is that right?

15 A. Yes.

16 Q. And when I use the term vertically
17 integrated electric utility, do you understand what
18 I mean?

19 A. Yes.

20 Q. What do I mean?

21 A. It's an electric utility that owns
22 all three functions of electric utility service:
23 Generation, transmission and distribution.

24 Q. Such as Ameren Missouri?

25 A. Correct.

1 **Q.** **Would you agree with me that today**
2 **vertically integrated electric utilities are**
3 **currently making substantial capital investments to**
4 **comply with environmental laws and regulations, as**
5 **a general matter?**

6 A. Yes.

7 **Q.** **And you would agree that Ameren**
8 **Missouri is one of those utilities?**

9 A. Yes.

10 **Q.** **Are you aware that the Environmental**
11 **Protection Agency has proposed carbon regulations**
12 **that would impact utilities like Ameren Missouri**
13 **that own coal-fired generation assets?**

14 A. I know such a legislation has been
15 proposed. I don't believe the implementation date
16 has been set or it has been approved for
17 implementation.

18 **Q.** **To the extent regulations are**
19 **imposed, capital investment would be required,**
20 **would you agree?**

21 A. I haven't looked at Ameren's plan,
22 integrated resource plan in a while. Generally
23 speaking, coal-fired utilities will have to either
24 make some sort -- depends on the compliance
25 objective. But if they have to reduce carbon

1 emissions, likely capital investment will be
2 necessary. However, if there is a cap and trade,
3 then there may be a tax for carbon emissions. Or
4 if there's a trading mechanism, they may be able to
5 buy allowances from other utilities.

6 But I think the point of your
7 question is, will there be costs associated with a
8 carbon legislation? And the answer would be -- my
9 understanding, it's yes.

10 **Q. Do you think that investment analysts**
11 **and investors themselves are aware of this fact?**

12 A. I'm confident they are, yes.

13 **Q. That is operating risk that investors**
14 **would consider in making investment choices?**

15 A. It's an investment risk which would
16 consume both operating and financial aspects of the
17 utility.

18 **Q. In general, are utilities in the**
19 **United States currently making investments to**
20 **replace aging infrastructure?**

21 A. Yes.

22 **Q. Would you agree with me that the**
23 **replacement of aging infrastructure is an**
24 **industry-wide phenomena?**

25 A. I do.

1 **Q. This is prevalent in the water, gas**
2 **and electric utility industries, correct?**

3 A. Yes.

4 **Q. And these expenditures have been**
5 **going on for at least the last decade?**

6 A. Yes.

7 **Q. You would also agree that fuel**
8 **adjustment clauses or similar mechanisms are common**
9 **among vertically integrated electric utilities**
10 **throughout the United States?**

11 A. Yes. Some form of them generally is
12 fairly common, and it's not always a -- a rider
13 mechanism. Some utilities have some form of
14 tracker mechanisms. But they are common, yes.

15 **Q. Capital markets are competitive. You**
16 **would certainly agree with that, correct?**

17 A. That's the premise of all the
18 financial models. It's an efficient competitive
19 marketplace.

20 **Q. And certainly Ameren Missouri must**
21 **compete for the capital it requires including**
22 **equity capital, correct?**

23 A. Correct.

24 **Q. And Ameren Missouri competes with**
25 **other utilities for capital, right?**

1 A. Yes.

2 Q. Ameren Missouri competes with other
3 equity investments, including non-utility
4 businesses in the S&P 500, right?

5 A. It's a different kind of investment,
6 but yeah, those are all investment options
7 available to investors.

8 Q. Are investors diversified?

9 A. Institutional investors probably are,
10 yes. Individual investors may be if they buy
11 mutual funds or if they're sophisticated enough to
12 develop a diversified portfolio on their own.

13 Q. For the purposes of preparing your
14 capital asset pricing model, is the underlying
15 assumption that investors are diversified?

16 A. All capital market models are based
17 on the assumption that utilities are able to
18 diversify away risk that they don't have to hold
19 within a diversified portfolio.

20 Q. Diversified investors have choices in
21 the stocks they include in their portfolios; is
22 that right?

23 A. Yes. They have choices and they
24 structure the portfolio in order to accomplish that
25 risk diversification, yes.

1 you made in Ameren Missouri's last case, docket
2 ER-2012-0166; isn't that correct?

3 A. Yes.

4 Q. In the last case, if I remember
5 correctly, and we can check this, you used a
6 3.7 percent risk-free rate of return. In this
7 case, you identified a 4.1 percent risk-free rate
8 of return; isn't that right?

9 A. Are you suggesting I used that
10 risk-free rate to form my recommended return on
11 equity range in the last case?

12 Q. I'm making no such suggestion. I'm
13 just asking, for the purposes of your CAPM, you
14 used at 3.7 percent risk-free rate of return, and
15 in this case you used a 4.1 percent risk-free rate
16 of return; isn't that right?

17 A. If you're only referring to the
18 development of CAPM, that probably is right, but --

19 Q. That value is based upon the Blue
20 Chip projected 30-year treasury rate, correct?

21 A. To be clear, though, that CAPM
22 treatment in the last case was not the same as the
23 treatment in this case.

24 Q. The value is based upon the Blue Chip
25 projected 30-year treasury rate, correct?

1 A. Yes.

2 Q. So at least for the purposes of your
3 CAPM, you would agree that your measure of the
4 risk-free rate of return based on treasury rates
5 since the last case has increased, correct?

6 A. The CAPM return in this case is
7 higher than the CAPM return --

8 Q. I didn't ask you about the CAPM
9 return. I asked you, for the purposes of your
10 CAPM, you would agree with me that your measure of
11 the risk-free rate of return since the last case
12 has increased; isn't that right?

13 A. You are asking about the CAPM, but if
14 you're only asking about the risk-free rate, the
15 risk-free rate increased, as did the CAPM rate.

16 Q. You conducted a constant growth
17 discounted cash flow analysis; is that right?

18 A. In this case, yes.

19 Q. If you would please refer to page 15,
20 your direct testimony.

21 A. I'm there.

22 Q. Discounted cash flow constant growth
23 analysis is a calculation that estimates investor
24 expected return on equity based upon the present
25 value of dividends and capital growth of

1 **appreciation. Is that a fair characterization of**
2 **what that model does?**

3 A. Well, I mean, a mathematical makeup
4 of the model is dividend growth into perpetuity,
5 but shortened versions of that cash flow stream can
6 be dividend growth over time and stock sale at some
7 point in the future, which would reflect some
8 expectation of capital appreciation of stock during
9 the holding period. So, yes and no to your answer.
10 It does reflect future cash flows to the investor.

11 **Q. You relied upon Zacks, SNL and**
12 **Reuters to calculate your constant growth DCF; is**
13 **that right?**

14 A. Referring to the growth rate?

15 **Q. Yes.**

16 A. That's correct.

17 **Q. Are those sources reliable, in your**
18 **opinion?**

19 A. Yes.

20 **Q. Have you relied upon the specific**
21 **analysts and their growth rates in other rate**
22 **cases, the specific ones that we mentioned?**

23 A. I have relied on those in other rate
24 cases, yes.

25 **Q. Are they recognized in the finance**

1 A. I believe so.

2 Q. Now, the consensus analyst growth
3 rates that you observed in this case are, in fact,
4 higher than Ameren Missouri's last rate case
5 ER-2012-0166 as based on -- as your analysis
6 provides; is that correct?

7 A. Three to five-year growth rates are
8 higher in this case than in the last case, based on
9 review of my proxy group in this case relative to
10 the proxy group in the last case.

11 Q. If you would look at your direct
12 testimony on page 18. Let's look specifically at
13 line 13.

14 A. I'm there.

15 Q. The average consensus growth rates
16 that you identified in your analysis here are equal
17 to 5.50 percent; is that right?

18 A. Yes.

19 Q. That is the average of Zacks, SNL and
20 Reuters' growth rates for the proxy group, correct?

21 A. Yes.

22 Q. Change gears for just a minute. In
23 the past 24 months, in your opinion, is the United
24 States economy improving?

25 A. I think there's been some positive

1 long-term GDP growth that I have used as a proxy
2 for maximum sustainable long-term growth rate for
3 utilities.

4 Q. It is a proxy value, then; is that
5 correct?

6 A. It is.

7 Q. The proxy value that you selected for
8 your analysis, right?

9 A. Based on the academic and
10 practitioner support I cite in my testimony, yes.

11 Q. Now, if you recall, in your
12 deposition I believe you told me that today analyst
13 growth rates are higher than GDP projections due to
14 the fact that capital expenditures will decline
15 after three to five years. Do you recall that?
16 Would you like a page number reference?

17 A. Yeah, if you would, please.

18 Q. Turn to page 87 of your deposition
19 transcript. Look at line 16. The sentence begins
20 in the middle. After that -- after that, the level
21 of capital investment will decline to more normal
22 levels. And the preceding sentence indicated that
23 after that you were referring to over the next five
24 years.

25 A. Well, I didn't like the way you

1 phrased the question. I don't think that was
2 correct. But my testimony in my deposition, it is
3 also described in this testimony. The idea of
4 long-term sustainable growth rate for utility
5 relates to customers' demand for utility service.
6 And that's proxied by economic growth in the
7 utility service territory. The most widely
8 recognized measure of economic growth is U.S. GDP.

9 Utilities make investments to meet
10 demand for utility service. As a rate base -- as
11 demand grows, the rate base grows and the earnings
12 grow and their dividend paying ability grows.
13 There's a tie between economic activity in the
14 utility service territory and the utility's ability
15 to lower its rate base, its earnings and its
16 dividends.

17 **Q. Referring back to your deposition,**
18 **look at page 86 on line 12. I asked you this**
19 **question: Why have the analysts calculated a**
20 **higher value for their growth rate than the**
21 **sustainable growth rate you have here? Please just**
22 **explain to me as a layperson in general terms.**

23 **Answer: Well, analysts are**
24 **projecting growth over the next three to five**
25 **years. Analysts are not projecting a long-term**

1 sustainable growth rate. And over the next three
2 to five years, analysts have estimated what their
3 growth rate outlooks for the industry and the
4 company specific will be.

5 During the next five years, rate base
6 investments will continue to be relatively high
7 levels for the electric utility industry as they
8 complete the environmental compliance, with
9 generation portfolios, with the modernization of
10 their delivery wire service, and that will cause
11 elevated levels of rate base growth over the next
12 five years.

13 Did I read that correctly?

14 A. You did.

15 Q. That was your answer in the
16 deposition, was it not?

17 A. It's similar to the testimony
18 prefiled, yes.

19 Q. Now, with respect to your past
20 testimony, I have a few questions for you
21 specifically with respect to growth rates. I am
22 going to mark an exhibit at this time.

23 JUDGE WOODRUFF: Your next exhibit
24 number is 59.

25 (AMEREN MISSOURI EXHIBIT NO. 59 WAS

1 MARKED FOR IDENTIFICATION BY THE REPORTER.)

2 BY MR. TOMC:

3 Q. Now, Mr. Gorman, I've handed you
4 what's been marked as Exhibit 59. This is a
5 document prepared by me. I represent to you that
6 this contains excerpts from your direct testimony
7 in the past Ameren Missouri rate cases starting in
8 2007.

9 MS. ILES: Your Honor, I'm going to
10 object to the use of this exhibit unless there's
11 some prior inconsistency. There's no basis for
12 introducing this hearsay testimony at this time.

13 MR. TOMC: I'm not -- sorry, your
14 Honor.

15 JUDGE WOODRUFF: I'll wait until he's
16 actually asked questions to establish what the
17 purpose of offering it is, and then you may wish to
18 renew your objection.

19 BY MR. TOMC:

20 Q. Now, in the 2007 Ameren Missouri rate
21 case, you found that growth -- analyst growth rates
22 were at 5.16 percent as an average; is that right?

23 A. Yes.

24 Q. And you found these to be consistent
25 with GDP projections of 5.1 percent; is that right?

1 A. Yeah. It's fairly similar, yes.

2 Q. And that direct testimony was filed
3 in December of 2006; is that correct?

4 A. Appears to be, yes.

5 Q. In 2008, which is the testimony that
6 follows in the handout -- feel free to reference
7 whichever versions you feel are appropriate.

8 MR. TOMC: And for those that are
9 following along, I'm looking at page 5 of the
10 Gorman cross exhibit, which is page 18 of that
11 testimony in 2008.

12 THE WITNESS: Okay. Thank you.

13 BY MR. TOMC:

14 Q. In this case you identified growth
15 rates of 6.8 percent, 7.25 percent, 8.03 percent,
16 and those growth rates exceeded your long-term
17 estimate of growth as well; is that correct?

18 A. Sorry. What page were you on again?

19 Q. Look at page 5 of 45 on the cross
20 exhibit.

21 A. In Docket 2008-0318?

22 Q. That's correct.

23 A. Can you repeat your question, please?

24 Q. You found that there were average
25 three to five growth rates for your proxy group at

1 6.8 percent, 7.25 percent and 8.03 percent; is that
2 right?

3 A. Referring to page 18? Sorry. I
4 thought you said page 8.

5 Q. Yes, 18. Look at line 21 on your
6 testimony in 2008.

7 A. Yes. That's correct.

8 Q. And in those values they did exceed
9 what you considered to be the long-term estimate of
10 growth; is that right?

11 A. Yes.

12 Q. And if you look at page 26 of that
13 testimony, I believe it was 4.9 percent was the
14 long-term sustainable rate of growth that you use
15 for your three-stage DCF, right?

16 A. Page 26, line 6, it's identified,
17 yes, it's 4.9 percent.

18 Q. That's right then?

19 A. Yeah. Yes, it is, at the page I just
20 mentioned.

21 Q. This testimony was filed in 2008, as
22 I recall?

23 A. It was.

24 Q. If you look at page 22 of your
25 testimony, line 30. You told this Commission, this

1 elevated capital spending level may continue over a
2 relatively long period of time. This indicates
3 that rate base growth will drive earnings growth
4 over the next three to five years. Do you see
5 that?

6 A. I do.

7 Q. If you refer to the 2010 case, your
8 testimony in that case you identified an average
9 growth rate of 6.74 percent and a median of
10 5.50 percent.

11 A. Case No. ER-2010-0036?

12 Q. Yes.

13 A. I'm sorry. Can you repeat that
14 question?

15 Q. Sure. Look at page 24, line 15. You
16 identify median growth rate of approximately
17 5.16 to 5.67 percent; is that right?

18 A. Yes.

19 Q. In that case, that value also exceeds
20 your long-term estimated maximum growth rate of
21 4.7 percent; is that right? It's on page 33 of
22 your testimony in that case, line 10.

23 A. Yes.

24 Q. Now, moving to the 2011 case that
25 follows, if we look at page 18 of that testimony --

1 I'm sorry -- page 17, line 14, the average median
2 consensus growth rates for the proxy group are
3 5.59 and 5.13 percent respectively; is that true?

4 A. Yes.

5 Q. In that case your long-term estimated
6 maximum growth rate was 4.7 percent. I would
7 direct your attention to page 18. Is that right?

8 A. 4.7 to 4.8, yes.

9 Q. Now, we've already spoken about your
10 testimony in the last case, which was the 0166
11 docket. Isn't it true that in every Ameren
12 Missouri rate case since 2006, the average
13 consensus analyst growth rates that you have
14 provided have either been consistent with or in
15 excess of your estimated long-term growth rates?

16 A. The projected growth by the analysts
17 have consistently exceeded the long-term GDP growth
18 rate outlooks as published by security analysts and
19 by consensus of economists. Those are not actual
20 growth rates. Those are projections.

21 Q. Your maximum long-term sustainable
22 growth rates are based upon five- and ten-year
23 nominal GDP projections. Those are based on a
24 publication, as we have discussed, referred to as
25 Blue Chips; is that right?

1 A. Yes. Blue Chip Financial Forecast
2 has a long-term GDP consensus forecast ranging out
3 to ten years. That is correct.

4 MR. TOMC: May I approach the
5 witness, your Honor?

6 JUDGE WOODRUFF: You may. Will this
7 be an exhibit also?

8 MR. TOMC: It will.

9 JUDGE WOODRUFF: This will be No. 60.

10 (AMEREN MISSOURI EXHIBIT NO. 60 WAS
11 MARKED FOR IDENTIFICATION BY THE REPORTER.)

12 BY MR. TOMC:

13 **Q. I caused to be presented to you**
14 **what's been marked as Exhibit No. 60, Ameren**
15 **Missouri. Do you recognize this document?**

16 A. Recognize the front page, yes.

17 **Q. Can you turn to the back page? Do**
18 **you see data there?**

19 A. I see data there, yes.

20 **Q. Is this the document you relied upon**
21 **in preparation of your analysis in this case, do**
22 **you know?**

23 A. Well, the column headings are blacked
24 out here, so you can't read what data is being
25 offered in this. But the footnote above talks

1 about projections for 2016 through 2020.

2 Generally, I rely on a different page of this
3 document.

4 **Q. You rely upon nominal GDP projections**
5 **with respect to your calculation of long-term**
6 **sustainability growth rate; is that right?**

7 A. I rely on Blue Chips consensus
8 analyst projections and nominal GDP, yes.

9 **Q. And the Blue Chips analyst consensus**
10 **growth or GDP values that you rely upon, those are**
11 **five year -- those are five-year average values; is**
12 **that correct?**

13 A. The GDP growth?

14 **Q. Yes.**

15 A. They're five and ten year.

16 **Q. Five and ten year.**

17 A. Well, first it gives two projections.
18 One is over the first five years, and the other
19 projection is years six through ten.

20 **Q. And typically you rely upon years six**
21 **through ten for your long-term sustainable growth**
22 **estimate; is that right?**

23 A. No. Actually, year six through ten
24 is usually lower than years one through five
25 because economists project that as the U.S. economy

1 recovers, it will have a period of accelerated
2 growth and then the growth will slow over time.
3 The same assumption I'm making for my DCF model for
4 utility's cash flow streams.

5 To be conservative, I average the two
6 growth rate periods together, which produces a
7 higher number, and then use that average growth
8 rate as my long-term sustainable growth.

9 **Q. Did you reference the nominal GDP**
10 **Blue Chips consensus for the period 2021 to 2025 in**
11 **estimating your third-stage growth rate?**

12 A. I'm sorry. Can you repeat that?

13 **Q. Sure. Did you rely upon Blue Chips'**
14 **projected GDP for the years 2021 through 2025 for**
15 **your third stage of your DCF?**

16 A. You said Blue Chips GDP projections?

17 **Q. Yes. Do you recall?**

18 A. It's their five- and ten-year
19 projections. I'm trying to identify specific
20 years. It would be five years out from the
21 publication date and then ten years out from the
22 publication date. So it sounds like that's pretty
23 close.

24 **Q. So if the publication date is in**
25 **2014, it would be five years, 2021 to 2025, right?**

1 A. That's about right, yes.

2 **Q. When does the third stage in your**
3 **model, what year would that begin?**

4 A. Year 11.

5 **Q. Which would be 2026, right?**

6 A. Be year 11, yeah. Using data as of
7 2014, that would be about right.

8 **Q. Why not reference a Blue Chip**
9 **projected GDP for 2026 and beyond?**

10 A. Well, I did do that to support the
11 reasonableness of my five- and ten-year consensus,
12 economist projections of future GDP. There is no
13 consensus beyond year ten, but there are individual
14 economist projections.

15 So I did -- did compare the
16 individual economist projections of future GDP
17 growth and compare that to those growths made by
18 the Blue Chip Financial Forecast. And that's
19 discussed at page 22 and 23 of my direct testimony.
20 And I found that those individual economist
21 projections of longer term growth are largely
22 consistent with Blue Chips' financial projections
23 over the next ten years.

24 **Q. Blue Chips does not offer such**
25 **projections in their publications at this time, do**

1 **they, at this time?**

2 A. They would if investors required
3 those to make investment decisions. So it's my
4 belief that since they're in the business to
5 provide investors the information they're looking
6 for to make investment, that this is the
7 information investors are looking at to draw
8 expectations of long-term GDP growth.

9 **Q. So investors and investment analysts**
10 **would review Blue Chip publications such as a**
11 **document like this; is that your testimony?**

12 A. I believe, yes, they would consider
13 consensus analyst projections, and the consensus
14 projections are more likely reflective of the
15 market in general.

16 **Q. Is it possible that the reason that**
17 **Blue Chips does not publish GDP projections beyond**
18 **the ten-year period as we've discussed here is**
19 **because investors do not find this information**
20 **useful to them?**

21 A. It's -- investors require information
22 to make investment decisions. If they wanted
23 projections and were willing to pay for projections
24 longer than ten years, I would think Blue Chip
25 would publish that information.

1 But investors recognize that the
2 longer the projection is, the more uncertain the
3 projection is. So for any given period of time,
4 investors generally look at the most reliable
5 outlook for longer-term projections, and that is
6 best approximated by the consensus ten-year
7 outlooks.

8 **Q. Referring again to the exhibit,**
9 **Ameren Missouri Exhibit 60 cross exhibit, if you**
10 **look at the nominal GDP column No. 3, I know you**
11 **can't see the headings, the far right indicates a**
12 **value of 4.4. Can you tell me, is that the basis**
13 **for your long-term estimated growth rate that you**
14 **replied upon in your multistage DCF in this case?**

15 MS. ILES: Objection. The witness
16 has already said he doesn't rely on this page of
17 the publication.

18 JUDGE WOODRUFF: I'll overrule that
19 objection. The witness can answer if he can.

20 THE WITNESS: Give me one second to
21 review my testimony on that.

22 BY MR. TOMC:

23 **Q. Look at, Mr. Gorman, page 24 of your**
24 **direct testimony, line 9.**

25 A. Yeah. That's what I was looking at.

1 I suspect that the last two columns might be the
2 five- and ten-year projections, but I had 4.4 to
3 4.8, and this is showing 4.4 to 4.7.

4 Q. Now, if you look below, and it's Item
5 No. 9 titled corporate profits pretax, No. 9 there,
6 if you look over there on the far-right column, it
7 has a 5 percent value. Do you see that?

8 A. I do.

9 Q. That 5 percent is higher than 4.4; is
10 that right?

11 A. It is. It's a different forecast.

12 Q. Are the Blue Chip analyst projections
13 of corporate profits pretax, are those sustainable,
14 Mr. Gorman?

15 A. Over the next five and ten years, I
16 would think those profit projections, which are
17 simply earnings projections, may be subject to what
18 the outlook is over the next five- and ten-year
19 period.

20 Q. Did you say profits are essentially
21 earnings projections, Mr. Gorman?

22 A. Pretax corporate profits.

23 Q. I'm asking you about your response.
24 Did you say that profits are essentially earnings
25 projections? Is that what you said?

1 A. The earnings are encapsulated in that
2 pretax profit, yes.

3 **Q. I'd like to ask you a few questions**
4 **about your review of data concerning authorized**
5 **rates of return as provided by RRA. Are you**
6 **prepared to discuss that today?**

7 A. I am.

8 **Q. Refer to page 4 of your surrebuttal**
9 **testimony.**

10 A. I'm there.

11 **Q. Beginning on line 11, you begin a**
12 **clause that states, investors would expect an**
13 **authorized return on equity of approximately**
14 **9.63 percent. Do you see that?**

15 A. That's part of that sentence, yes.

16 **Q. That 9.63 percent is based on your**
17 **review of the 2014 electric utility rate decisions**
18 **that are detailed in your Schedule MPG-SR-1; is**
19 **that right?**

20 A. It is.

21 **Q. Now, specifically you examined both**
22 **distribution utilities and vertically integrated**
23 **utilities together; is that correct?**

24 A. I review it as an industry and draw
25 observations about what commissions are authorizing

1 for electric utility companies that have reasonably
2 similar investment risk.

3 Q. For the purposes of this exhibit
4 here, Mr. Gorman, and you've included an analysis
5 of distribution utilities and vertically integrated
6 utilities on page 1, and then on page 2 you've
7 included only vertically integrated utilities; is
8 that right?

9 A. That's correct.

10 Q. And distribution utilities would
11 include such utilities as ConEd up in New York or
12 ConEd in Chicago or Ameren Illinois in metro east,
13 right?

14 A. Correct.

15 Q. And those utilities do not own
16 generation assets, do they?

17 A. Distribution companies do not,
18 correct.

19 Q. This --

20 A. Well, I mean, ConEd does.

21 Q. ConEd generates steam; is that right?

22 A. They generate steam and they also
23 have some onsite ancillary service support.

24 Q. Correct. But for the most part those
25 companies do not own generation in the United

1 **States?**

2 A. For the most part, but it's more
3 complicated than simply categorizing them as
4 vertically integrated delivery companies.

5 **Q. Let's take ConEd and Ameren Illinois**
6 **over on the Illinois side. Those utilities do not**
7 **own generation, do they, Mr. Gorman?**

8 A. No. Correct.

9 **Q. Now, utilities that do not own**
10 **generation do not have the asset risk of operating**
11 **generation assets, do they?**

12 A. You don't have that risk, that's
13 correct.

14 **Q. You don't have the commodity risk of**
15 **producing electricity from generation resources; is**
16 **that right?**

17 A. Not entirely, no. They don't have to
18 buy commodity to make the electricity, but they
19 often have to buy power to resell to customers that
20 take service on a fully bundled basis from the
21 wires company. So from that standpoint they may
22 have commodity risk.

23 **Q. I want to refer you to your**
24 **deposition on page 39. Beginning on line 15, you**
25 **told me, so it's a complicated question. Generally**

1 distribution companies don't have the asset risk of
2 owning generation resources, don't have the
3 commodity risk of producing electricity from those
4 sources, and they may not have the purchased power
5 agreement contractual risk associated with meeting
6 their entire native load power demands. Is that
7 what you told me in the deposition?

8 A. Well, I think we went through this in
9 detail, and I did explain in this same deposition
10 that a wires company can have commodity risk if
11 they're buying power for resale or retail customers
12 on a public service basis.

13 Q. My question is, Mr. Gorman, do they
14 have the commodity risk of producing electricity,
15 and they do not, do they?

16 A. They don't produce the electricity,
17 that's correct. But that's not to say that there's
18 no commodity risk included in the total investment
19 risk characteristics of a wires company.

20 MR. TOMC: May I approach the
21 witness, your Honor?

22 JUDGE WOODRUFF: You may.

23 MR. TOMC: This will be Exhibit 61.

24 (AMEREN MISSOURI EXHIBIT NO. 61 WAS
25 MARKED FOR IDENTIFICATION BY THE REPORTER.)

1 BY MR. TOMC:

2 Q. Mr. Gorman, I've handed you what's
3 been marked as Exhibit 61. Do you recognize this
4 document?

5 A. Yes.

6 Q. This is the most recent Moody's
7 Investor Service credit opinion for Ameren
8 Missouri, is it not?

9 A. It's the most recent one I'm aware
10 of.

11 Q. Now, investors would review this type
12 of document, would they not, in making investment
13 decisions?

14 A. Well, it's a subscription-based
15 document. I would think that most institutional
16 investors would have access to it. If they had
17 access to it, I would think they'd want to review
18 it.

19 Q. Mr. Gorman, I would refer you to the
20 second page of this document. Do you see the
21 heading marked details ratings consideration?

22 A. Yes.

23 Q. Okay. And the first item listed
24 there is environmental compliance in investment
25 becoming a bigger focus. Do you see that?

1 A. I do.

2 Q. And if you look in the second
3 paragraph, about the third line, it indicates, its
4 integrated resource plan lays out a proposed
5 investment to achieve CO2 emissions reductions
6 proposed by the EPA by 2035. Do you see that?

7 A. I do.

8 Q. We would not expect a wires company
9 with no generating assets to have a similar such
10 statement in it's credit report, would we?

11 A. I wouldn't expect you would, no.

12 Q. Given that it's at the top of the
13 detail ratings considerations, is it reasonable to
14 believe that Moody's found this potential operating
15 risk to be something that they would be focusing
16 closely on in the future?

17 A. I would think that carbon regulation
18 is a concern to credit analysts and they would be
19 looking at all coal-fired utilities in compliance
20 requirements if carbon legislation and carbon rules
21 are placed into effect.

22 Q. Now, referring back to your exhibit,
23 MPG-SR-1, page 1, the value, the 9.63 percent that
24 you identified in your testimony that we discussed
25 earlier, that is derived from your examination of

1 this fully litigated rate case column; is that
2 correct?

3 A. I'm sorry. Can you repeat that one
4 more time?

5 Q. Sure. Let's walk through it step by
6 step here. You see the average 9.63, the bottom
7 right-hand corner of your schedule?

8 A. Yes.

9 Q. Is that the source of the 9.63 value
10 you cited on page 4 of your testimony?

11 A. Yes.

12 Q. And that is a product of your average
13 of what you've identified here as the fully
14 litigated rate cases average?

15 A. Under column 12, yes.

16 Q. And you've included both Ameren
17 Illinois and ConEd return on equity values in your
18 fully litigated column; is that right?

19 A. I did.

20 Q. Both of those utilities, as we've
21 discussed, are distribution utilities, correct?

22 A. Correct.

23 Q. Both of those utilities are
24 participants in the special formula rate plan that
25 corresponds to the Illinois Energy Infrastructure

1 **Modernization Act, correct?**

2 A. I'm wondering why you put special in
3 there, but they're subject to rate setting based on
4 a formula rate plan based on that infrastructure --
5 infrastructure regulatory plan in Illinois.

6 **Q. And that's a formula rate plan,**
7 **correct?**

8 A. It is.

9 **Q. And under that law the return on**
10 **equity is determined annually by a formula,**
11 **correct?**

12 A. A market-based formula, that's
13 correct.

14 **Q. And you have been involved in all of**
15 **those formula rate cases filed by both ConEd and**
16 **Illinois?**

17 A. Yes.

18 **Q. And you have testified on behalf of**
19 **industrial consumers in those cases, correct?**

20 A. Industrials, consumer advocates and
21 the Attorney General.

22 **Q. No party has ever contested the rate**
23 **of -- the return on equity for either ConEd or**
24 **Ameren Illinois in any formula rate update filing**
25 **in Illinois; is that correct?**

1 A. Did you say rate of return or return
2 on equity?

3 **Q. No party has ever contested the**
4 **return on equity of either ConEd or Ameren Illinois**
5 **in any formula rate update filing in Illinois; is**
6 **that correct?**

7 A. That's generally correct, unless
8 there was some dispute over whether or not the
9 formula was properly implemented. And I don't
10 recall a dispute of that nature.

11 **Q. There's nothing to litigate because**
12 **the value is prescribed by formula; is that**
13 **correct?**

14 A. There's nothing to litigate because
15 the risk premium model is clearly defined and it
16 states the utility will use that rate whether it
17 believes it's too high or too low, and the
18 consumers are obligated to accept it as well.

19 **Q. The 2014 cases that are cited here in**
20 **your schedule, these were included in your**
21 **RRA report for 2014 as they were decided in the**
22 **fourth quarter of that year; is that correct?**

23 A. Yes.

24 **Q. If we were to exclude the ConEd and**
25 **Ameren Illinois ROE values, the average calculated**

1 **9.63 would increase; is that true?**

2 A. Well, it would because those -- both
3 those authorized returns on equity are below the
4 average. So, yes, it would.

5 **Q. Now, if I understand correctly, you**
6 **were recently involved in a rate case that was**
7 **settled in Colorado; is that right?**

8 A. Yes.

9 **Q. That was Docket No. 14AL-0663. That**
10 **was the Public Service of Colorado rate case; is**
11 **that right?**

12 A. I don't remember the docket number,
13 but there was a settlement with Public Service of
14 Colorado recently, yes.

15 **Q. That was a vertically integrated**
16 **utility, correct?**

17 A. Correct.

18 **Q. Does the Public Service Company of**
19 **Colorado have an FAC or similar mechanism?**

20 A. It does.

21 **Q. And the settlement included a**
22 **56 percent equity ratio for the cap structure; is**
23 **that correct?**

24 A. Based on the unique circumstances of
25 that company, that was part of the settlement, yes.

1 **example?**

2 A. Not as I sit here, but I think your
3 description of qualifying investments sounds
4 correct.

5 **Q. Isn't it true that you advised your**
6 **client that the settlement was reasonable and your**
7 **client agreed with you?**

8 A. It is, based on the final rates
9 included in that settlement, yes.

10 **Q. You were also involved in a settled**
11 **rate case from last year for Nevada Power and**
12 **Sierra Pacific Resources, Docket No. 14-05004. Do**
13 **you recall that?**

14 A. Yes.

15 **Q. And those are the electric utilities**
16 **that serve Las Vegas, Reno and Tahoe, Nevada,**
17 **correct?**

18 A. Amongst other -- those are within
19 their service territory, yes.

20 **Q. In that case, your clients also**
21 **signed on to the settlement; is that right?**

22 A. Yes.

23 **Q. And the return on equity agreed to**
24 **was 9.8 percent; is that right?**

25 A. It was.

1 it has the right to ask you for a rider. I asked
2 you, today, does it have a rider mechanism on its
3 books that allows it to recover capital costs
4 between rate cases?

5 A. I'm not aware of one.

6 Q. Does Ameren Missouri have a
7 56 percent equity ratio?

8 A. Not in this rate case.

9 Q. Does it have any ability to recover
10 CWIP or any costs associated with CWIP in its rates
11 in the state of Missouri?

12 A. It has the -- potentially if it can
13 demonstrate a financial need, not necessarily for a
14 current return on CWIP, but what is economically
15 the equivalent. Kansas City Power & Light had a --

16 Q. Mr. Gorman, if I may, I'm not asking
17 you about the equivalent to CWIP. I'm asking you
18 about construction work in progress. Today, can
19 Ameren Missouri ask this Commission to approve its
20 inclusion of recovery on CWIP in its rates?

21 A. In order to answer that question, I
22 have to understand what you mean by it. And
23 generally speaking, when you're asking for a
24 current return on CWIP, it's generally to improve
25 the cash position of the utility during a major

1 construction period. And if you're asking whether
2 or not that's possible for a utility within
3 Missouri, my answer is it is possible, because such
4 a regulatory mechanism was approved for Kansas City
5 Power & Light.

6 Q. I would refer you to your Table 1 on
7 page 6 of your testimony.

8 A. Direct testimony? Are you in my
9 direct?

10 Q. I'm sorry. I'm in your surrebuttal
11 testimony. Table 1, page 6 of your surrebuttal.

12 A. I'm there.

13 Q. Okay. Mr. Gorman, Table 1 you've
14 titled Ameren Missouri bond yields; is that right?

15 A. Yeah. It's not a very good title.
16 It's utility bond yield. Thank you.

17 Q. These figures are not Ameren
18 Missouri's bonds, they're Moody's averages of bonds
19 issued by other utilities, correct?

20 A. That's correct. Moody's public
21 utility bond yield averages, correct.

22 Q. My return on equity witness referred
23 to gas utility, so we'll take this correction here
24 for you, Mr. Gorman. Would it be possible -- would
25 it be more accurate to refer to this as a Moody's

1 average bond yields as an appropriate title?

2 A. Yes. Thank you.

3 Q. Okay. Please refer to MPG-SR-2.

4 This is a exhibit that's attached to your
5 surrebuttal testimony.

6 A. I'm there.

7 Q. Now, these values listed here, again,
8 they're Moody's average values; is that right?

9 A. Yes.

10 Q. And the bonds themselves were issued
11 by various utilities; is that correct?

12 A. Correct.

13 Q. And those actual bonds have different
14 covenants, and it has the covenants that are
15 specific to the companies that issued them, right?

16 A. Yes.

17 Q. And the bonds would have different
18 terms ranging from 15 to 30 years; is that right?

19 A. To my understanding, yes.

20 Q. Now, at the time you prepared your
21 surrebuttal, you did not research the specific
22 issuances included in Moody's; is that right?

23 A. That's correct.

24 Q. Now, Mr. Gorman, let me ask you with
25 respect to this data, you did examine more current

1 **data after filing your testimony; is that right?**

2 A. Filing the surrebuttal testimony?

3 **Q. Yes.**

4 A. Yeah. We have that updated study
5 since I filed this testimony.

6 **Q. And if it appears to me by the dates**
7 **here that Moody's releases this information weekly,**
8 **would you agree?**

9 A. Yes.

10 **Q. And in recent weeks, Moody's average**
11 **bond yields have increased, haven't they?**

12 A. Yes. Actually, we responded to a
13 data request from the company that updated this to
14 February.

15 **Q. And that data request showed an**
16 **increase in Moody's average bond yields; is that**
17 **right?**

18 A. Small increase, yes.

19 MR. TOMC: Your Honor, this would be
20 62; is that correct?

21 JUDGE WOODRUFF: That is correct.

22 (AMEREN MISSOURI EXHIBIT NO. 62 WAS
23 MARKED FOR IDENTIFICATION BY THE REPORTER.)

24 BY MR. TOMC:

25 **Q. I've handed you what has been marked**

1 as Ameren Missouri Cross Exhibit No. 62. Do you
2 recognize that document?

3 A. I do, yes.

4 Q. Is this the data request that you
5 just mentioned?

6 A. It is. And thank you for providing
7 this because the yields actually went down, not up.
8 And also, there is a typo on page 1 of this data
9 response. I apologize for it. But in response to
10 bullet A, on the 13K average should be through
11 February 13, not January 23rd. May I make that
12 correction on this schedule?

13 Q. Point to me again. Is that the --

14 A. Response A, the yield reflected
15 13-week average ending -- I'm sorry. I'm sorry.
16 My mistake. I was thinking that was referring to
17 the date on the attachment, but it's not.

18 Q. Okay. Let's compare this to the
19 surrebuttal exhibit just for a moment. And I see
20 that the last observation in terms of the Moody's
21 average was 1/23/2015?

22 A. Yes.

23 Q. Okay. And your updated analysis here
24 provided in discovery in response to the DR, that
25 includes the week ending 1/30/2015, week ending

1 2/6/2015, the week ending 2/13/2015. Do you see
2 that?

3 A. Yes.

4 Q. So the week ending on January 23rd, I
5 see BAA rated yields at 4.33 percent. Do you see
6 that?

7 A. I do.

8 Q. And on 2/13/2015, I see BAA rated
9 yields at 4.5 percent. Do you see that?

10 A. Yes.

11 Q. 4.5 percent is higher than
12 4.33 percent, correct?

13 A. It is, but it's lower than the
14 13-week average of 4.55. It's also lower than the
15 13-week average shown in my surrebuttal testimony.

16 Q. Mr. Gorman, since the time that you
17 filed your surrebuttal testimony, the bond yields
18 that were current as of that date, the average now
19 increased above that value; isn't that correct?

20 A. Above 4.5?

21 Q. Above 4.33 percent.

22 A. For BAA utility bond yields, yeah, I
23 believe that's correct.

24 MR. TOMC: Your Honor, will this be
25 63?

1 JUDGE WOODRUFF: It would be 63.

2 (AMEREN MISSOURI EXHIBIT NO. 63 WAS

3 MARKED FOR IDENTIFICATION BY THE REPORTER.)

4 BY MR. TOMC:

5 Q. Mr. Gorman, we have marked for
6 identification a color copy of the Blue Chips
7 document. Do you see that?

8 A. I do, yes.

9 Q. And if you turn to the second page of
10 what's been marked as Ameren Missouri Cross Exhibit
11 No. 63, you will see that the blacked-out titles
12 are no longer blacked out.

13 A. I do.

14 Q. Do you recognize this document?

15 A. Yes.

16 Q. Is this the document you relied upon
17 in the preparation of your testimony?

18 A. It has the same data I relied on from
19 the same document. So it is the source that I
20 relied on for my testimony.

21 Q. Thank you. Okay. Now, in January of
22 this year, you offered testimony before the
23 Illinois Commerce Commission concerning the
24 acquisition of People's and North Shore Gas
25 Companies by a company called Wisconsin Electric;

1 **is that right?**

2 A. Wisconsin Electric Corp, yes.

3 **Q. That's a holding company, right?**

4 A. It is, yes.

5 MR. TOMC: Your Honor, at this time I
6 would like to discuss some highly confidential
7 information. I would ask that we go in-camera.

8 JUDGE WOODRUFF: At this point we
9 will go in-camera then. If there is anyone in the
10 room that needs to leave, please do so.

11 (REPORTER'S NOTE: At this point, an
12 in-camera session was held, which is contained in
13 Volume 22, pages 1259 through 1261 of the
14 transcript.)

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1 JUDGE WOODRUFF: All right. We're
2 back in regular session.

3 MR. TOMC: Thank you, your Honor.

4 BY MR. TOMC:

5 Q. Now, Mr. Gorman, I want to ask you a
6 clarifying question with respect to something you
7 said earlier. You said if your analysis was
8 adopted, it would continue to support investment
9 credit rating for Ameren Missouri; is that right?

10 A. My recommended return on equity and
11 overall rate of return, I believe, yes.

12 Q. Now, currently Ameren Missouri's
13 investment grade is two notches above speculative;
14 is that correct?

15 A. Standard & Poor's bond rating now I
16 believe is BBB+.

17 Q. How many notches?

18 A. Would be three notches.

19 Q. Three notches. So there's two
20 notches below it, correct?

21 A. Yes. Investment grade notches, yes.

22 Q. Would you agree with me, Mr. Gorman,
23 that it's important that a company not be on the
24 edge of junk bond status?

25 A. That a company or a utility?

1 **Q. A utility.**

2 A. A utility company to the extent they
3 have not engaged in imprudent or unlawful practices
4 but generally conducted themselves reasonably and
5 prudently, I believe the rate setting process
6 should provide that utility an opportunity to
7 maintain strong credit in its financial integrity.

8 So there can be situations where I
9 don't believe the customer should be asked to bail
10 out the utility for inappropriate or illegal
11 activity. But with that caveat, I would generally
12 agree with that statement.

13 **Q. And there is no bailout request in**
14 **this proceeding, at least by the utility in this**
15 **rate case; is that right?**

16 A. Correct.

17 MR. TOMC: I have no further
18 questions.

19 JUDGE WOODRUFF: Okay. Again, we've
20 been going for almost two hours. We'll take a
21 break before we come back for questions from the
22 Bench, and we'll come back at 3:40.

23 (A BREAK WAS TAKEN.)

24 JUDGE WOODRUFF: Let's come back to
25 order. We're back from break. Before we do

1 anything else, I wanted to go back to Mr. Tomc and
2 ask him if he wanted to offer 59 through 63.

3 MR. TOMC: I did want to offer
4 certain exhibits into the record, your Honor, but
5 not all of them. Those would be Ameren Missouri
6 Cross Exhibits 61, 62 and 63. And to tell you what
7 those documents are, I know that there were a
8 number of them proffered, 61 would be the Moody's
9 credit report for Ameren Missouri. 62 would be the
10 Ameren MIEC DR response that is designated as 011.
11 And then 63 is the Blue Chips document that was
12 identified.

13 JUDGE WOODRUFF: So you're not going
14 to offer 59 and 60?

15 MR. TOMC: That's correct.

16 JUDGE WOODRUFF: Just for
17 clarification, I understand 60 is the same as 63
18 without the blackouts, the unfortunate blackouts?

19 MR. TOMC: That's correct, your
20 Honor.

21 JUDGE WOODRUFF: All right.

22 MS. ILES: Your Honor, I'd object to
23 61, but no objection to 63 and 60.

24 JUDGE WOODRUFF: All right. Are we
25 clear?

1 MS. ILES: I'm sorry. 62 I have no
2 objection to. The only one I'm trying to object to
3 on the basis of hearsay is Exhibit 61, and improper
4 foundation. Have I got it wrong again? That's the
5 Moody's credit opinion.

6 JUDGE WOODRUFF: 61 is the Moody's
7 credit opinion.

8 MS. ILES: That's the one I'm
9 objecting to. I'm sorry.

10 MR. TOMC: Your Honor, I did ask the
11 witness if he was familiar with the document. He
12 indicated he was. The document is probative as to
13 the issues discussed in testimony, and I would
14 submit that it's relevant evidence.

15 JUDGE WOODRUFF: I'll rule first on
16 62 and 63. There is no objection to those. They
17 will be received.

18 (AMERENUE EXHIBIT NOS. 62 AND 63 WERE
19 RECEIVED INTO EVIDENCE.)

20 JUDGE WOODRUFF: On 61, which is the
21 Moody's credit opinion, I'm going to overrule the
22 objection and allow it into evidence. So it will
23 be received.

24 (AMERENUE EXHIBIT NO. 61 WAS RECEIVED
25 INTO EVIDENCE.)

1 JUDGE WOODRUFF: All right. We had
2 some off-the-record discussions before we went back
3 on the record about possibly rescheduling items for
4 tomorrow. Are the parties ready to talk about that
5 on the record?

6 MR. WOODSMALL: I think in very
7 general terms, and I'll allow others to jump in
8 because things are definitely in a state of flux
9 here. The issues for tomorrow are, as it currently
10 stands, are the non-Noranda class cost of service
11 rate design issues, and there have been discussions
12 along those lines amongst the consumer groups.
13 They haven't been shared yet with Ameren and Staff.
14 We're hopeful of sharing that with them tonight. I
15 don't expect them to be able to give us an answer
16 on that tonight.

17 So we were hoping to possibly start
18 tomorrow later, maybe after lunch, so we can try to
19 tie those down. The hope is that that won't cause
20 a pinch for anybody because there are other issues
21 in the latter half of this week, specifically
22 depreciation and fuel, that are also close to
23 settlement, and I think Wendy might be able to give
24 more guidance on that.

25 MS. TATRO: Yes. We've been working

1 on the depreciation and the net base energy costs
2 for a while, and I think we're just waiting on a
3 couple parties to confirm that they either support
4 or don't oppose those. So hopefully we'll have
5 those and be able to file those shortly.

6 MR. WOODSMALL: So the long and short
7 is, I think, given the way things are going, we'll
8 have plenty of time in this week even if we don't
9 get tomorrow's issue fully settled.

10 JUDGE WOODRUFF: Okay.

11 MR. WOODSMALL: So I guess all we're
12 asking for is to start at one o'clock tomorrow if
13 it is the Commission's desire.

14 JUDGE WOODRUFF: That sounds
15 reasonable.

16 MS. TATRO: And you're assuming we
17 get through ROE today, correct?

18 MR. WOODSMALL: That was my
19 assumption.

20 JUDGE WOODRUFF: Well, my assumption
21 is we'll push on and finish ROE.

22 MS. TATRO: That gets it done.

23 JUDGE WOODRUFF: That will get that
24 done. We'll be out of here by 11:45 at the latest.
25 Okay. I would hope it won't actually go that late.

1 Okay. We're ready for questions from
2 the Bench for Mr. Gorman. Mr. Chairman.

3 QUESTIONS BY CHAIRMAN KENNEY:

4 **Q. Mr. Gorman, good to see you again.**

5 A. Nice to see, Chairman.

6 **Q. You were in the room for some of the**
7 **questions that I asked Mr. Hevert, right?**

8 A. I was, yes.

9 **Q. And I asked him a question about**
10 **stock prices increasing and what that was**
11 **indicative of, dividend yields decreasing and**
12 **interest rates declining. So let me ask you the**
13 **same questions that I asked him. I think he**
14 **disagreed with me. So is there -- in your opinion,**
15 **when stock prices increase, do ROEs decrease?**

16 A. Well, in this instance, I think that
17 is the reasonable conclusion.

18 **Q. Why is that?**

19 A. Let me explain a little bit just to
20 show that some of the parameters identified by
21 Mr. Hevert I agree with.

22 **Q. Okay.**

23 A. Stock prices can increase if there's
24 a significant increase in the expected growth
25 outlook for that stock. So the cash flow outlooks

1 could increase. The discount rate or the cost of
2 capital may not change. But that's not the case
3 here. Growth has increased a little bit, my
4 testimony relative to the last case, but not much.
5 Dividend yields have gone down quite a bit.

6 Because the price of stock has gone
7 up and the other parameters of the stock have not
8 significantly changed, that's a clear indication
9 that investors have reduced their required cost of
10 capital which has bid up the stock price. So
11 they're willing to pay more for stock for the cash
12 flows expected to be produced from those stocks,
13 from that stock.

14 It's similar to a bond yield where
15 the utility investor will pay more for a bond at a
16 stated coupon rate, say 6 percent. They may -- the
17 6 percent is above market. The utility may price
18 that bond up to a price that has an effective yield
19 something closer to market level, something less
20 than 6 percent.

21 So as the cash flows remain stable,
22 the price goes up, the expected return on the
23 investment comes down. And that same principal
24 holds for common stock.

25 **Q. And is that because there's a**

1 perception of, I don't know, less risk associated
2 with that security?

3 A. The risk I think is what is
4 attracting so many investors to utility security
5 investments.

6 Q. Okay.

7 A. And that competition to buy them is
8 bidding up the price.

9 Q. I see.

10 A. Which is making the expected return
11 on those investments come down.

12 Q. All right. That makes sense. Let me
13 ask the same questions that I asked of Mr. Hevert.
14 Have you testified -- I know you worked for the ICC
15 after college, right?

16 A. Yes.

17 Q. And then for Merrill Lynch after
18 that?

19 A. For one year, yes.

20 Q. And then with Mr. Brubaker's company?

21 A. Correct.

22 Q. Since you've been with Mr. Brubaker's
23 company, have you testified with respect to ROE
24 issues on behalf of a utility?

25 A. Yes.

1 Q. How many times?

2 A. Twice.

3 Q. And out of how many times total?

4 A. Over 100.

5 Q. So less than 2 percent of the time?

6 A. Yes.

7 Q. When were those two times?

8 A. One was for a Wyoming gas company
9 case a number of years ago, and more recently it
10 was a capital structure issue on behalf of a
11 Missouri water utility.

12 Q. It was a capital structure issue?

13 A. Yes.

14 Q. But upwards of 98 percent of the
15 time, though, your ROE testimony is on behalf of an
16 industrial consumer or a consumer organization of
17 some sort?

18 A. Yes. Generally large industrial or
19 federal executive agencies.

20 Q. And what's your hourly rate for being
21 here?

22 A. \$235.

23 Q. And is that the same for your
24 prefiled testimony as for your testimony here at
25 trial?

1 A. Yes.

2 Q. At hearing. There's no markup for
3 being here?

4 A. No.

5 Q. And I didn't ask this of Mr. Hevert
6 but somebody else did, and I should have asked it.
7 What's your total bill so far for your client, if
8 you can estimate it?

9 A. Generally, I -- it's between 25 and
10 \$30,000.

11 CHAIRMAN KENNEY: I don't actually
12 have any other questions. I think everybody
13 exhausted all the ones I was going to ask. Thanks
14 for your time.

15 THE WITNESS: Thank you.

16 JUDGE WOODRUFF: Commissioner Kenney?

17 COMMISSIONER W. KENNEY: I just have
18 a couple.

19 QUESTIONS BY COMMISSIONER W. KENNEY:

20 Q. Hello, sir. How are you?

21 A. Good. And you?

22 Q. Great. I just had a little
23 clarification. I'm trying to understand this. On
24 your surrebuttal testimony on page No. 3, line 17,
25 I think we might have already talked about this.

1 Someone might have brought it up. As shown in the
2 attached Schedule MPG-SR-1, the authorized returns
3 on equity for electric utility companies, both
4 integrated and delivery companies, range from 9.17
5 to 10.4 with an average of 9.76. That's for 2014,
6 correct?

7 A. That is, yes.

8 Q. Did you hear when I asked Mr. Hevert
9 regarding the average rate of return between 2012
10 to current and he said it was -- ranged between
11 9.96 and 10.03? Without having to look at numbers,
12 would you say that's probably a correct number?

13 A. I actually have it in my testimony.

14 Q. Oh, you did? I didn't see it. From
15 2012 on?

16 A. Yes. Actually, it goes back for a
17 number of years. It's on my Exhibit MPG-11, first
18 column, authorized returns for electric utilities.
19 These are both delivery and integrated. And in
20 2011 and '12, because that kind of overlaps the
21 last rate case, authorized returns on equity for
22 electric utilities ranged from about 10.07 to
23 10.01. They dropped by about 25 basis points in
24 2014 since that time.

25 Q. Okay. So it was 10.07 to 10.01.

1 They dropped about 20 basis points?

2 A. 20, 25, yes.

3 Q. Okay. So that range of saying maybe
4 between for the cumulative average for '12 to '14
5 he said 9.96 to 10.03, might be a little high,
6 might be a little -- probably within eight or ten
7 basis points?

8 A. That's his testimony, but he doesn't
9 limit that to all observations of authorized
10 returns on equity.

11 Q. All right. And then you went on to
12 say on line 19, as shown on page 1 of Schedule
13 MPG-SR-1, I excluded authorized returns on equity
14 for utility rate cases where the commission either
15 approved a settlement return on equity or simply
16 used the same return on equity in the current case
17 as was approved in a prior case. Under these
18 conditions, industry average return for 2014 was
19 9.63. Then you went on to say 9.63 is the -- a
20 return that the investors in Ameren would be
21 satisfied with. You said that on the next page.

22 A. Yeah.

23 Q. My question, why did you do that?
24 Why did you separate those? What's the reason so I
25 can understand that?

1 A. Well, in a -- in a settlement
2 proceeding, you know, the customers and the utility
3 come together and negotiate price, terms and
4 conditions. So from the customers' standpoint, the
5 groups I typically represent, we look at the prices
6 within the settlement. We determine whether or not
7 we're willing to pay those prices. The utility
8 will look at it and look at the prices but they'll
9 look at other factors, too, such as the suggestion
10 of what the return on equity is that's included in
11 the settlement.

12 But importantly, in a settlement you
13 don't build up the revenue requirement by the
14 utility and then take that revenue requirement and
15 produce the settlement rates. In fact, there may
16 be no connection whatsoever between the settlement
17 rates and the stated return on equity in the
18 settlement. May be just completely separate
19 factors that are stated in the settlement.

20 But all the parties come together and
21 agree on the rates and certain other elements
22 within the settlement and find that that's a fair
23 resolution of all the issues in the case.

24 **Q. So you're saying because I might take**
25 **one thing and give up another thing?**

1 A. That is correct. That's usually the
2 tradeoff.

3 **Q. Tradeoff. Okay. So that's why you**
4 **separated them?**

5 A. Yes. In contrast to that, in a
6 litigated proceeding the Commission will make
7 findings on all elements of the revenue
8 requirement. That revenue requirement will then be
9 used to ultimately develop rates. So those rates
10 will reflect all findings of the Commission.
11 That's not the case in a settlement.

12 **Q. Okay. And that's why -- then when**
13 **you came up with, on the next page on line 5 and 6**
14 **you came with Mr. Hevert's chart information, if**
15 **you removed all those other factors, his rate of**
16 **return would have been 9.85 percent, if he -- if**
17 **you removed the settled issues?**

18 A. Right. If you limit it to only
19 vertically integrated utilities rather than all
20 utilities that have similar investment risk, and
21 just look at the vertically integrated utilities
22 with litigated findings, then the ROE would be
23 9.85.

24 **Q. Okay. So you still believe that, I**
25 **believe it is reasonable and rational for an**

1 investor to believe that if the Commission is
2 attempting to measure the current market cost of
3 equity for a utility in a rate case, as I believe
4 the Missouri Commission is attempting to do here
5 for Ameren Missouri, investors would expect an
6 authorized return on equity of approximately
7 9.63 percent?

8 A. Just based on that data, yes. If
9 they're using that data to gage what other
10 commissions have been awarding utilities based on
11 litigated findings, based on explicit findings of
12 what the current market cost of equity is for
13 utility companies, I think that analysis tells us
14 that the investors would expect something around
15 9.63.

16 Q. And that's just right outside the
17 upper limit of your 9.60?

18 A. Yes.

19 COMMISSIONER W. KENNEY: Thank you
20 very much. No more questions.

21 CHAIRMAN KENNEY: Commissioner Hall?

22 COMMISSIONER HALL: Yes.

23 QUESTIONS BY COMMISSIONER HALL:

24 Q. Good afternoon.

25 A. Good afternoon.

1 Q. I believe you testified earlier today
2 that if the Commission were to set an ROE below
3 that which you believe is reasonable, that that
4 would have an adverse effect on the utility both in
5 terms of cost of debt and cost of equity; is that
6 correct?

7 A. It could impact its financial
8 integrity, and it would impact both cost of debt
9 and equity.

10 Q. It would impact its financial
11 integrity in that it -- its bond rating could be
12 downgraded, so that would increase its cost of
13 debt, and if the ROE was below that which is
14 reasonable, it would make it less attractive to
15 invest in?

16 A. Right. And its stock price would
17 likely fall and the yield would go up and the
18 equity cost would be impacted as well.

19 Q. Has there ever been any analysis that
20 you're aware of that looked at an ROE determination
21 to see whether or not it that effect on any utility
22 in any state?

23 A. Had the effect of increasing the cost
24 of capital?

25 Q. Yes. Or are those variables too hard

1 **to isolate?**

2 A. Well, I mean, generally it's not
3 based on just the awarded return on equity alone.
4 It's usually a bigger, larger financial issue in a
5 rate case. ROE is a huge issue in this case, but
6 going back to -- well, considering other cases
7 where there's major investments that plan to be
8 brought online and major disallowances of those
9 investments, those are some cases where we saw
10 significant impact on utilities' financial
11 integrity.

12 You know, it happened to Union
13 Electric in the Callaway investment back in the
14 '80s, and their sister company, Ameren Illinois'
15 affiliate Illinois Power also had large
16 disallowances for a Clinton nuclear plant
17 investment. In both of those instances the
18 utilities were temporarily downgraded below
19 investment grade because the rate structure wasn't
20 supporting full capital on the books. It was just
21 supporting reasonable and prudent investments on
22 the utility on the books.

23 And it took years for both of those
24 companies and some concessions by the regulators to
25 eventually build their rate structure up to allow

1 them to better support the invested capital
2 recorded on the books, including invested capital
3 that was actually disallowed and written off after
4 regulatory decisions.

5 There's smaller degrees of similar
6 type impacts on other utilities, but that -- that
7 was a period where we saw significant impact on
8 utilities by designing rate structures which didn't
9 fully reflect their cost -- their cost of service
10 but rather only reflected reasonable and prudent
11 cost of service.

12 **Q. So in other words, ROE is just one of**
13 **many variables that investors would take into**
14 **account when evaluating whether or not to invest in**
15 **the company?**

16 A. Generally, and there's explicit
17 statements by this by Standard & Poor's and
18 Moody's, is the authorized return on equity is
19 important, but the regulatory mechanisms are far
20 more important. They want to know, does the
21 utility have a legitimate opportunity to earn the
22 approved or authorized return on equity. So lower
23 return on equity with stronger regulatory
24 mechanisms is more attractive from a credit rating
25 and investor standpoint than weaker regulatory

1 mechanisms and a higher return on equity.

2 **Q. Looking at page 7 of your**
3 **surrebuttal, line 16, 17, when stock prices**
4 **increase, all else equal, utility's cost of capital**
5 **declines.**

6 A. Yes.

7 **Q. When you say stock prices, you're**
8 **talking about the stock of the utility? You're not**
9 **talking about the stock -- not talking about stock**
10 **prices generally?**

11 A. Well, the publicly traded stock
12 prices of the publicly traded utility company. If
13 everything is held constant, dividend outlook and
14 dividend growth are not expected to change but the
15 price of the stock goes up, then utility investors
16 are willing to receive a lower rate of return for
17 buying that future stream of cash flows. So all
18 else equal, when a price goes up, the cost of
19 capital goes down.

20 COMMISSIONER HALL: Thank you.

21 JUDGE WOODRUFF: Commissioner Rupp?

22 COMMISSIONER RUPP: Thank you.

23 QUESTIONS BY COMMISSIONER RUPP:

24 **Q. Welcome.**

25 A. Thank you.

1 **Q. In your opinion, what is the biggest**
2 **risk that vertically integrated utilities face**
3 **today?**

4 A. There's a lot of discussions on
5 regulatory mechanisms being important risk. You
6 know, we've gone through carbon potential impacts
7 on integrated utility companies. For wires
8 companies, there is the potential for contracting
9 for power supply to resell as a bundled service to
10 sales customers if the state regulatory commissions
11 required them to do that and then not being allowed
12 to charge rates to fully recover that purchased
13 power. That has had a significant impact on
14 distribution utilities' risk.

15 So right now I don't know if there's
16 one major risk for utility companies because
17 there's so many variables that have significant
18 risk implications for electric utility companies in
19 general. But the risk for a utility is receiving
20 rate structures that fully recover their cost of
21 service. And from a customer standpoint, the
22 ability to pay for utility service and support
23 their load on the system and grow their load is
24 also a risk for the utility and their customers,
25 because if the utility customer can't afford to pay

1 their bill, the utility's investment risk is not
2 going to be very strong.

3 Q. You had made the statement earlier
4 that capital investment will grow earnings,
5 increase revenues and things of that nature in
6 general. Do you view capital investment that is
7 government mandated for like EPA regulations as
8 still giving that same amount of earnings growth
9 because of those specific type of capital
10 investments?

11 A. I do, and I appreciate that question
12 because capital investments for complying with
13 carbon taxes and growing demands and retiring older
14 units and replacing new ones is kind of a
15 double-edged sword. It does reflect investment
16 risk because utilities are required to invest. It
17 also gives a utility an opportunity to grow their
18 rate base, which allows them to grow their
19 companies.

20 So there's risk in making those
21 capital investments, but that's also what they're
22 in business to do. And by doing that, they grow
23 their rate base, they grow their earnings, they
24 grow their dividend paying ability, and they
25 attract investors to that segment because --

1 **Q. Walk me through how they would grow**
2 **their rate base via the environmental regulation.**

3 A. There would be an increase in capital
4 spending for retrofitting existing generating
5 stations. There would be increase in capital
6 spending if they retired older coal-fired
7 generating stations and replaced it by newer
8 gas-fired stations or some other more modern
9 generation technology.

10 Those new investments would be added
11 to rate base. Typically there's limited pushback
12 by parties to rate cases because they have to do it
13 to comply with federal or state mandates. After
14 they're included in rate base and the rate
15 structures are adjusted to reflect that larger rate
16 base, the earnings of the utility increase. And as
17 the earnings of the utility increase, the utility's
18 ability to pay dividends will increase.

19 During the major construction period,
20 there's going to be a little tradeoff and increased
21 earnings and increased dividends because there's a
22 need to retain a lot of earnings to fund that
23 buildup in investment and rate base. So the
24 dividend increase can come later, but eventually
25 it's going to come as the capital investment

1 program either slows down or is not as large a
2 percentage of total capital investment as it was
3 several years ago. And eventually at that point
4 dividends will start to grow.

5 Q. Okay. And you'd stated that ROE
6 should reflect the risk the company faces, and then
7 it was also stated that riders would shift risk.
8 So with a company like the one we're dealing with
9 here today, without an infrastructure rider or an
10 environmental rider or CWIP or things of that
11 nature, do you believe that this company faces more
12 risk than other companies that have those riders?

13 A. I don't think so. I think the record
14 shows that with the regulatory mechanisms that are
15 available to the companies, this company, and those
16 which it chooses to use, that it has been able to
17 earn more than its authorized return on equity in
18 the last two years at least.

19 Back when its rate base was growing
20 at the faster pace, it had more difficulty. But
21 the current regulatory mechanisms have resulted in
22 this utility being able to meet the objective of at
23 least earning its authorized return on equity, and
24 as others from MIEC have shown, it's actually
25 earned more than it's authorized return on equity.

1 Q. Okay. Looking at the Exhibit 61, the
2 Moody's Investor Service, on page 2, under the
3 detailed rating considerations, end of the first
4 paragraph states, Ameren Missouri currently does
5 not have any specific mechanism for its
6 environmental investment. Without a specific
7 recovery mechanism, we believe Ameren Missouri will
8 have to rely on its general rate cases to recover
9 the prudently incurred environmental investment
10 costs. Would you agree with that statement?

11 A. I do, but if I can explain that.

12 Q. Please.

13 A. A utility that doesn't -- isn't
14 allowed current return on CWIP, that doesn't mean
15 it is not allowed to recover its construction
16 period carrying charge. There's a mechanism called
17 allowance for funds used during construction which
18 allows them capitalize it, include it as part of
19 the cost, the original cost of the plant
20 investment. Then when it's placed in service, all
21 of the direct capital expenditures and the
22 construction period carrying charges are included
23 in rate case. So the rate base is larger and the
24 rate increase is larger because customers are
25 paying return on a larger capital investment and

1 then paying larger depreciation expense for it.

2 Q. So would I find -- if I looked at
3 other companies that had CWIP and some of these
4 other trackers, would I find that since they have
5 them the rate base would be higher for companies
6 that do not? Is that -- am I following your
7 statement there?

8 A. It can be, because customers that are
9 required to pay a current return on CWIP are
10 actually prepaying for that asset that hasn't yet
11 been placed in service. So customers pay the same
12 amount of money. They just pay it a lot sooner
13 when they have to pay a current return on CWIP.

14 There's a factor in measuring the
15 cost to customers known as net present value
16 revenue requirement. Customers will pay the same
17 net present value revenue requirement with a
18 current return on CWIP and without a current return
19 on CWIP. The utility earns the same amount of
20 money over the life of the asset.

21 It's just customers pay it in a more
22 level basis over the expected economic life of the
23 asset without CWIP compared to some jurisdictions
24 where they're required to pay for part of the asset
25 before it's placed in service.

1 Q. Looking at your surrebuttal
2 testimony, page 7, following up on a question that
3 Commissioner Hall, had where you stated, further,
4 utility stock -- utility stock prices have
5 increased and their dividend yields have gone down.

6 Since you filed this, we've had
7 testimony that there's been a 10 percent reduction
8 in utility stock prices of the index, which would
9 then do the reverse on the dividend yield. So if
10 that is the case, would you then need to increase
11 your numbers of what an -- for a higher ROE?

12 A. Well, no, because that testimony
13 dealt with changes from January to February this
14 year. My analysis in this case dealt with a
15 13-week period last summer where the prices used
16 there are still lower than they are today. So even
17 if I reflected those lower prices available right
18 now, the dividend yields right now are lower than
19 they are as reflected in my DCF studies.

20 Even still, the dividends in my DCF
21 studies were lower than they were two years ago
22 when they got a 9.8 percent return on equity. So
23 it's important to distinguish what you're comparing
24 it to. Stock prices got really high for utility
25 companies in January, and they did come back down.

1 But even the decline in the stock price from
2 February over January is still higher priced than
3 what's reflected in my testimony. My testimony
4 prices are from last year.

5 **Q. Do you in your personal opinion view**
6 **that that drop in utility stock prices is a trend**
7 **or as a correction or is just a normal market**
8 **glitch over the last several weeks?**

9 A. Well, when I do the study, I try to
10 measure what investors think, not what I think, but
11 I think the run up in stock prices beginning in
12 January was unsustainably high. I think the prices
13 have come down to a level where they still might
14 decline a little bit. But the prices I used in my
15 study I believe reflect dividend yields that
16 reflect current cost of capital. They weren't
17 biased by those run up in the prices in January and
18 February.

19 COMMISSIONER RUPP: That's all I
20 have, Judge.

21 JUDGE WOODRUFF: All right. We'll
22 come back for recross based on questions from the
23 Bench, beginning with Public Counsel.

24 RECROSS-EXAMINATION BY MS. BAKER:

25 **Q. I just have a couple of**

1 clarifications. You were talking with Commissioner
2 Hall and I believe some others about regulatory
3 mechanisms and whether you looked at -- whether
4 investors looked at regulatory mechanisms more and
5 whether regulatory mechanisms were one of the
6 biggest risks for vertically integrated utilities.
7 Do you remember that?

8 A. Yeah. I think the question was, what
9 is regarded as one of the bigger risks right now?

10 Q. Okay. Whenever we're talking about
11 regulatory mechanisms, you would agree that in the
12 way that Ameren is at the moment coming into this
13 rate case, they do have an FAC in place; you would
14 agree with that?

15 A. Yes.

16 Q. And you would agree that they have
17 trackers in place?

18 A. Yes.

19 Q. And you would agree that they have
20 the ability to have an environmental mechanism but
21 that they have not taken advantage of that?

22 A. I do. Correct.

23 Q. Okay. And you would agree that for
24 the AFUDC that you were speaking of, is that what
25 you had mentioned earlier that Kansas City Power &

1 **Light has available to it?**

2 A. No. That was a regulatory mechanism
3 to support its cash flows during a major
4 construction program. KCP&L did receive what
5 effectively from an economic perspective was the
6 equivalent of a current return on CWIP. They paid
7 more than traditional cost of service to enhance
8 the utility's cash flow while Iatan 2 was being
9 developed, and then that payment during
10 construction period was used to offset the increase
11 in revenue requirement for Iatan 2 after it was
12 placed in service.

13 That is effectively the same economic
14 result to the utility as giving them a current
15 return on CWIP. KCPL, it is my understanding, does
16 not currently have a fuel clause.

17 **Q. And so as far as Ameren coming into**
18 **this rate case is concerned, a lot of those**
19 **regulatory mechanisms it has, so it does not have**
20 **some of the biggest risk that is facing other**
21 **vertically integrated utilities?**

22 A. Well, yeah. It has deferred
23 accounting also, which is a regulatory mechanism.
24 And a regulatory mechanism is any kind of price
25 mechanism or cost recovery assurance mechanism

1 that's not available to a non-regulated company. A
2 non-regulated company can't defer things and then
3 charge customers for them later. Non-regulated
4 company can't have line items riders typically
5 where they will adjust the prices for the service
6 to a customer, unless there's contractual
7 provisions that permit.

8 So regulatory mechanism really
9 describe rate-setting mechanisms that are unique to
10 the utility, and they are all reflected in Ameren's
11 current bond rating.

12 MS. BAKER: That's all the questions
13 I have. Thank you.

14 JUDGE WOODRUFF: Consumers Council?

15 MR. COFFMAN: No questions.

16 JUDGE WOODRUFF: Staff?

17 MR. THOMPSON: No questions. Thank
18 you.

19 JUDGE WOODRUFF: MECG?

20 MR. WOODSMALL: No questions. Thank
21 you.

22 JUDGE WOODRUFF: Ameren?

23 MR. TOMC: Yes, your Honor. Just a
24 couple quick questions.

25 RECROSS-EXAMINATION BY MR. TOMC:

1 Q. Just to clarify, there was some
2 discussion about AFUDC allowance for funds used
3 during construction; is that right?

4 A. Yes.

5 Q. And once construction is completed,
6 that allowance stops and those carrying costs are
7 no longer incorporated in that capital asset; would
8 you agree?

9 A. Yes.

10 Q. And there may be a gap between the
11 time that capital asset is completed and when new
12 rates are approved in a rate case; would you agree?

13 A. There can be, yes.

14 Q. And additionally would ask, with
15 respect to AFUDC, between rate cases AFUDC does not
16 provide any cash to the utility; is that right?

17 A. No. That's the distinction between
18 AFUDC. It provides the utility with the earnings.
19 There's no earnings erosion, but it's an accrual
20 earnings, not cash earnings.

21 Q. Accrual not cash; is that right?

22 A. That's correct.

23 MR. TOMC: I have no further
24 questions.

25 JUDGE WOODRUFF: Redirect?

1 MS. ILES: Yes, your Honor.

2 REDIRECT EXAMINATION BY MS. ILES:

3 Q. You were asked by several, I think by
4 some of the Commissioners as well as some of the
5 other attorneys here about deferrals, and you
6 stated that the purpose of a deferral is to enhance
7 the likelihood of earning an authorized ROE.

8 So my question for you, Mr. Gorman,
9 is, is it appropriate to allow recovery of a
10 deferral when the utility has earned its ROE during
11 the period that the expenses included in the
12 deferral were incurred?

13 A. Generally, that's not consistent with
14 the objective of the regulatory commission -- or
15 the regulatory mechanism. Pardon me. If the
16 utility can expense the costs that are being
17 deferred and still earn its authorized return on
18 equity, then there's really no need for a deferral.

19 A deferral is designed to protect the
20 utility's earnings in the event the prices the
21 customers are paying don't provide enough revenue
22 to cover that cost. This cost typically wasn't
23 incurred in the last rate case, and that provides a
24 mechanism for the utility to recapture those costs
25 in the next rate case if their current rates don't

1 provide recovery of that cost.

2 So I don't think it would be
3 consistent with the objective of the regulatory
4 commission to allow a utility to defer expenses
5 during a period where the deferral was not
6 necessary. It could expense those expenses during
7 that period and still earn its authorized return or
8 equity, or some portion of that could have been
9 expensed and still earn the authorized return on
10 equity.

11 To allow them to defer expenses under
12 those scenarios would allow the utility to
13 essentially recover the cost of those deferrals
14 twice, the revenue they collected during the
15 deferral period and then revenue would be enhanced
16 during the new rate effective period as the
17 deferral was included in the new rate structure.

18 **Q. And Mr. Tomc asked you about your**
19 **risk-free rate that you used in the last case in**
20 **your CAPM analysis.**

21 A. Yes.

22 **Q. Do you remember those questions? I**
23 **believe you stated that the risk-free rate you used**
24 **in that case was 3.7 percent. I wanted to ask you,**
25 **what -- I had the impression that you wanted to**

1 explain to us something about the significance of
2 the difference in those rates. Could you explain
3 to us what the significance is and does it make any
4 difference in your analysis in this case?

5 A. It does, because in the last --
6 actually in the last few cases, I was concerned
7 about the reliability or the reasonableness of the
8 CAPM return estimates in forming my recommended
9 return on equity range.

10 And I'm looking at what is -- was
11 marked as one of the cross exhibits. I'm sorry.
12 There's not a number on this, but essentially it's
13 my testimony from the last case. My recommended
14 range for return on equity in that case was 9.2 to
15 9.4, but my CAPM return estimate in the last case
16 was 8.7 percent.

17 So that low treasury bond yield
18 resulted in a CAPM return estimate that I felt was
19 too low and, therefore, didn't recognize it when I
20 formed my recommended return on equity range. So
21 the implication from the cross on what the treasury
22 bond yield and implying that somehow it was
23 reflected in the CAPM return estimate concerned me
24 because it suggested that I relied on the CAPM
25 return estimate in the last case, which I did not

1 because I felt the return was too low, and that
2 with the treasury bond being a little higher in
3 this case, I'm producing a CAPM return which falls
4 within my recommended range. So I'm acknowledging
5 somehow that capital market costs have increased in
6 this case relative to the last case.

7 So I wanted to clear that up because
8 I think that suggestion, that implication in that
9 cross question was disingenuous, because in the
10 last case treasury bond yields were low. They
11 produced really low CAPM return estimates, so I
12 disregarded them. In this case, treasury bond
13 yields are a little higher, CAPM return estimate
14 was a little higher and fell within my recommended
15 range in this case.

16 So it's the full development of the
17 CAPM return estimate, not just the treasury bond
18 rate, which I consider in developing my recommended
19 return on equity.

20 **Q. Mr. Tomc also asked you a number of**
21 **questions about your past testimony and the growth**
22 **rates that you included in your analyses in those**
23 **cases.**

24 A. Yes.

25 **Q. Do you remember those questions? I**

1 just ask you to comment on your long-term growth
2 rates. I think he pointed out in each one of those
3 that you found short-term growth rates to be higher
4 than what you ex-- what you considered a reasonable
5 long-term growth rate to be; is that correct?

6 A. It is correct, yes.

7 Q. Is that -- would you like to comment
8 on whether that's something unusual or is there
9 some reason why the Commission should not take your
10 recommendations into account because of those
11 facts?

12 A. The circumstances around three to
13 five-year analyst projected growth rates producing
14 DCF return estimates was elevated about ten years
15 ago when the utility industry started making
16 significant capital improvements and the rate base
17 was growing quite significantly.

18 That's the second time it's happened
19 while I've been in this business. The first time
20 was in the early 1990s when utilities weren't
21 making capital investments because they were
22 anticipating the deregulation of the industry. At
23 that growth rates were really low and DCF returns
24 were really low. So at that time I started using
25 multi-growth-stage DCF to reflect the period of low

1 capital investments followed by a return to more
2 normal capital investments.

3 In this case, because utilities are
4 making major capital investments and will start to
5 slow over time for two reasons, but because there
6 is an outlook for growth at an accelerated level
7 for a relatively short period and then a decline to
8 a lower sustainable level of growth justifies the
9 use of a multi-growth-stage DCF analysis.

10 The relative differences in price to
11 earnings ratio which Mr. Hevert was talking about
12 made me challenge the constant growth DCF model
13 based on that one factor also supports use of a
14 multi-growth-stage DCF model because that can
15 reflect the expectation of high growth followed by
16 more sustainable growth later. So that PE ratio
17 indicates placing more reliance on your multistage
18 growth DCF rather than your constant growth DCF.

19 But the industry ten years ago, with
20 major CAPM programs starting, created something of
21 an overly-- in my judgment, overly optimistic view
22 by credit analysts or security analysts on what the
23 growth rate's going to be for utility companies
24 over the next three to five years.

25 There is no uncertainty, however,

1 that that growth would not be sustainable. So each
2 case we've looked at over the last ten years, the
3 three to five year growth rates are likely higher
4 than sustainable long-term growth rates.

5 What we didn't look at is whether or
6 not the three to five year growth rates were
7 actually achieved by security analysts. So it's
8 not reasonable to conclude that three to five year
9 growth rate should be recognized as long-term
10 sustainable growth rates because there's no measure
11 or whether or not utilities have consistently
12 achieved those three to five year growth outlooks.

13 But there's significant reasons why
14 it's reasonable and rational to expect that there
15 will be accelerated growth for a period of time
16 that will be followed by a period of more moderate
17 sustainable growth.

18 **Q. Thank you. Mr. Tomc also asked you**
19 **about, and the Commissioners did, too, about your**
20 **Schedule MPG-SR-1 where you talk -- where you**
21 **analyze the 2014 authorized returns on equity for**
22 **electric utilities.**

23 A. Yes.

24 **Q. Why did you include distribution**
25 **companies in your analysis on page 1 of that chart?**

1 A. Up until the time you look at this
2 RRA data, all rate of return analysts agree that
3 the rate of return should reflect investment risk.
4 And all rate of return analysts in this case and
5 everywhere I've testified measures investment risk
6 based on bond rating.

7 I'm not aware of any rate of return
8 selecting companies based on being integrated
9 electric utilities or only distribution electric
10 utilities. Rather, it's investment risk. There
11 are unique operating risks for integrated utility
12 companies, that's true. Asset ownership and some
13 purchased commodity costs are a unique risk to an
14 integrated company.

15 However, there are similar risks for
16 distribution companies if they're obligated to
17 enter into purchased power agreements and resell
18 that power to its integrated -- or bundled service
19 customers. So there is commodity risk for
20 distribution companies.

21 Those risks and all other relevant
22 risks for the utilities are encapsulated in the
23 bond ratings of those utilities. So when looking
24 at industry data and determining what an investor
25 would expect for an authorized return on equity for

1 a given level of investment risk, it's better to
2 distinguish the authorized return on equity based
3 on bond rating than it is for integrated utilities
4 versus distribution utilities.

5 A second reason is, is there's just
6 not that many integrated utility rate cases that
7 weren't settled. Most integrated utility companies
8 find a way to settle their rate cases, so we don't
9 get a commission finding with current market cost
10 of equity. That's not as much the case with
11 delivery companies.

12 Q. And then on -- in the second half of
13 your right side of the page of your Schedule
14 MPG-SR-1 where you list the fully litigated rate
15 cases, Mr. Tomc asked you about the inclusion of
16 Ameren Illinois and Com Ed in that column, and he
17 specifically asked you about special formula rates,
18 or I believe you corrected him and just said they
19 were formula ROEsthat are used -- were used in
20 those cases.

21 Why did you include those formula
22 cases? Are they truly fully litigated cases?

23 A. They are, and I wasn't sure why he
24 was using special formula rates. I wasn't familiar
25 with that term. But the Illinois cases are fully

1 litigated cases. It is true that the return on
2 equity is prescribed by formula, but the formula
3 rate process requires the Commission to only
4 approve a revenue requirement that is based on
5 reasonable cost of service, reasonable and prudent
6 cost of service.

7 While no party challenged the return
8 one equity formula, all the parties are free to
9 challenge it if they find that the return on equity
10 produces rates which are not just and reasonable.

11 So there is -- there is some
12 mechanism for the stakeholders in the process to
13 argue to the Commission that the return on equity
14 does not produce a reasonable result or at least
15 the revenue requirement doesn't produce a
16 reasonable result. To my knowledge, neither the
17 utilities nor any stakeholder has requested the
18 Commission review that formula rate process in
19 terms of the return on equity.

20 There are many other aspects of the
21 formula which have been revisited, but the return
22 on equity mechanism was adjusted once, and I don't
23 believe there's been a request to adjust it a
24 second time.

25 **Q. And do the inputs for the formulas**

1 that are used in those cases, do they include
2 market-based data?

3 A. Yes. It's a risk premium type
4 methodology that adds a prescribed equity risk
5 premium to average treasury bond yields. So it is
6 based on market factors and prescribed equity risk
7 premium.

8 Q. You were also asked about a Colorado
9 rate case. Do you remember those questions?

10 A. Yes.

11 Q. And I think your testimony in that
12 case was that you represented a client who you
13 advised to settle the case, and the settlement
14 included a 9.83 percent ROE; is that correct? Have
15 I got those correct?

16 A. Actually, they brought up two cases.
17 One was in Colorado. The other was in Nevada. It
18 was 9.83 in Colorado and 9.8 in Nevada.

19 Q. Right. And so I think the
20 implication was that that's much higher -- that is
21 a higher ROE than what you're recommending in this
22 case, in the instant case, in the Ameren case. So
23 why did you -- why did you advise your client to
24 accept the 9.8 and the 9.83 ROEs in those cases?

25 A. In those cases, the rate structure,

1 the settlement rate structure was judged to be
2 reasonable. And the 9.83, while it was stated in
3 the settlement, did not detract from our finding
4 that we were getting rates which we felt were a
5 balanced outcome of all the issues in the case.

6 It was not our finding that those
7 rates reflected a 9.83 percent return on equity.
8 Rather, it was just our finding that those rates
9 appeared to be a reasonable resolution of all the
10 issues in the case.

11 **Q. So is this an example of the kind of**
12 **case, I think when you were answering one of the**
13 **questions of one of the Commissioners and**
14 **explaining that there's sometimes a disconnect in a**
15 **settlement between the ROE that's included in the**
16 **settlement and the actual rates that are in a**
17 **settlement, would this case, the Colorado and**
18 **Nevada cases be examples of that?**

19 A. From our standpoint it is, yes.

20 MS. ILES: No further questions.

21 JUDGE WOODRUFF: Okay. Then,

22 Mr. Gorman, you can step down.

23 (Witness excused.)

24 JUDGE WOODRUFF: Call up Mr. Schafer.

25 (Witness sworn.)

1 LANCE SCHAFER testified as follows:

2 DIRECT EXAMINATION BY MS. BAKER:

3 Q. Please state and spell your name for
4 the court reporter.

5 A. My name is Lance Schafer,
6 S-c-h-a-f-e-r.

7 Q. And by whom are you employed?

8 A. I'm employed by the Office of the
9 Public Counsel.

10 Q. And what position do you hold with
11 the Office of the Public Counsel?

12 A. I am a Public Utility Financial
13 Analyst.

14 Q. Are you the same Lance Schafer who
15 filed direct, rebuttal and surrebuttal testimony in
16 this case?

17 A. Yes, I am.

18 Q. Do you have any changes or
19 corrections to your testimony?

20 A. No, I do not.

21 Q. Is your testimony true and accurate
22 to the best of your knowledge and belief?

23 A. Yes, it is.

24 Q. And if asked the same questions
25 today, would your answer be essentially the same?

1 A. Yes, they would.

2 MS. BAKER: Public Counsel will move
3 for admission of Schafer direct, both NP and HC
4 versions, 409NP, 409HC, and Schafer rebuttal,
5 Exhibit No. 410, and Schafer surrebuttal,
6 Exhibit 411. And I believe this is his last time
7 to appear, so we will go ahead and offer.

8 JUDGE WOODRUFF: 409, 410 and 411
9 have been offered. Any objection to their receipt?

10 (No response.)

11 JUDGE WOODRUFF: Hearing none, they
12 will be received.

13 (OPC EXHIBIT NOS. 409NP/HC, 410 AND
14 411 WERE RECEIVED INTO EVIDENCE.)

15 MS. BAKER: We will tender for
16 cross-examination.

17 JUDGE WOODRUFF: Okay. And for
18 cross, we begin with Consumers Council.

19 MR. COFFMAN: Welcome, but I have no
20 questions.

21 JUDGE WOODRUFF: Then for Staff?

22 MR. THOMPSON: No questions. Thank
23 you.

24 JUDGE WOODRUFF: MIEC?

25 MS. ILES: Just one question.

1 CROSS-EXAMINATION BY MS. ILES:

2 Q. Mr. Schafer, in your direct testimony
3 on page 4, you provided the results of your
4 analysis of Mr. Gorman's testimony?

5 A. I'm sorry. Which testimony are you
6 speaking of?

7 Q. I'm sorry. Your rebuttal.

8 A. Page 4?

9 Q. Yes.

10 A. Thank you.

11 Q. Could you explain to us, isn't it
12 true that when you made changes to his testimony
13 which you considered to be corrections, your result
14 was a final recommendation of 9.2 percent?

15 A. Yes, that is true.

16 MS. ILES: That's all.

17 JUDGE WOODRUFF: MECG?

18 MR. WOODSMALL: No questions. Thank
19 you.

20 JUDGE WOODRUFF: Ameren?

21 MR. TOMC: Thank you, your Honor.

22 CROSS-EXAMINATION BY MR. TOMC:

23 Q. Good afternoon, Mr. Schafer.

24 A. Good afternoon.

25 Q. I'd just like to ask you a few

1 questions, Mr. Schafer, about your relevant
2 experience, if we may.

3 A. Sure.

4 Q. I understand this is the first
5 regulatory hearing that you have testified in?

6 A. Yes, it is.

7 Q. Welcome.

8 A. Thank you.

9 Q. The testimony you have submitted in
10 this case, I understand you've also filed testimony
11 in Empire, but this is the first time you've
12 submitted your direct testimony, prefiled testimony
13 before a regulatory commission; is that right?

14 A. Yes, that is correct.

15 Q. And I understand that you have
16 recently graduated from the University of
17 Missouri's MBA program last spring; is that
18 correct?

19 A. Yes.

20 Q. Congratulations.

21 A. Thank you again.

22 Q. I also understand that you completed
23 one of three phases of the Chartered Financial
24 Analyst exam; is that right?

25 A. Yes, I have.

1 Q. Good luck with the next two phases.

2 A. Thank you again.

3 Q. Prior to your employment at the
4 Office of the Public Counsel, you have not been
5 employed as a financial analyst; is that correct?

6 A. That is correct, I have not.

7 Q. And you have not worked at an
8 investment bank or a depositor bank; is that
9 correct?

10 A. Again, correct.

11 Q. You have not been employed in a
12 corporate treasury department; is that right?

13 A. That's right.

14 Q. You have not worked as a licensed
15 broker or trader of securities?

16 A. That is correct.

17 Q. You have not worked in a position
18 where you were involved in the issuing of debt or
19 equity; is that correct?

20 A. That is correct.

21 Q. Now I'd like to ask you about your
22 constant growth DCF model. Your constant growth
23 DCF, you relied upon Value Line, Zacks, and Yahoo
24 Finance for your constant -- or for your growth
25 rates; is that correct?

1 A. Yes.

2 Q. And are those reliable sources, in
3 your opinion?

4 A. Yes, I believe they are.

5 Q. Would you expect that investors would
6 be aware and review these sources when making
7 investment decisions?

8 A. Yes. They're publicly available
9 sources that investors have access to, and I
10 believe they would review those sources, yes.

11 Q. The analyst growth rates that you
12 have identified from these sources, I understand
13 slightly above 5?

14 A. Yes, that's correct.

15 Q. The analyst growth rates today that
16 have been projected with respect to the proxy
17 companies are in excess of nominal gross domestic
18 product; would you agree?

19 A. Are they in excess to my, the
20 estimate of nominal GDP that I used or Mr. --

21 Q. Let me rephrase the question. The
22 growth rates that analysts are projecting today are
23 in excess of the nominal gross domestic product
24 projections that you rely upon for your third phase
25 of your DCF; is that right?

1 A. Yes, they are.

2 Q. If you would refer to page 26 of your
3 direct testimony, line 9, I believe there's a
4 nominal GDP projection of 4.86 percent; is that
5 right?

6 A. Yes, that's correct.

7 Q. Now, with respect to -- just for
8 clarification, with respect to the capital asset
9 pricing model that you prepared, you looked at
10 approximately 90 years of financial history in
11 developing that model; is that correct?

12 A. I looked at from 1926 to 2013.

13 Q. What was the average gross domestic
14 product on a nominal basis during that period?

15 A. I looked at historical GDP from 1947
16 to the present based on the data I obtained from
17 the St. Louis Federal Reserve, and I believe that's
18 around 6.3.

19 Q. 6.3 percent. Now, the third stage of
20 your DCF incorporates your perspective on what the
21 long-term sustainable growth rate would be; is that
22 right?

23 A. It actually uses the 100 percent of
24 the nominal GDP. And as far as it is my
25 perspective that 100 percent of the nominal GDP

1 should be used in the third stage, then it reflects
2 my perspective. But that is a perspective that
3 I've adopted from other analysts, and the FERC has
4 given their opinion that that is an appropriate
5 rate to use for a third stage.

6 **Q. With respect to that long-term growth**
7 **rate, it is your belief, then, that we will not see**
8 **a return to the 6.3 percent long-term growth rate**
9 **that we've experienced in the past in this country;**
10 **is that right?**

11 A. I personally have not calculated
12 long-term GDP. I've used estimates from analysts,
13 estimates that were available from analysts. So
14 whether it's my opinion it will go back to
15 historical GDP at some point in the future, be it a
16 hundred years from now, that didn't come into play
17 in the analysis.

18 **Q. It's quite possible that we could**
19 **experience economic growth in this country**
20 **commensurate with past experience, isn't it?**

21 A. Is it possible? The word possible,
22 yes, I suppose. That's simply not what is being
23 projected, though.

24 **Q. The dividend yield is the product of**
25 **the stock's annualized dividend divided by the**

1 **stock price, correct?**

2 A. Yes, that's correct.

3 **Q. And dividends are declared quarterly**
4 **as a per-share value; would you agree?**

5 A. Yes.

6 **Q. If the stock price goes up, the**
7 **dividend yield goes down, all else equal, correct?**

8 A. Yes, all else equal, if the dividend
9 doesn't change and the stock price rises, that
10 dividend yield is going to decrease.

11 **Q. You use a 13-week average to measure**
12 **stock prices, is that correct, for your DCF**
13 **analysis?**

14 A. Yes, that's correct.

15 **Q. Similar to Mr. Gorman, correct?**

16 A. Yes. Yes. Mr. Gorman also used a
17 13-week average.

18 **Q. Mr. Hevert used a 30-day, 90-day and**
19 **180-day average measurement periods and provided**
20 **the results of all of those periods, correct?**

21 A. Yes, he did.

22 **Q. Based on a historical perspective,**
23 **you would agree that utility stocks typically pay a**
24 **dividend of 4 and a half percent, correct?**

25 A. Yes, I believe that is the -- very

1 close to the historical average.

2 Q. You would agree that with respect to
3 your proxy group, the historic dividend yield is
4 4.37 percent, correct?

5 A. Yeah, that sounds correct.

6 Q. You would agree that the Value Line
7 forecasted yield for the proxy group is
8 4.44 percent, correct?

9 A. Yes, 4.4 percent.

10 Q. In your constant growth DCF, you used
11 a 3.5 percent yield; is that right?

12 A. Yes. That's the yield that was
13 implied by the prices and the dividend that I used
14 in that model.

15 Q. In your deposition, do you recall
16 that?

17 A. Oh, yes.

18 Q. Do you have a copy of your deposition
19 with you?

20 A. I can obtain one right here.

21 Q. Certainly. Now, if you recall, I
22 asked you if you had followed the stock prices of
23 your proxy companies after the filing of your
24 surrebuttal testimony, and you indicated to me that
25 you had done so. Do you recall that discussion?

1 A. Yes, I do.

2 Q. Your deposition was on February 19th;
3 is that correct?

4 A. Yes, it was.

5 Q. You indicated to me in your
6 deposition that the utility industry had traded
7 down in recent days and weeks; is that correct?

8 A. That is correct.

9 Q. You indicated to me that the utility
10 stocks had declined 5 to 10 percent; is that right?

11 A. That is around the neighborhood of
12 where they had declined, yes.

13 Q. Based on the proxy companies that you
14 looked at, your proxy companies, those company
15 stock prices were affected as well, correct?

16 A. Yes, they were.

17 Q. A decline in stock price, all else
18 equal, can be expected to increase dividend yield;
19 is that correct?

20 A. That is correct, yes.

21 Q. Would you agree with me that the
22 reason for the downturn in stock prices could
23 potentially be the result of something called
24 sector rotation?

25 A. I think -- I think we mentioned this

1 earlier in the deposition, and I said that as far
2 as sector rotation being motivated by an underlying
3 economic condition that investors are following,
4 investors are using to base their sector rotation
5 on, then yes, then that could be -- could be a
6 reason why people are rotating out of one sector
7 into another.

8 **Q. What do you mean by the term sector**
9 **rotation?**

10 A. Well, a diversified investor is going
11 to hold investments in different industries,
12 different sectors, and is going to find one more
13 favorable at a moment than a different one
14 depending on their projections or how they believe
15 the economy is going to play out in the future.
16 They can literally move into -- move out of the
17 sector they feel is not going to be in favor in the
18 future and move into one that's going to be more
19 favorable.

20 **Q. In recent weeks, would you agree that**
21 **we have observed swings in treasury rates upwards**
22 **of 50 basis points over a short period of time?**

23 A. Yes. That's occurred from --
24 certainly from January to February we've seen rates
25 go from 2.7 to 2.-- around 2.3, then back up to

1 2.7. I believe at the time of our deposition they
2 were 2.7 again. Today it's at 2.6.

3 **Q. Can investors perceive volatility in**
4 **bond markets as a risk factor to consider when**
5 **they're making investment decisions?**

6 A. I believe volatility certainly is a
7 risk factor that investors consider.

8 **Q. You would agree with me that you**
9 **believe the Federal Reserve will move to increase**
10 **rates this year?**

11 A. This is one of the things I took in
12 consideration in my direct testimony, and I believe
13 that they are still online to do so, and all of the
14 latest articles I've seen have indicated that
15 they're still hoping for a midyear raise of
16 interest rates.

17 **Q. Utility stocks are typically**
18 **considered income investments; would you agree?**

19 A. That's correct. Thanks to their high
20 payout ratio and high dividend yields, they are
21 considered an income investment as opposed to a
22 growth investment.

23 **Q. Unlike income investments, growth**
24 **stocks pay a relatively small dividend or no**
25 **dividend at all; would you agree?**

1 A. Yes, that is correct. Growth stock
2 is certainly -- as you've characterized it, might
3 not pay any dividend at all.

4 **Q. When looking at growth stocks as**
5 **compared to utility stocks, you would expect to so**
6 **higher growth rates, correct?**

7 A. Absolutely. The growth stock by
8 definition is a growth venture.

9 **Q. For companies that are growth stocks,**
10 **is it true as a general proposition that rather**
11 **than pay out earnings as dividends, these companies**
12 **can reinvest earnings to achieve higher rates of**
13 **growth?**

14 A. Normally a growth company is going to
15 identify expansion opportunities, whether that's
16 overseas or expanding into markets. And so rather
17 than pay out that money to investors, they'd rather
18 capitalize on the opportunity they see to expand
19 into other markets and to put other plant in place.
20 And that's one of the reasons they retain that
21 money and they don't pay it out to investors.
22 Stock price will tend to appreciate rather than
23 reflect -- rather than the company paying out a
24 dividend.

25 **Q. You conducted capital asset pricing**

1 model analysis in this case, as we discussed,
2 right?

3 A. Yes, I did.

4 Q. As a general matter, CAPM would
5 measure return on equity in a manner relative to
6 other investment choices that an investor might
7 choose to include in an overall portfolio of
8 investments, correct?

9 A. Certainly.

10 Q. And that would include both income
11 and growth opportunities, correct?

12 A. The market risk premium that is --
13 the market risk component of that CAPM usually is a
14 measure of the broad general market, the S&P 500 or
15 the NYSE Index. And then what we do is multiply
16 that measure of return over treasury yield by a
17 company-specific number called beta. It measures
18 the systematic risk of the company.

19 So typically I believe the beta of my
20 proxy group was around .74. So what we do is we
21 take the return for that market and multiply it by
22 .74. So just the fact that that proxy group beta
23 as you can see is lower than one means the
24 volatility is less and the risk is less than the
25 full S&P 500 or NYSE.

1 So there are measures of those other
2 companies inside that CAPM, but there are
3 company-specific measures also as represented by
4 the beta.

5 **Q. Now, if we were to look at companies**
6 **in the S&P 500, you would agree with me that with**
7 **respect to consensus analyst growth rates, it would**
8 **not be uncommon to find companies with growth rates**
9 **higher than GDP, correct?**

10 A. Correct.

11 **Q. If we were to examine analyst growth**
12 **rates today, right now, among S&P 500 companies, it**
13 **would not be hard to find growth rates of 12, 13 or**
14 **14 percent, correct?**

15 A. That is correct.

16 **Q. For example, Apple would be one such**
17 **company with a three to five year projected growth**
18 **rate of over 12 percent, right?**

19 A. I believe it was 12.5, yes.

20 **Q. Many companies listed in the S&P 500**
21 **are, in fact, multinational corporations; would you**
22 **agree?**

23 A. Yes.

24 **Q. In your deposition we spoke about the**
25 **company Home Depot as an example of a company**

1 listed on the S&P 500. Do you recall that
2 discussion?

3 A. Vaguely, yes.

4 Q. You indicated to me that -- I'll
5 represent to you, you indicated to me that Home
6 Depot is considering expanding into over countries
7 and would dictate growth -- or dedicate -- I'm
8 sorry. Let me start my question over.

9 You indicated to me that Home Depot
10 is considering expanding into other countries and
11 would dedicate growth to that end. Do you recall
12 telling me that?

13 A. I believe I mentioned something about
14 their failed attempt to expand into China.

15 Q. Let's look at your deposition on
16 pages 46 to 47.

17 MR. COFFMAN: Your Honor, I'm going
18 to object here. These are questions that Mr. Tomc
19 can ask directly to the witness now. He's here.
20 I'm not sure if this is the proper use of
21 depositions.

22 JUDGE WOODRUFF: I'll overrule the
23 objection.

24 BY MR. TOMC:

25 Q. Okay. So I'm looking on page 46 of

1 your deposition, beginning on line 23. So we take,
2 just for example, a company like Home Depot. That
3 company would pay relative speaking, in comparison
4 to a utility, a lower dividend and would
5 potentially reinvest more of its capital into its
6 operation. Would you agree with that?

7 A. That is the question you asked there
8 at line 23, yes.

9 MS. BAKER: Objection, your Honor. I
10 don't know if he's asking does he agree that that's
11 what it says, is he agreeing with what it means.

12 JUDGE WOODRUFF: If you can clarify
13 your question. Are you asking him to agree that
14 that was what's in the deposition or are you
15 reasking the question at this point?

16 MR. TOMC: I'm asking if I read the
17 deposition correctly, to your memory.

18 MS. BAKER: Your Honor, I think we're
19 getting way beyond. I agree.

20 JUDGE WOODRUFF: Okay.

21 MS. BAKER: He can ask questions.
22 He's here. Just ask the question.

23 JUDGE WOODRUFF: If you're asking the
24 question again, that's fine. I don't think this is
25 the proper use of the deposition in that you're not

1 contradicting anything that he's --

2 MR. TOMC: I was laying foundation,
3 your Honor. I have one more question to ask.
4 Perhaps that would bring light to the --

5 JUDGE WOODRUFF: Go ahead and ask
6 your question.

7 BY MR. TOMC:

8 Q. In your response to me, Mr. Schafer,
9 you told me, I think Home Depot is still
10 considering expanding into different countries and
11 dedicating growth to that. So I think your
12 statement is fair. Was that your deposition
13 answer?

14 A. Yes, that was my answer.

15 Q. Now, if an S&P 500 company does, in
16 fact, dedicate growth outside the U.S., would its
17 growth rate be constrained by nominal U.S. gross
18 domestic product?

19 A. It sounds like you're asking me how
20 much a foreign GDP would affect an international
21 company's operations.

22 Q. It's a straightforward question. If
23 an S&P 500 company dedicates growth outside the
24 U.S., would its growth rate be constrained by
25 nominal U.S. GDP?

1 A. I believe Home Depot's performance is
2 going to be reflected in GDP.

3 **Q. But would the company's growth be**
4 **restrained by U.S. GDP?**

5 A. Well, to the extent that it's going
6 to grow outside the United States, for example, if
7 it would enter into a country like India and find
8 success there, it's just fairly speculative.

9 **Q. Is the market for capital today a**
10 **global market?**

11 A. Yes, it is.

12 **Q. The capital asset pricing model**
13 **estimates market risk premium based upon a**
14 **calculation of the total market return, correct?**

15 A. Yes.

16 **Q. In your CAPM analysis, I believe you**
17 **utilized both a geometric and an arithmetic**
18 **average. I want to ask you about arithmetic**
19 **average. The arithmetic average market return for**
20 **the S&P 500 you relied upon is 12.2 percent; is**
21 **that correct?**

22 A. It was either 12.2 or 12.1.

23 **Q. What was your source of the**
24 **arithmetic average?**

25 A. The SBBI. It's a publication by

1 Morningstar.

2 Q. Mr. Hevert utilized several sources
3 of data to calculate his ex-ante market risk
4 premium. One of those sources was Value Line;
5 would you agree?

6 A. I believe Mr. Hevert used three to
7 five year earnings growth rates in order to
8 calculate his market risk premium from Value Line
9 and from Bloomberg.

10 Q. And one of those sources being Value
11 Line is a source that your also relied upon, albeit
12 for different purposes, right?

13 A. Yes. I used Value Line as well.

14 MR. TOMC: I'm thinking, your Honor,
15 we're at 64.

16 JUDGE WOODRUFF: That sounds right.

17 Yes, 64.

18 MR. TOMC: May I approach the
19 witness?

20 JUDGE WOODRUFF: You may.

21 (AMERENUE EXHIBIT NO. 64 WAS MARKED

22 FOR IDENTIFICATION BY THE REPORTER.)

23 BY MR. TOMC:

24 Q. This document that I've placed before
25 you, do you recognize this to be a portion of

1 Mr. Hevert's analysis that was included in his
2 testimony in this case?

3 A. Yes, it is. It's the second half of
4 his Schedule R-9, RBH-R-9.

5 Q. In looking at this Ameren Missouri
6 Exhibit No. 64, you see at the top, ex-ante market
7 risk premium, and it identifies Value Line at the
8 top in the title?

9 A. Yes, I see that.

10 Q. You reviewed this document in the
11 preparation of your testimony; is that right?

12 A. Yes, I did.

13 Q. And first let me ask you, the word
14 ex-ante you would agree just means forward looking,
15 right?

16 A. Yes, it does.

17 Q. And based on the Value Line consensus
18 analyst data, that Mr. Hevert calculates a market
19 average expected return of 12.75 percent, correct?

20 A. That is what he's calculated, yes.

21 Q. You'd agree with me, Mr. Schafer,
22 that whether the average return is 12.1, 12.2 or
23 12.75, some component of that return can be
24 attributable to growth, correct?

25 A. Yes.

1 **Q. Growth rates for both income**
2 **investments as well as stocks; is that right?**

3 A. That's correct.

4 **Q. Growth rates for both domestic**
5 **corporations and international companies, correct?**

6 A. Yes.

7 MR. TOMC: I have no further
8 questions.

9 JUDGE WOODRUFF: Okay. Did you wish
10 to offer 64?

11 MR. TOMC: Your Honor, that
12 particular document's already in the record. It
13 was included in Mr. Hevert's testimony.

14 JUDGE WOODRUFF: All right. We'll
15 come up for questions from the Bench, then.
16 Mr. Chairman?

17 CHAIRMAN KENNEY: Mr. Schafer, thanks
18 for your time. I don't have any questions.

19 THE WITNESS: Thank you.

20 JUDGE WOODRUFF: Commissioner Hall?

21 COMMISSIONER HALL: I have no
22 questions. Thank you.

23 JUDGE WOODRUFF: Commissioner Rupp?

24 COMMISSIONER RUPP: No questions, but
25 on your time out of the gate, you did a very good

1 job.

2 THE WITNESS: Thank you very much.

3 JUDGE WOODRUFF: Then there were no
4 questions from the Bench, so no need for recross.
5 Any redirect?

6 MS. BAKER: I do just have a couple
7 of things.

8 REDIRECT EXAMINATION BY MS. BAKER:

9 Q. You were asked about swings in
10 treasury rates. Did you look at treasury rates in
11 your analysis?

12 A. Yes, I did. And one thing that's
13 worth noting is that I was looking at treasury
14 rates. I and two of the other analysts are, in
15 fact, using a forecasted treasury rate for our
16 analysis, because often the question I've heard
17 come up is, well, if these things increase right
18 now, would that necessitate a modification to your
19 model?

20 Well, three of the analysts in this
21 case have used a forecasted rate, which is up in
22 the 4 percents. So the fact that the treasury rate
23 right now is 2.6 or that it was 3.2 exactly when we
24 turned in our analysis, well, that projected rate
25 which is projected to occur from various sources

1 over the period of sometime within the next five
2 years, we factored that in to our models. So I
3 would definitely not want you to have the
4 impression that as soon as these rates start going
5 up, that somehow the models that the analysts
6 turned in here are invalidated. Certainly mine's
7 already taken into consideration an increase in
8 treasury rates.

9 **Q. And along with that analysis, is**
10 **volatility included in your analysis as well?**

11 A. The volatility analysis -- the
12 volatility I looked at in the analysis was one of
13 the prime reasons that I shifted to a projected
14 rate.

15 **Q. And have you found -- you were asked**
16 **about growth rates that exceed GDP. Do you**
17 **remember that?**

18 A. Yes.

19 **Q. Have you found utility growth rates**
20 **that exceed GDP?**

21 A. I have certainly not found long-term,
22 and by long-term I mean more than three to five
23 years. These three-to-five-year estimates are
24 alternatively referred to as long-term by certain
25 analysts. They're referred to as three to five.

1 They'll be referred to as first stage growth rates,
2 depending on what their juxtaposing those rates
3 against.

4 In other words, when we're discussing
5 GDP as a long-term estimate, three to five is no
6 longer the long term. So I definitely recommend
7 keeping in mind what exactly an analyst means by
8 long-term when he or she states long-term.

9 Yes, I've not seen long-term
10 projected growth rates, that is to say beyond these
11 three to five years, that are going to
12 significantly exceed GDP say, for example, over 40
13 years. In fact, we see -- we see at least
14 recommendations to the contrary, that these should
15 not exceed nominal GDP in the long term.

16 **Q. And you were asked some, I'll**
17 **describe them as convoluted questions about Ameren**
18 **being compared to Apple and Ameren being compared**
19 **to Home Depot. Is Ameren anything like Apple or**
20 **Home Depot?**

21 A. Yeah, I find those questions a little
22 bit confusing. I suppose the best way to
23 categorize this is, I believe what the implication
24 is is that since there are growth companies in the
25 S&P and, in fact, utilities do compete for capital,

1 we somehow need to compare utilities to the --
2 directly to growth companies in the S&P.

3 This is not really the case. We use
4 that information for the CAPM to establish a market
5 risk premium, and then we use beta, which is the
6 company-specific number, in order to find out what
7 portion that we should be applying, what portion of
8 that market risk premium we should be applying in
9 order to determine the ROE.

10 So companies like Apple, high-growth
11 companies that are in the S&P are included in the
12 analysis we do via the CAPM.

13 **Q. And you were asked a little bit about**
14 **your choice to do both an arithmetic average and a**
15 **geometric average. Could you explain why you chose**
16 **to do both of those?**

17 A. Yeah. I chose to do both because
18 basically if -- if the arithmetic means were
19 unflawed representations, independent
20 representations of each year's return, basically
21 just to set the stage a little larger, I looked at
22 returns from 1926 to 2013 to try to discover
23 historically what the return was.

24 Well, SBBI, Morningstar offers -- two
25 numbers it offers, the geometric mean and it offers

1 the arithmetic mean. Now, if these years were
2 completely independent of each other, the
3 arithmetic would probably be the perfect one to go
4 with. The geometric is always a little bit lower.

5 As it turns out, there is significant
6 negative auto correlation between these numbers.
7 That is to say, if there's one very high year, it's
8 typically -- there's a larger chance it will be
9 proceeded by a low year and vice versa. In other
10 words, these years are not independent.

11 So instead of relying on one, I've
12 relied on the average of both, because it
13 represents the most -- most investor sentiment, I
14 believe. Analysts are relying on both of these
15 numbers, and really to exclude one of them for the
16 other one completely would not really give the full
17 picture of the way analysts feel.

18 MS. BAKER: I have no further
19 questions.

20 JUDGE WOODRUFF: Mr. Schafer, you can
21 step down.

22 (Witness excused.)

23 JUDGE WOODRUFF: We have one more
24 witness. We'll take a short break before we bring
25 up Mr. Murray, and we'll come back at 5:15.

1 (A BREAK WAS TAKEN.)

2 JUDGE WOODRUFF: Let's come back to
3 order, please. We're back from our break and
4 Mr. Murray has taken the stand. I'll ask you to
5 raise your hand and I'll swear you in.

6 (Witness sworn.)

7 JUDGE WOODRUFF: Thank you. You may
8 inquire.

9 MR. THOMPSON: Thank you, Judge.

10 DAVID MURRAY testified as follows:

11 DIRECT EXAMINATION BY MR. THOMPSON:

12 Q. State your name, please.

13 A. David Murray.

14 Q. And how are you employed?

15 A. Utility Regulatory Manager in the
16 Financial Analysis Unit for the Missouri Public
17 Service Commission.

18 Q. Are you the same David Murray that
19 prepared or caused to be prepared a portion of the
20 Staff Cost of Service Revenue Requirement Report NP
21 and HC --

22 A. I am.

23 Q. -- that has been designated as Staff
24 Exhibit 202?

25 A. Yes.

1 **Q.** And also prepared or caused to be
2 prepared what has been designated as Exhibit 227,
3 the rebuttal testimony of David Murray, and
4 Exhibit 228NP and HC, the surrebuttal testimony of
5 David Murray?

6 A. Yes.

7 **Q.** And do you have any corrections to
8 those testimonies?

9 A. I do, and please be patient. I've
10 got a few things to go through.

11 **Q.** Which item do you need to correct?

12 A. In the Cost of Service Report under
13 the rate of return section which I sponsored, on
14 page 19, line 25, it indicates the compound average
15 annualized return for the utilities index was
16 13.91 percent. That's actually 15.41 percent.

17 And here's the part that may pose a
18 little more problems. For whatever reason, a
19 section of the multistage DCF testimony explaining
20 the overview of the test -- of the model was
21 accidentally left out of the report.

22 **Q.** Let me --

23 MR. THOMPSON: May I approach?

24 JUDGE WOODRUFF: You may.

25 BY MR. THOMPSON:

1 **Q. Let me show you a document,**
2 **Mr. Murray, and ask you if you recognize that?**

3 A. I do.

4 **Q. What do you recognize that to be?**

5 A. I recognize that to be the section
6 that is missing that explains the multistage DCF
7 and gives an overview of the results.

8 MR. THOMPSON: What exhibit number
9 are we up to, Judge?

10 JUDGE WOODRUFF: 245.

11 MR. THOMPSON: This will be Staff
12 Exhibit 245, and it is the missing section of the
13 description of the multistage DCF method from
14 Staff's Revenue Requirement Report.

15 (STAFF EXHIBIT NO. 245 WAS MARKED FOR
16 IDENTIFICATION BY THE REPORTER.)

17 BY MR. THOMPSON:

18 **Q. Do you have any other corrections?**

19 A. I do, and I apologize. I actually
20 left a copy of my schedules up on my desk when I
21 just went to go use the restroom, and that has some
22 of the other corrections I need to make. Is it all
23 right if I be excused for -- just take a minute,
24 just to go grab it?

25 JUDGE WOODRUFF: We'll go off the

1 record for a moment.

2 (AN OFF-THE-RECORD DISCUSSION WAS
3 HELD.)

4 JUDGE WOODRUFF: We're back on the
5 record. Mr. Murray is back on the stand.

6 MR. THOMPSON: Thank you, Judge.

7 BY MR. THOMPSON:

8 **Q. Mr. Murray, did you say you had some**
9 **other corrections?**

10 A. Yes, I do. In the schedules attached
11 to the Staff Cost of Service Report, I believe it's
12 Appendix 2, Schedule 14-1 through 14-3, I
13 actually -- whenever I originally had prepared
14 these schedules, it was at a later date than
15 whenever I had done the initial analysis in the
16 body of the testimony. So a couple of growth rates
17 were not updated, and so I noticed that when I was
18 reviewing my testimony.

19 So I'll just go into the three
20 companies in which the growth rate is a little bit
21 different for growth in years one through five,
22 which is identified in column 2. For column 2,
23 Great Plains Energy, the growth rate should be
24 4.78 percent rather than 4.95 percent. For
25 Southern Company, the growth rate should be

1 3.71 percent rather than 3.68 percent. And for
2 West Star Energy, the growth rate should be
3 3.38 percent rather than 2.13 percent.

4 If you prefer, I can just tell you
5 how that affects the final results instead of going
6 into all the details. The final cost of equity
7 estimate using that multistage is 7.28 percent
8 rather than 7.25 percent, which is the average of
9 all those companies. And then the average without
10 Cleco and Wisconsin Energy is 7.42 percent rather
11 than 7.38 percent. So not a material change in my
12 opinion.

13 And then those same -- those same
14 growth rates would need to be corrected in
15 Schedules 14-2 and 14-3, and I'll just give you --
16 if it's okay, I'll give you the final results
17 again. Schedule 14-2, the total average is 7.67
18 rather than 7.64, and the average without Cleco and
19 Wisconsin Energy is 7.8 rather than 7.77. And for
20 Schedule 14-3, the result is 8.9 -- or excuse me.
21 8.06 rather than 8.03, and then 8.19 rather than
22 8.15.

23 Again, because I looked at multiple
24 different types of analyses to evaluate the change
25 in the cost of equity, multiple proxy groups, I

1 really did not consider this to be a material issue
2 for purposes of estimating that the cost of equity
3 had declined by about 25 to 75 basis points since
4 Ameren Missouri's last rate case.

5 **Q. Is that all of your corrections,**
6 **Mr. Murray?**

7 A. Let me just make sure on rebuttal and
8 surrebuttal. I don't believe there is, but just to
9 refresh my memory.

10 The only other one is in surrebuttal,
11 on page 15, line 10, we need to delete -- there
12 needs to be a question mark after "fairly valuing
13 securities", and delete the "to determine the
14 required return over securities." There's some
15 duplication. It just doesn't make sense the way
16 it's worded.

17 Those are the only corrections I need
18 to make.

19 **Q. Very well. With those corrections in**
20 **mind, Mr. Murray, is your testimony true and**
21 **correct to the best of your knowledge and belief?**

22 A. Yes.

23 **Q. If I were to ask you the same**
24 **questions today, would your answers be the same?**

25 A. Yes.

1 **Q. And are you scheduled to testify**
2 **again in this proceeding?**

3 A. I am not.

4 MR. THOMPSON: Therefore, Staff moves
5 to -- Staff offers Exhibit 227, Exhibit 228NP and
6 HC and Exhibit 245 and tenders Mr. Murray for
7 cross-examination.

8 JUDGE WOODRUFF: 227, 228HC and NP
9 and 245 have been offered. Any objections to their
10 receipt?

11 (No response.)

12 JUDGE WOODRUFF: Hearing none, they
13 will be received.

14 (STAFF EXHIBIT NOS. 227, 228NP, 228HC
15 AND 245 WERE RECEIVED INTO EVIDENCE.)

16 JUDGE WOODRUFF: And for
17 cross-examination, we begin with MIEC.

18 MS. ILES: No questions, Judge.

19 JUDGE WOODRUFF: Public Counsel?

20 MS. BAKER: Yes.

21 CROSS-EXAMINATION BY MS. BAKER:

22 **Q. Good evening?**

23 A. Good evening.

24 **Q. You've determined that a reasonable**
25 **return on equity for Ameren Missouri is between**

1 9.00 percent and 9.50 percent; is that correct?

2 A. Reasonable allowed return on equity,
3 yes.

4 Q. And your recommendation for ROE is
5 9.25 percent; is that correct?

6 A. Yes.

7 Q. And this determination is based on
8 your expert analysis of market-driven data using
9 traditional analytical tools?

10 A. Yes.

11 Q. And anywhere within the range of
12 9.00 and 9.50 you believe is a reasonable return?

13 A. Yes.

14 Q. And you would agree that during the
15 local public hearings, there have been a lot of
16 customer concern over the affordability of rates;
17 is that correct?

18 A. That's my understanding.

19 Q. And you would agree that the goal of
20 the Commission is to set rates that are just and
21 reasonable?

22 A. Yes.

23 Q. On February the 20th, 2015, just
24 before the hearing began, Staff filed a
25 reconciliation of the positions for various issues

1 in this case; is that correct?

2 A. I don't remember a specific date, but
3 I do know the Staff filed a reconciliation.

4 Q. Have you reviewed that
5 reconciliation?

6 A. I have. It's been some time.

7 MS. BAKER: Okay. May I approach?

8 JUDGE WOODRUFF: You may.

9 BY MS. BAKER:

10 Q. I have a copy of the reconciliation
11 that was filed in the case. If you could look that
12 over. And I realize that since the hearing began,
13 there have been some settlement agreements that may
14 have affected the values that are shown on Staff's
15 February 20th reconciliation. But for
16 demonstrative purposes, do you see that the
17 reconciliation includes reconciliations of
18 positions of the various parties on the issue of
19 return on equity?

20 A. I do.

21 Q. And according to this reconciliation
22 from Staff, Staff's recommendation of a return on
23 equity at 9.25 percent would lower the company's
24 revenue requirement by just over 69 million; is
25 that correct?

1 A. Yes.

2 Q. And so the calculation of the impact
3 of MIEC's position of 9.3 percent ROE in this
4 reconciliation would be to lower the company's
5 revenue requirement by just over 65.4 million?

6 A. Yes.

7 Q. And similarly, according to this
8 reconciliation, the impact of OPC's position of
9 9.01 percent ROE would be to lower Ameren's revenue
10 requirement by just over \$82 million?

11 A. Yes.

12 Q. And you would agree that Public
13 Counsel's recommended ROE of 9.01 percent is within
14 your reasonable return on equity range for Ameren
15 Missouri?

16 A. Yes.

17 Q. And so you would agree that at an ROE
18 of 9.01 percent, Ameren would receive a reasonable
19 return on equity and customers would save
20 approximately \$82 million per year?

21 A. If things are normal, yes.

22 MS. BAKER: No further questions.

23 JUDGE WOODRUFF: Consumers Council?

24 MR. COFFMAN: No questions. Thank

25 you.

1 JUDGE WOODRUFF: For Ameren?

2 MR. TOMC: Yes, your Honor.

3 CROSS-EXAMINATION BY MR. TOMC:

4 Q. Good evening, Mr. Murray.

5 A. Good evening.

6 Q. Do you have a copy of your deposition
7 with you?

8 A. I do.

9 Q. Now, as you took the stand today, you
10 went through a list of corrections to your
11 testimony, including an additional page or two. I
12 just want to ask you for the purpose of
13 clarification, has there been any change in your
14 underlying recommendation in this case?

15 A. No.

16 Q. So your changes with respect to your
17 corrections do not affect your recommendation to
18 this Commission; is that right?

19 A. They do not.

20 Q. Now, would you agree with me that the
21 measurement of the cost of equity is essentially a
22 measurement of investor expectations?

23 A. I don't -- I think that needs to be
24 defined a little more specifically.

25 Q. So in other words, the measurement of

1 the cost of equity is essentially a measurement of
2 investor expectations in the sense of what is
3 required of investors to invest in a utility?

4 A. I agree with the required aspect, the
5 requirement of investors.

6 Q. And the requirement of investors
7 would necessarily be a product of their
8 expectations with respect to what their investment
9 choices might be, right?

10 A. I think the requirement is going to
11 be -- is going to be considered along with what
12 they believe their expected returns could be for a
13 given investment. I mean, a required return could
14 be 6 percent and they could expect a return of
15 9 percent. And so if they believe that that's not
16 factored into stock prices, then they will buy that
17 security. I believe there should be a distinction
18 of the definition between expectations and
19 requirement.

20 Q. Staff has recommended the Commission
21 set Ameren Missouri's return on equity equal to
22 9.25 percent in this case; is that right?

23 A. Yes.

24 Q. This is an increase from Staff's
25 recommendations in the last case; is that right?

1 A. The point estimate, yes.

2 Q. And that point estimate in Ameren
3 Missouri's last rate case was 9.0; is that correct?

4 A. Yes.

5 Q. Sitting here today, you believe that
6 the cost of equity has declined since the last
7 case; is that right?

8 A. Yes.

9 Q. And you do not believe Ameren
10 Missouri's cost of equity actually is 9.25 percent,
11 right?

12 A. Yes.

13 Q. You are not recommending that the
14 Commission approve a return on equity equal to what
15 you actually believe the cost of equity to be?

16 A. That is correct.

17 Q. You believe a high end estimate of
18 the cost of Ameren Missouri's equity would be
19 8 percent; is that right?

20 A. I'd have to look at -- let me look at
21 the multistage. Multistage is the main methodology
22 I relied upon for estimating the cost of equity,
23 and --

24 Q. Mr. Murray, if you could refer to
25 your deposition on page 64.

1 MR. THOMPSON: I object. He didn't
2 allow him to answer, finish answering that last
3 question.

4 JUDGE WOODRUFF: I'll sustain that
5 objection.

6 THE WITNESS: My multistage cost of
7 equity estimate was between 7.6 and 8.37, midpoint
8 about 8 percent. So that's my cost of equity
9 estimate using multistage DCF.

10 BY MR. TOMC:

11 Q. Mr. Murray, if you could please refer
12 to page 64 of your deposition, specifically line
13 15, or actually line 11. I asked you, the actual
14 cost of equity that you believe to be substantially
15 less than 9.25 percent; is that right? Your answer
16 was yes; is that correct?

17 A. Yes.

18 Q. By at least 125 basis point; is that
19 correct? Your answer was, let me see here. Yes.
20 Based on multistage, the DCF results, 8 percent is
21 what I provide for a cost of equity estimate. Was
22 that your answer?

23 A. Yes. It's consistent with what I
24 just answered, yes.

25 Q. And then I asked you, and you would

1 characterize that 8 percent estimate as
2 conservative; is that right? And you said,
3 conservative at the high end. Is that what
4 your --is that how you characterize that?
5 Confirmed your correction. Your answer on page 65
6 is yes; is that correct?

7 A. Yes.

8 Q. Now, you believe the cost of equity
9 for utility companies today ranges between 6 and
10 8 percent with the actual cost being closer to
11 6 percent; is that right?

12 A. Yes. In the 6 percent range, that's
13 correct.

14 Q. If the Commission were to actually
15 set the company's cost of equity to 6 percent, is
16 it fair to say that investment analysts would
17 perceive this as a negative development?

18 A. Yes.

19 Q. You are not aware of any instance in
20 which any commission in any jurisdiction authorized
21 a return on equity for a vertically integrated
22 utility between 6 and 8 percent; is that right?

23 MR. THOMPSON: Objection. That's not
24 Staff's recommendation in this case either.

25 MR. TOMC: It's in his testimony,

1 your Honor.

2 JUDGE WOODRUFF: I'm going to
3 overrule the objection. He didn't ask what was
4 Staff's position.

5 THE WITNESS: Repeat the question,
6 please. Sorry.

7 BY MR. TOMC:

8 Q. You are not aware of any instance in
9 which any commission in any jurisdiction authorized
10 a return on equity for a vertically integrated
11 utility between 6 and 8 percent; is that right?

12 A. Not since 1980. That's when data's
13 been compiled. Before then we didn't know. I
14 believe that's what our conclusion was was data was
15 not compiled before 1980.

16 Q. For clarification purposes, you're
17 not aware of a decision in 1980 that approved a
18 return on equity of between 6 and 8 percent?

19 A. I'm not aware of any period between
20 1980 and current where anything lower than 6 to 8
21 was approved. I'm just indicating that we
22 discussed that there was no data compilation before
23 the period of 1980. We discussed that in the
24 deposition, I believe.

25 Q. And just to be clear, you're not

1 **aware of any cases ever before 1980 where a**
2 **Commission set an authorized return on equity for a**
3 **vertically integrated utility between 6 and 8**
4 **percent?**

5 A. I don't know of a source to look for
6 for that.

7 **Q. Refer to page 32 of the Staff Report.**

8 A. Yes.

9 **Q. Line 4 through 6. The average**
10 **consensus long-term growth rates for the broader**
11 **proxy group is currently 5.74 percent as compared**
12 **to 5.6 percent for the refined proxy group; is that**
13 **right?**

14 A. That's an accurate replication of the
15 FactSet five-year earnings per share forecast for
16 my proxy group.

17 **Q. You relied upon SNL Financial and a**
18 **company called FactSet for your analyst growth**
19 **rates; is that correct?**

20 A. Well, I think we clarified this
21 during the deposition as well. SNL Financial
22 receives information from FactSet. SNL does not
23 actually compile or does not actually produce the
24 estimates. FactSet receives the estimates from
25 equity analysts, provides them to SNL Financial,

1 and through our subscription to SNL Financial, we
2 receive the FactSet estimates.

3 **Q. Mr. Murray, is this the type of**
4 **information that investors and finance**
5 **professionals would recognize as authoritative in**
6 **the finance industry?**

7 A. For looking at earnings per share
8 forecast, sure.

9 **Q. Would investors reference SNL and**
10 **potentially FactSet information when evaluating**
11 **investment choices?**

12 A. I'm sorry. Did you say evaluating or
13 valuating?

14 **Q. Would investors reference SNL and/or**
15 **FactSet information when evaluating investment**
16 **choices?**

17 A. If the question is evaluating with
18 e-v-a-l-u-a-t-i-n-g as the spelling, I agree, yes.

19 **Q. You did not use 5.74 percent or**
20 **5.6 percent in your constant growth DCF; is that**
21 **correct?**

22 A. I did not.

23 **Q. Instead, you chose to use**
24 **3.5 percent; is that right?**

25 A. 3 and a half to 4 and a half percent.

1 The point estimate would be 4 percent, midpoint.

2 Q. And, in fact, for Ameren Missouri you
3 believe the current growth rate is probably closer
4 to 3 percent; is that right?

5 A. (REPORTER'S NOTE: The answer was
6 moved to the in-camera transcript.)

7 JUDGE WOODRUFF: If it was highly
8 confidential, we'll have it taken out of the
9 transcript. Just tell me.

10 MS. TATRO: Yes, please do that.

11 MR. TOMC: Can we go in camera for
12 just a moment, your Honor?

13 JUDGE WOODRUFF: We can. And I'll
14 direct the -- before we do that, I'll direct the
15 court reporter to remove that last statement of the
16 witness from the public transcript and put it into
17 the highly confidential portion.

18 (REPORTER'S NOTE: At this point, an
19 in-camera session was held, which is contained in
20 Volume 22, pages 1353 through 1354 of the
21 transcript.)

22

23

24

25

1 JUDGE WOODRUFF: All right. I'll
2 come back into regular session. We are back in
3 regular session, if somebody would let the people
4 who just left come back in. You can inquire.

5 MR. TOMC: Thank you.

6 BY MR. TOMC:

7 Q. Mr. Hevert, Mr. Gorman and
8 Mr. Schafer all relied upon consensus analyst
9 growth rates that were greater than 5 percent in
10 their constant growth DCF analysis; isn't that
11 correct?

12 A. I don't recall if they relied on it
13 for their estimate. I know that -- as far as their
14 cost of equity recommendation, I know that they
15 included it with -- they simply just added the
16 growth rate plus the dividend yield to come up with
17 the cost of equity estimate.

18 Q. Do you review commission orders with
19 respect to return on equity for past Ameren
20 Missouri rate cases as you prepared to testify in
21 the proceeding?

22 A. Yes.

23 Q. In the past few cases, is it fair to
24 say that the Commission has found your
25 recommendation to be too low?

1 A. Yes.

2 Q. Is it also true that your
3 recommendations are routinely below national
4 average authorized returns generally?

5 A. Yes.

6 Q. If I understand correctly, you
7 believe that pervasively among utility regulatory
8 jurisdictions, including this jurisdiction, there
9 is a hesitance to recognize the true cost of
10 equity; is that right?

11 A. Yes.

12 Q. For those commissions that set return
13 on equity numbers above 9 percent, you believe
14 those jurisdictions are wrong if they believe that
15 they are approving an ROE consistent with what the
16 actual cost of equity is?

17 A. Yes.

18 Q. Now, you would agree that investors
19 are aware of ROEs authorized by commissions,
20 including this commission, right?

21 A. Yes.

22 Q. You would agree that, because of
23 this, investors have come to expect a return
24 between 9.5 and 10 percent; is that right?

25 A. Maybe last year. I think from this

1 point forward, 9 and a half would be more of what I
2 think investors would expect. I think that that's
3 pretty widely recognized. I mean, it's not real
4 hard to understand with interest rates declining,
5 price to earnings ratios increasing, obviously the
6 cost to issue equity is declined for utilities.

7 So that past average is based on a
8 different capital market environment. So I -- I
9 mean, I have it in my testimony that, even from
10 investors themselves, that they expect some
11 compression in allowed ROEs.

12 Q. Would you refer to page 55 of your
13 deposition, line 12. Question: If this commission
14 or any other commission were to set a return equal
15 to 6 percent as an allowed authorized rate of
16 return, do you believe that investment analysts
17 that you mentioned would react negatively,
18 positively or neutral? And your answer was
19 negatively; is that right?

20 A. Yes.

21 Q. Now, there was a follow-up question.
22 I asked you, why would that be? And your answer,
23 first line of your answer is, because they come to
24 expect a 9 and a half to 10 percent return on
25 equity; is that right?

1 A. Yes. That was -- that's just the
2 first line. I said I believe there's going to be
3 come compression in allowed ROEs due to the simple
4 fact the capital market situation that we have
5 right now, interest rates. Actually, I believe
6 it's in my testimony that Ameren Missouri's own
7 long-term utility bond yields are trading over the
8 counter at 3 and a half percent.

9 So even though the average was 9 and
10 a half to 10 percent recently, I believe that the
11 capital market evidence supports that -- and
12 investment commentary supports that 9 and a half is
13 probably something that would be reasonably
14 expected.

15 **Q. So sitting here today, your opinion**
16 **has changed since your deposition was taken, and**
17 **you believe that, based on what you know, investors**
18 **would expect a 9.5 percent return on equity; is**
19 **that right?**

20 A. I don't believe my position has
21 changed. I said 9 and a half to 10 percent, and I
22 said that they've come to expect that because
23 that's the way the capital markets were before
24 2014.

25 Right now all the commissions

1 throughout the country are debating this capital
2 market evidence. And so when, you know, when they
3 realize that the interest rate levels have dropped
4 significantly, price ratios have increased
5 significantly, that going forward they would expect
6 it to be closer to 9 and a half percent if not
7 lower. I mean, that was based on talking about
8 2014 time period.

9 Q. Now, Mr. Murray, if we are to accept
10 the premise that investors have come to expect a
11 return of 9.5 percent, with that understanding,
12 investors would then expect a return higher than
13 what Staff is recommending in this case; is that
14 right?

15 A. It's at the top end of Staff's
16 recommended range.

17 Q. It would certainly be higher than the
18 point estimate of 9.25 percent?

19 A. Yes, it's higher.

20 Q. You conducted a multistage DCF
21 analysis, and part of that analysis contains what
22 you believe to be the long-term growth expectations
23 of investors, correct?

24 A. Yes.

25 Q. What was the growth rate that you

1 used in the third stage?

2 A. 3 to 4 percent.

3 Q. Now, I understand if I've read the
4 Staff Report correctly, you believe the long-term
5 rate of growth to actually be about 2 percent; is
6 that right?

7 A. Most of what I've reviewed with
8 investment analysts shows 2 to 2 and a half
9 percent, consistent with inflation.

10 Q. And that is why on this corrected new
11 portion of your testimony that was provided today
12 on line 13 of the first page, you indicate, in
13 fact, in Staff's experience, most DCF analysts do
14 not assume a growth rate much higher than the
15 expected rate of inflation, currently 2 percent to
16 2.5 percent; is that right?

17 A. That is correct.

18 Q. Now, 2 percent would be consistent
19 with what we would expect in terms of rate of
20 inflation, right?

21 A. Yes.

22 Q. Sitting here today, you believe that
23 investors purchase stock with the expectation of no
24 real growth, and the only compensation they would
25 be provided would be through the dividend yield; is

1 **that your opinion?**

2 A. That exceeds the -- that's a real
3 return of 3 and a half percent with bond yields of
4 1 and a half to 2 percent and a 2 percent nominal
5 growth rate, I mean, they've have a nominal return
6 of close to 6 percent. I mean, take 2 percent in
7 inflation off that, it's a real return of
8 5 percent. I believe that that is a pretty good
9 return in this environment.

10 **Q. Now, sitting here today, in candor,**
11 **you do not believe that this Commission would**
12 **approve a return of equity of 6 percent, do you,**
13 **Mr. Murray?**

14 A. No, I do not.

15 **Q. You do not believe that they would**
16 **return a return of equity of 8 percent; is that**
17 **right?**

18 A. No, I do not.

19 MR. TOMC: Your Honor, I think
20 Mr. Murray has answered my questions, and at this
21 point I have no further cross-examination.

22 JUDGE WOODRUFF: Questions from the
23 Bench, Mr. Chairman.

24 QUESTIONS BY CHAIRMAN KENNEY:

25 **Q. Mr. Murray, good evening.**

1 A. Good evening.

2 Q. Just a few quick questions. I think
3 most of the folks in the room have used the phrase
4 return on equity and cost of equity
5 interchangeably. I think I even the exchange that
6 you just had with Mr. Tomc would reveal that. You
7 don't use those terms necessarily synonymously,
8 correct?

9 A. If I did, I should not have. I think
10 it's very important to distinguish the two.

11 Q. Please do.

12 A. The allowed return on equity, when he
13 was talking about expected returns, there's no
14 doubt in my mind, I've reviewed investment analyst
15 reports that indicate that they expect commissions
16 to allow returns of 9 and a half to 10 percent or,
17 you know, I believe they might be -- and there's
18 information that reveals that they believe the
19 commissions will start lowering the allowed returns
20 to about 9 to 9 and a half percent, somewhere in
21 that range, because the capital market evidence
22 just supports it.

23 But their cost of equity, their
24 required return that they use to discount cash
25 flows, there is a spread between the cost of equity

1 and allowed return on equity. I mean, I said I've
2 actually reviewed well-respected, qualified
3 investment analysts in Wall Street, buy side, sell
4 side, that indicate that they -- the allowed
5 returns they come to -- they've gotten used to
6 allowed returns having about a 250 to 300 basis
7 point spread. If it gets a little too wide, they
8 expect it to narrow.

9 It doesn't mean that they believe
10 that the -- like as he mentioned, the 6 percent of
11 cost of equity, it doesn't mean that they're going
12 to deem that fair and reasonable. But there is --
13 there's very little dispute in the investment
14 analyst world that the cost of equity is lower than
15 allowed returns.

16 **Q. So the 6 to 8 percent that you were**
17 **just discussing, that's your estimation of the cost**
18 **of Ameren or another utility to actually go out in**
19 **the market and acquire equity financing?**

20 A. On multistage it's 8 percent. I
21 provide some what I consider commonsense tests by
22 just looking at the bond yields and just realizing
23 that, you know, basic characteristics of a utility
24 stock, it's a yield -- it's a yield investment, and
25 history has shown that about two-thirds of the

1 returns for utility stocks come from the dividend
2 portion of the return, not the capital
3 appreciation.

4 So for a growth rate, for expected
5 growth rate in the stock price to be higher than
6 the dividend yield, it just -- it defies the basic
7 characteristics of what utility stock should be.
8 So point being is, while I have my multistage and I
9 do have a constant growth DCF which shows about
10 8 percent cost of equity, what I'm saying is if you
11 look at some of these what I consider
12 straightforward and commonsense tests as to what
13 would you expect to -- what would an investor
14 really require when they go into the markets with a
15 3 and a half percent bond yield and they're
16 investing in utility stock that has bond-like
17 characteristics and you know the capital gains have
18 been less than the dividend portion of the return,
19 the expected return on your portfolio is going to
20 be about 6 percent for utilities.

21 It's -- and that's -- like I said,
22 that is pretty commonly understood in the
23 investment community. That does not mean that they
24 expect commissions to set the allowed returns at
25 that level.

1 CHAIRMAN KENNEY: Okay. That's all I
2 have. Thank you.

3 JUDGE WOODRUFF: Commissioner Kenney?

4 COMMISSIONER W. KENNEY: No
5 questions.

6 CHAIRMAN KENNEY: Commissioner Hall?

7 QUESTIONS BY COMMISSIONER HALL:

8 Q. Good evening, Mr. Murray.

9 A. Good evening.

10 Q. How would you characterize the
11 regulatory environment in Missouri compared to
12 other states?

13 A. Generally, it's considered to, you
14 know, have constructive outcomes for the report and
15 orders. I believe there's more of a concern about
16 the legislative aspect with -- as far as respect to
17 the construction work in progress and the
18 historical test year, you know, as to whether or
19 not that is causing utilities to have some
20 regulatory lag. One of the things I'm not sure
21 about with the regulatory lag, that's just a matter
22 of time value of money. It's not -- it's not a
23 problem with the actual ultimate recovery, because
24 if you expect to recover the cost, the lag should
25 be just a time value of money issue.

1 But no, it's -- it is recognized that
2 we're probably -- we're within the average
3 category, and I think S&P might even do some rank
4 order. I don't think Moody's does a rank order.
5 But we're not -- we're not in the top of the
6 average. We're in the lower part of the average
7 category, and so -- but, you know --

8 **Q. Lower part of the average, what do**
9 **you mean by that?**

10 A. We're not -- we're not the median of
11 the average. There's a lot of states in the
12 average. I don't have the document in front of me.
13 But there's a lot of states in the average. FERC
14 is in the above average because they are very
15 generous in their regulatory ratemaking treatment.
16 But yeah, I can't tell you exactly where we're at.

17 **Q. I'm sorry. So we are below the**
18 **median?**

19 A. Below the median in the average
20 category, which like I said, that's based on
21 Standard & Poor's. But RRA has us, I believe, in
22 the average category.

23 **Q. Okay. Well, how significant is it**
24 **that we have anti-CWIP provision in Missouri law**
25 **from your perspective?**

1 A. I think Mr. Gorman mentioned this
2 earlier. Actually, whenever a company has faced a
3 significant project such as building a power plant,
4 the Iatan 2 power plant, that the parties came
5 together and recognized the need for cash flow
6 during the period of the investment because it was
7 a five-year project, significant investment.

8 So there was -- the ratemaking was
9 considered extra cash flow needed by just looking
10 specifically at the credit metrics that are
11 evaluated by rating agencies. I think that the
12 funds flow from operations to debt was the main
13 rating cash flow metric that drove the need or the
14 perceived need at least for additional cash flow
15 above and beyond what traditional ratemaking would
16 have allowed.

17 So, I mean, that obviously didn't
18 produce the amount of AFUDC that needed to be
19 booked, but there are -- I mean, within -- within
20 the confines of a, you know, a settlement, there
21 have been ways in which Staff and other parties
22 have worked with the companies to try to make
23 things work even though there are certain statutory
24 issues.

25 **Q. Did you perform an average market**

1 yield calculation?

2 A. A dividend yield or -- I'm sorry.

3 Q. I believe this was a term that
4 Ameren's expert used to compare the dividend and
5 stock growth of a non-regulated company to a
6 regulated company. I may have gotten that wrong.

7 A. Yeah. I'm sorry. I don't recall
8 that specific.

9 COMMISSIONER HALL: Okay. I have no
10 further questions.

11 JUDGE WOODRUFF: Commissioner Rupp?
12 All right. We'll come back for recross based on
13 questions from the Bench, beginning with Public
14 Counsel.

15 MS. BAKER: No questions. Thank you.

16 JUDGE WOODRUFF: Consumers Council?

17 MR. COFFMAN: No questions.

18 JUDGE WOODRUFF: MIEC?

19 MS. ILES: No questions.

20 JUDGE WOODRUFF: Ameren?

21 MR. TOMC: No questions, your Honor.

22 JUDGE WOODRUFF: Any redirect?

23 MR. THOMPSON: I think a little bit,
24 Judge. Thank you.

25 REDIRECT EXAMINATION BY MR. THOMPSON:

1 Q. You recall you were asked by Mr. Tomc
2 about whether you believe Ameren Missouri's cost of
3 equity is, in fact, below the amount you have
4 recommended that the Commission set as an allowed
5 return on equity; is that correct?

6 A. Yes.

7 Q. I wonder if you could explain, do you
8 believe that commission-awarded returns on equity
9 are generally above the actual cost of equity of
10 the companies concerned?

11 A. Yes.

12 Q. And do you believe there has been a
13 reluctance on the part of commissions to lower
14 their awards to reflect the changing financial
15 market?

16 A. Yes. I believe that's widely
17 recognized. I mean, sometimes it's a gradual
18 process.

19 Q. So do you believe that commissions
20 tend to look at what other commissions are
21 awarding?

22 A. Yes.

23 Q. And does that have the effect of
24 artificially reducing the flexibility or the
25 volatility of awarded ROEs?

1 A. Yes.

2 Q. Now, I think you explained that you
3 absolutely do not expect this Commission to award
4 an ROE of 6 percent, do you?

5 A. No, I do not.

6 Q. Or 8?

7 A. No, I do not.

8 Q. If the Commission awards an ROE
9 within the range that you have proposed, do you
10 believe that all requirements of Hope and Bluefield
11 will be met?

12 A. Yes.

13 MR. THOMPSON: I think that's all I
14 have. Thank you, Mr. Murray.

15 JUDGE WOODRUFF: Then thank you very
16 much, Mr. Murray. You can step down.

17 (Witness excused.)

18 JUDGE WOODRUFF: And that concludes
19 the ROE issue. General acclaim from the audience.

20 MR. THOMPSON: We're happy to put
21 that issue to bed, Judge.

22 JUDGE WOODRUFF: All right. And then
23 that concludes the hearing for today. We'll resume
24 tomorrow at 1 p.m.

25

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