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PUBLIC SERVICE COMMISSION

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

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

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

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P R O C E E D I N G S

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

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

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

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

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

MR. THOMPSON: Staff has another matter we'd like to raise. Natelle Dietrich is here. During last week, the Chairman was asking about collaboratives, and there was a homework assignment basically given to Staff with respect to some collaboratives. And so we wanted to inquire for guidance as to how we should report those results to the Commission. Should it be filed in this case or --

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

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

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

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

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

MS. DIETRICH: Okay. Thank you.

JUDGE WOODRUFF: Thank you.

MR. THOMPSON: Thank you, Judge.

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

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

MR. TOMC: Thank you, your Honor. May it please the Commission. My name is Matt Tomc. I'm corporate counsel for Ameren Missouri.

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

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

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

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

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

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

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

Pursuant to those cases, a fair rate of return must do three things: One, the return must be comparable to returns investors expect to earn on other investments with similar risk. Two, it must be sufficient to ensure confidence in the company's financial integrity. And three, it must be adequate to maintain and support the company's credit and attract capital.

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

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

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

We must recognize the operations of Ameren Missouri are of long-term consequence to its customers and to the state. A return must be sufficient to ensure continued investment in the capital-intensive operations of the company.

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

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

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

Nonetheless, as counsel suggests, please do ask Mr. Hevert why his recommendation is appropriate and why the other positions offered in this proceeding are unsupported. Please also ask him about cost recovery mechanisms that other utilities have available today across the country, and ask him how those utilities compare to Ameren Missouri.

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

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

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

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

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

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

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

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

This specific case concerns the electric utility infrastructure that serves the state's biggest city, St. Louis. Authorizing a below market return is clearly at odds with the long-term interests of consumers and the state in general.

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

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

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

I mention the statements of attorneys in this case with respect to the return on equity, but this is an evidentiary hearing, and it is the testimony of the expert witnesses that is important. On behalf of Ameren Missouri, Mr. Hevert provides competent testimony with respect to the measurement of capital costs, specifically the return on equities.

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

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

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

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

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

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

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

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

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

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

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

As was the case in the last Ameren Missouri rate case, Mr. Gorman and Mr. Murray take a pessimistic view of the investor expectations for investment growth. As our economy moves farther from the recession, Staff and intervenors want you to believe this is as good as it gets. They assume perpetual growth will fall well below current analysis consensus estimates.

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

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

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

Staff and intervenors use a historic market risk premium covering a period of much higher interest rates and dividend yields than those that exist today. That market risk premium relies upon about 90 years of historic data starting in 1926. But they apply that market risk premium to five years of interest rate forecasts and use current beta coefficients.

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

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

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

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

JUDGE WOODRUFF: Questions?

CHAIRMAN KENNEY: No, thanks.

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

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

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

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

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

MR. TOMC: Yes. With respect to the Bluefield case, in that particular example Bluefield Waterworks Company, a water utility I believe in West -- state of West Virginia, had proposed a rate increase in that proceeding. The facts in that case, as I recall, those costs that they actually invested in service providing facilities in that state were high, I think, I believe due to high commodity costs during a -- I think it might have been World War I in the period after that. And the Commission chose to ignore those particular economic conditions and set a rate that was very low, and the rate of return in that case that was authorized was 8 percent, but depreciation was included in that return, so the return was actually about 6 percent, and the Commission found that to be confiscatory and unlawful, and in doing so set forth the standards.

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

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

MR. TOMC: Well, I think it's a consideration that does factor into the ratemaking process, and in particular my experience in rate cases is that it's assessed in the rate impact analysis of the varying rate designs.

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

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

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

COMMISSIONER HALL: Thank you.

JUDGE WOODRUFF: Commissioner Rupp?

COMMISSIONER RUPP: Not at this time.

JUDGE WOODRUFF: Thank you. Opening for Staff.

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

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

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

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

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

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

But there is a danger that you have to be aware of in doing that, and the danger is circular reasoning. If all of those utilities have a return that has been set by another state Commission, then in looking at the returns they've received, you're looking at the actions that other state commissions have taken. In other words, it's not set by the market. It's set by a commission. And if all the commissions are looking at other commissions and saying, what are they doing, there's a danger of circularity. There's a danger that commissions will essentially copy each other in assigning returns.

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

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

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

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

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

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

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

9.22.

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

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

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

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

With equity, you have a residual claim. You only get paid after all the other creditors are paid. The cost of Ameren Missouri's long-term debt is 5.59 percent. So that sets an absolute floor. You can't set ROE lower or even at 5.59 because it's got to be higher than the cost of debt because equity is more risky than debt.

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

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

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

You've also heard evidence, or should I say evidence has been tendered to you in Staff's report about the general economic condition of this state. Missouri has not yet recovered from the great research in 2008. The gross domestic product growth of Missouri has been smaller than that of the United States as a whole. It was negative for the year 2011. Unemployment in Missouri is still higher than it was before the recession.

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

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

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

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

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

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

Finally, let me close by telling you that the United States Supreme Court in Market Street Railway Company versus Railway Commission of the State of California stated that Hope Natural Gas does not assure that the regulated business make a profit. All it holds is that the company cannot complain if the return that is allowed is sufficient for the company to continue to operate.

Thank you very much.

JUDGE WOODRUFF: Questions?

CHAIRMAN KENNEY: No, no questions. Thanks.

JUDGE WOODRUFF: Commissioner Rupp?

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

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

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

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

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

COMMISSIONER RUPP: That's all. Thank you.

MR. THOMPSON: Thank you.

JUDGE WOODRUFF: Opening for Public Counsel.

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

May it please the Commission? The charge of the Commission is to set rates that are just and reasonable, and part of determining a just and reasonable rate is to make rates as affordable as possible without causing detriment to the utility.

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

It is important to note -- for the Commission to note that three of the four experts that are testifying today have return on equity recommendations in the low 9 percent area. Mr. Schafer recommends 9.01. Mr. Murray recommends 9.25. Mr. Gorman recommends 9.3.

However, company witness Mr. Hevert somehow recommends 10.4 percent, which is higher than what Ameren was awarded in its last rate case. And this is surprising because capital markets are lower now than at Ameren's last rate case. The cost of equity has gone down. As a result of the capital market decline, average ROE awards for electric companies similarly situated to Ameren Missouri throughout the country have also declined. But still Ameren requests an ROE that exceeds the ROE it was awarded in its last rate case.

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

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

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

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

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

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

Public Counsel asks the Commission to focus on ensuring rate affordability and fairness for the customers. There is no denying that the lower the approved ROE, the more affordable the rates are to the customers.

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

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

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

Mr. Hevert, Mr. Schafer, Mr. Gorman and Mr. Murray all utilize traditional tools, including discounted cash flow, DCF models, risk premium, RP studies and the capital pricing -- capital asset pricing model, CAPM, to determine the reasonable range of return on equity in these cases given market forces.

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

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

Thank you.

JUDGE WOODRUFF: Questions?

CHAIRMAN KENNEY: Just a couple. And I appreciate your voice, so I won't ask too many questions. And these, I think, are legal questions. The low of Mr. Schafer's recommendation is 8.74?

MS. BAKER: Yes.

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

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

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

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

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

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

CHAIRMAN KENNEY: Okay.

JUDGE WOODRUFF: Thank you.

MS. BAKER: Thank you.

JUDGE WOODRUFF: Then opening for MIEC.

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

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

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

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

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

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

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

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

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

Now, Mr. Tomc accused Mr. Gorman of being a pessimistic economist, having a pessimistic outlook on where things are going. I would term him realistic. We are at historic lows in the capital markets. Might they go up in the future? Of course they might. But have they gone up? I'm sure everyone was saying the same thing when we were here in 2000-- for the 2012 rate case, and capital costs have not gone up since then. They've gone down, and they continue to go down even since surrebuttal testimony's been filed in this case.

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

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

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

Now, not surprisingly, Ameren

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

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

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

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

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

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

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

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

Now, there's another issue that we think needs to be considered when you're looking at those authorized returns, and that is that not all of the authorized returns, not all of the decisions that we look at coming out of other commissions necessarily represent a thorough vetting of the ROE issue. Some cases, as you know, are settled. In some cases the Commission uses the same ROE as in the most recent case without really examining what's going on in the market environment.

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

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

How does that compare to where we

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

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

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

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

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

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

Thank you.

JUDGE WOODRUFF: Questions?

CHAIRMAN KENNEY: Not for me. Thank you.

COMMISSIONER W. KENNEY: None for me.

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

MR. COFFMAN: I'll be very brief. Good morning. I concur in the opening statements of the Staff and of the Office of Public Counsel.

I would commend to you that the -- that there is likely going to be a zone of reasonableness in this case between at least the recommended amounts of 9.01 to 10.40. And within that -- I mean, that is what I believe the law considers the zone of reasonableness to be, which is supported by the evidence. Assuming that at the end of the day that you consider that to be competent evidence, that's what you have to work with.

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

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

And I would urge that you not transfer any more, not one dollar more than what you believe is necessary and sufficient to attract capital and do the things that we've talked about the Bluefield and Hope test requires.

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

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

That's all I have.

JUDGE WOODRUFF: Questions?

CHAIRMAN KENNEY: No questions. Thank you.

JUDGE WOODRUFF: Thank you. For MECG.

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

I'm not going to stand before you today and delve into the various court holdings, methodologies, growth rates, data, flaws in certain methodologies or outcomes. Instead, what I'm going to try to do today is put this issue in context, show you this Commission's recent thoughts on the various witnesses, and demonstrate that Mr. Hevert's recommendations are historically as found by all commissions to be inflated.

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

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

Now, why do I bring that up? And the Commissioners have asked many questions about that, and I would echo what Mr. Thompson said, because this is the issue in which the Commission has the most discretion. But I'll take it one step further. Not only is this where the Commission exercises the most discretion, this is the biggest issue in the case. 10 basis points here equals $6.2 million.

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

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

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

For instance, in the 2011 case this Commission said, Hevert's recommended return on equity is higher than the other recommendations in large part because he overestimates future long-term growth in his various DCF analyses, making them too high to be reasonable estimates of long-term sustainable growth.

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

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

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

You see here a chart from

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

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

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

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

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

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

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

Now, in this case, MECG supports the position of MIEC witness Gorman. So I thought it would be interesting to compare for you what this Commission has said about Mr. Gorman. Here's a previous Ameren case: Quote, in particular, the Commission accepts as credible the testimony of MIEC's witness Michael Gorman. Of the witness who testified in this case, Michael Gorman, the witness for MIEC, does the best job of presenting the balanced analysis that the Commission seeks.

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

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

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

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

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

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

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

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

That kind of goes to one of the questions that the Chairman asked. Within the range of 9.01 to 10.4, can we pick a point anywhere in there? And I would agree you can, but I would caution. If you pick a number like 9.8 that is not a particular point in anybody's testimony, you have to have findings of fact about how you got there. You can't just throw a dart and say 9.8, it's in the range. You have to have findings of fact. But I've never seen a Commission decision deemed confiscatory.

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

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

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

JUDGE WOODRUFF: Questions?

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

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

CHAIRMAN KENNEY: Okay. Thank you.

JUDGE WOODRUFF: Commissioner Kenney?

COMMISSIONER W. KENNEY: No.

MR. WOODSMALL: Thank you.

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

(Witness sworn.)

JUDGE WOODRUFF: You may inquire.

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

ROBERT B. HEVERT testified as follows:

DIRECT EXAMINATION BY MR. TOMC:

Q. Good morning, Mr. Hevert.

A. Good morning.

Q. Would you please state your name and

business address for the record.

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

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

A. Yes, I am.

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

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

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

And lastly, there seemed to have been

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

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

A. Yes, that's correct.

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

A. That is correct.

Q. Any other additions or corrections to testimony?

A. No, I do not.

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

A. Yes, they would.

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

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

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

(No response.)

JUDGE WOODRUFF: Hearing none, they will be received.

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

JUDGE WOODRUFF: Cross-examination, MECG?

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

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

CROSS-EXAMINATION BY MR. WOODSMALL:

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

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

A. That is correct.

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

A. Yes.

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

A. I do not offhand, no.

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

BY MR. WOODSMALL:

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

A. It was indeed 10.7.

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

A. That is correct.

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

A. 10.5.

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

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

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

declined since the last case?

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

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

A. I do.

Q. Do you recall responding to this data request?

A. I do.

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

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

Q. And to try to avoid having to go

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

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

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

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

Q. 44.

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

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

MR. WOODSMALL: I'm sorry.

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

BY MR. WOODSMALL:

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

A. Yes, I agree with that.

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

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

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

A. I do.

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

A. Let me just pull that one up. Yes. As I recall, that was again within a range of 10 to 10.5. So as I'd mentioned earlier, if you were to look within the context of range, the minimum is -- would be zero basis points.

MR. WOODSMALL: No further questions. I'd move for the exhibit of Exhibit 970 -- entrance of Exhibit 970.

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

MR. TOMC: No objection.

JUDGE WOODRUFF: It will be received.

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

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

MR. COFFMAN: No questions.

JUDGE WOODRUFF: Public Counsel?

CROSS-EXAMINATION BY MS. BAKER:

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

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

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

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

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

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

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

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

A. As with all commissions, yes.

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

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

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

A. That is correct.

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

A. That is correct.

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

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

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

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

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

A. Not all. I think we all used some form or looked at some form of the constant growth DCF model. We all looked at some form of the multistage DCF model, as well as the capital asset pricing model. Mr. Gorman and I also considered a bond yield plus risk premium approach, although our approaches differ.

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

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

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

A. To the extent that the company is able to attract capital at reasonable terms, that the return is commensurate of enterprises of corresponding risk and it does maintain the company's financial integrity, then it would meet those three standards on over -- excuse me -- with respect to Hope and Bluefield, and by that measure most people would consider it to be reasonable.

Q. And not detrimental to Ameren?

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

MS. BAKER: No further questions. Thank you.

JUDGE WOODRUFF: Then we move to MIEC.

CROSS-EXAMINATION BY MS. ILES:

Q. Good morning, Mr. Hevert.

A. There you are.

Q. I'm way back here. Is this okay? Just a few questions.

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

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

A. Yes, that is correct.

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

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

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

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

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

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

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

A. I'm sorry. Can you repeat your

question?

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

A. Yes, I agree with that.

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

A. That's right.

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

A. Unreasonably low or unreasonably high.

Q. It could be either way?

A. It could be either way.

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

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

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

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

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

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

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

A. Very good.

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

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

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

A. It does, yes.

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

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

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

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

Q. Okay.

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

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

BY MS. ILES:

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

A. Can you tell me when this was downloaded?

Q. Last week.

A. Last week? Okay.

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

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

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

A. I don't think so.

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

A. I would say it's probably close.

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

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

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

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

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

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

JUDGE WOODRUFF: Can you ask the witness about that? Have him explain more what the document is.

BY MS. ILES:

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

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

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

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

A. I am, yes.

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

the website?

A. Yes, I have.

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

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

JUDGE WOODRUFF: Still object?

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

JUDGE WOODRUFF: Exhibit 517 will be received.

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

BY MS. ILES:

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

A. That's right.

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

A. Correct.

Q. And then at least two industry

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

A. That is correct.

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

A. That's right.

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

A. That is correct.

Q. Have I stated that correctly?

A. That's right.

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

A. Correct. There was one other.

Q. Okay. What was one other?

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

Q. Okay. Thank you. And then in

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

A. That's right.

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

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

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

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

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

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

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

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

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

A. Yes, it did.

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

merchant generation after March 14th of 2013?

A. That's right.

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

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

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

A. Yes, that's what I meant.

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

A. Correct. And again, just to be clear, we're here setting the rate of return for Ameren Missouri, the regulated electric operations, and that's the purpose of developing the proxy group. So to the extent that there's a potential proxy company that would be affected by merchant operations, we want to eliminate that. Because we're looking at the company as a standalone company with respect to its regulated utility risks.

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

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

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

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

A. Oh, it tells you a lot.

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

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

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

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

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

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

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

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

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

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

MS. ILES: No further questions.

JUDGE WOODRUFF: All right. Cross for Staff?

MR. THOMPSON: No questions. Thank you.

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

QUESTIONS BY CHAIRMAN KENNEY:

Q. Mr. Hevert.
A. Good morning.
Q. Good morning. Good to see you again.
A. Nice to see you as well.
Q. I searched high and low and I couldn't find Attachment A to your direct testimony that listed your prior testimony.
A. Uh-oh.
Q. And it could be my fault. So I'm just going to ask my questions without the benefit of that attachment. Have you -- do you typically testify for utilities?
A. I do, yes.
Q. Have you testified for a consumer group in the last, I don't know, ten cases in which you've testified?
A. Let me sort of back up on my first answer. I took your question to mean with respect to rate of return issues. I have testified, for example, on behalf of the Maine Public Utility Commission on an issue regarding the incremental value of pipeline capacity into the New England region.
Q. My question was poorly worded, and you're correct, I wanted you to limit this to ROE

issues.

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

Q. Solely?

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

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

A. None taken.

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

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

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

A. It is, yes.

Q. Same rate?

A. It is.

Q. So you charge the same whether you're

testifying on paper versus actually appearing here?

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

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

A. Yes.

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

A. That's right.

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

A. That's right.

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

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

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

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

A. I would agree with that, yes.

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

A. I would agree.

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

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

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

A. On the equity side?

Q. Yeah.

A. I think that's right.

Q. As a measure of risk?

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

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

A. Right.

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

A. Correct.

Q. State pension funds, private pension funds, teachers' pension funds?

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

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

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

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

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

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

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

Q. Relative to other similarly situated entities?

A. That's correct. And I think another point that's possibly especially important now in this environment is relative to other market sectors. So, for example, if you have a situation in which a sector is trading at relatively high levels, at some point the market will see that the relationship between that sector and other sectors is out of line and it will correct itself. I think that's what we've been seeing recently.

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

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

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

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

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

A. I do not.

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

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

Q. That's a big one, right?

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

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

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

A. Right.

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

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

Q. They have stayed at that 2.9 percent?

A. The average over that period.

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

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

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

A. I think it's a starting point. You can look at a lot of reasons why treasury yields bounce around. Sometimes it's the flight to safety issue, which would mean actually as treasury yields go down, risk aversion is going up. The required return on equity is going up. So there are, I think, a lot of interactions to be considered. But as a broad measure, it's probably a good starting point.

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

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

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

A. Not entirely, no.

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

A. Right. I think --

Q. First, do you agree with the statement that stock prices are increasing? Secondarily, do you agree with what we should read from that?

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

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

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

The other thing that I would say is that when we talk about treasury yields, if you look back in 2012, that was right about when the Federal Reserve was starting its quantitative easing. It finished that in October of last year. One thing that people often overlook is the volatility of treasury rates. The volatility of treasury rates now over the past few months is about twice what it was in 2012, meaning that even that market which typically is relatively stable has been far more unstable now than it had been.

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

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

A. No, not at all. And the qualification that I believe was in that slide was all else being equal. And the all else that's typically not even is growth rate. Stock prices will go up if growth rates go up. If you look at the constant growth discounted cash flow method, you'll see that the two tended to offset each other. As growth rate goes up, the stock price will go up, the dividend yield will go down.

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

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

A. Correct.

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

A. Well, I --

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

A. First off, I find that when I testify before commissions, there's a range of recommendations. I would be interested to see where the other witnesses sit in terms of their recommendations and final decisions. I would not be surprised if there was a similar difference.

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

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

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

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

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

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

A. Correct.

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

THE WITNESS: Thank you very much.

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

QUESTIONS BY COMMISSIONER W. KENNEY:

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

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

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

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

numbers. Can you give me a second?

Q. I don't believe that.

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

Q. 9.96?

A. Right.

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

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

To the extent cash flow is diluted, that is the biggest risk. And to the extent there's a prospect of cash flow being diluted over the long-term, that's a very big risk. And I'll tell you that in 2008, what we saw were strong BBB rated companies having to go out and issue debt at 9.75 percent, companies that wanted to go out 30 years but could only go out ten. We saw companies with BBB+/A- ratings not able to draw down on their lines of credit because the banks considered the financial market to have undergone a material adverse change, so they had to borrow two-year debt.

Q. When was that?

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

Q. You're fine. Keep going.

A. One issue that I have often found interesting is that utilities do not have options that unregulated companies have. Utilities have mandates. They have to invest. They have to maintain reliable service. They have to extend service. As a consequence, they have to access the capital markets. Again, they're cash flow negative, so they can't rely on internally generated cash to fund those investments.

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

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

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

Q. How will that eventually affect the ratepayers?

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

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

A. Absolutely.

COMMISSIONER W. KENNEY: Thank you.

JUDGE WOODRUFF: Commissioner Hall?

COMMISSIONER HALL: Yes.

QUESTIONS BY COMMISSIONER HALL:

Q. Good morning.

A. Good morning, sir.

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

A. Somewhat more than that, yes, sir.

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

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

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

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

Q. All of them?

A. Yes, sir.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

JUDGE WOODRUFF: Commissioner Rupp?

COMMISSIONER RUPP: Yes, thank you.

QUESTIONS BY COMMISSIONER RUPP:

Q. Good afternoon.

A. Good afternoon.

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

agree that dividends are down across the sector?

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

Q. Yes.

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

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

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

That, of course, is highly unusual and so if were to be willing to pay that much more money than the market, perhaps they were doing it for that yield because they wanted the dividend yield. But what we've seen very quickly is that sentiment has changed, and we've seen the market fall quite a bit. You sometimes hear the adage, when you reach for a yield, you get what you deserve. And perhaps that's what's happening now. People were reaching for a yield. They wanted that 3 percent or so dividend yield. But now they've lost two to three times that in the capital losses.

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

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

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

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

A. Those high price earnings ratios?

Q. Yeah.

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

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

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

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

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

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

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

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

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

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

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

One is at some point you have to let the market be the market. You can't be constantly interfering with the market. There are concerns about federal intervention creating low interest rates and, therefore, creating perhaps asset bubbles from time to time. Federal intervention can create some risks that people are identifying and becoming concerned with.

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

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

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

Now, there's another interesting aspect to this, though, which is, again, a function of the fact that this is usual, this whole situation is unusual, which is that if the fed is going to continue to increase rates, they're going to do it because they have confidence in the overall economy.

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

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

A. I think it could have. If you see the European Central Bank cutting interest rates, going through its own round of quantitative easing bringing down interest rates in the euro zone, then treasury yields in the United States, even if low, would look comparatively attractive. So that certainly could have an effect.

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

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

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

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

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

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

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

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

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

QUESTIONS BY JUDGE WOODRUFF:

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

A. Yes, sir.

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

A. That's correct.

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

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

JUDGE WOODRUFF: Okay. Thank you.

THE WITNESS: Thank you.

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

(A BREAK WAS TAKEN.)

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

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

MR. WOODSMALL: Yes, real briefly.

RECROSS-EXAMINATION BY MR. WOODSMALL:

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

A. No, I did not.

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

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

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

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

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

JUDGE WOODRUFF: Public Counsel?

MS. BAKER: No questions, Judge. Thank you.

JUDGE WOODRUFF: Consumers Council?

MR. COFFMAN: No questions.

JUDGE WOODRUFF: MIEC?

MS. ILES: Yes, your Honor.

RECROSS-EXAMINATION BY MS. ILES:

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

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

BY MS. ILES:

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

A. Thank you.

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

confirm that, please.

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

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

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

A. Yes, that's right.

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

A. Correct.

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

A. Yes, I see that.

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

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

Q. Correct.

A. Column 3 for the 30-day yield is

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

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

A. Yes, I did.

Q. Where would we find those in your testimony?

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

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

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

Q. Let's do both.

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

Q. Okay.

A. Okay. Are we ready?

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

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

Q. Okay.

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

Q. And how about the 90-day?

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

Q. Yes. That's great.

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

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

A. Sure. And that's part of what we talked about earlier this morning, drifting into this afternoon. When you have a period during which those price-to-earnings ratios were very high, the consequence of that, of course, was a relatively low dividend yield. What this model, this exhibit that you gave me assumes is that the dividend yield that created the -- excuse me -- the price earnings ratios that created yields contained in my Exhibit RBH-R-7 will stay in place forever.

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

A. I'm not making any assumptions.

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

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

Q. All right. But --

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

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

A. I spoke --

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

JUDGE WOODRUFF: Overruled.

MS. ILES: I think it's --

JUDGE WOODRUFF: The objection's overruled.

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

BY MS. ILES:

Q. Of what year?

A. I was about to say, 2015.

Q. Right.

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

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

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

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

MR. TOMC: Objection, argumentative.

JUDGE WOODRUFF: Again, overruled. Ms. Iles, make sure your microphone is on. They're having a hard time hearing you.

MS. ILES: I'm sorry.

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

BY MS. ILES:

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

A. Sure.

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

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

A. Yes, I believe that's correct.

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

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

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

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

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

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

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

A. Well, I appreciate that.

Q. I may be wrong about that. I just

wanted to make that clear.

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

A. Correct.

Q. All right.

A. And -- well --

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

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

(No response.)

JUDGE WOODRUFF: Hearing none, it will be received.

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

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

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

JUDGE WOODRUFF: Redirect?

MR. TOMC: Thank you, your Honor.

REDIRECT EXAMINATION BY MR. TOMC:

Q. Mr. Hevert.

A. Good afternoon.

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

A. I do.

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

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

Again, when I worked at a utility, I was part of the management team that decided when or whether to seek rate relief. I also work with many utilities in an advisory capacity on rate and regulatory policy issues, and I can tell you that the decision to seek rate relief is never taken lightly. It is always taken with respect to the effect on ratepayers, and that's precisely why I read the transcripts, because I want to see it and I want to understand it.

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

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

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

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

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

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

A. Yes.

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

JUDGE WOODRUFF: Your response?

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

MR. THOMPSON: I was just going to

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

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

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

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

MR. TOMC: I will.

BY MR. TOMC:

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

adjustment clause or similar mechanism?

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

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

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

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

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

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

A. I do.

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

A. Well, I think really any discounted cash, any constant growth discounted cash flow model that used data from that period used data that violates one of the principal assumptions of the model, which is that the PE ratio will stay constant forever. At that time the PE ratio was 20 or 21. The long-term average is about 16.5.

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

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

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

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

A. Yes.

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

A. The yield goes down.

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

JUDGE WOODRUFF: Then you can step down.

THE WITNESS: Thank you, sir.

(Witness excused.)

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

(Witness sworn.)

JUDGE WOODRUFF: You may inquire.

MICHAEL GORMAN testified as follows:

DIRECT EXAMINATION BY MS. ILES:

Q. Please state your name for the record.

A. My name is Michael Gorman.

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

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

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

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

A. Yes.

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

A. They would.

Q. Do you have any corrections?

A. No.

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

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

Hearing none, they will be received.

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

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

MS. BAKER: Thank you.

CROSS-EXAMINATION BY MS. BAKER:

Q. Good afternoon, Mr. Gorman.

A. Good afternoon.

Q. In your experience and in the

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

A. In the past two years?

Q. Uh-huh.

A. Yes.

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

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

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

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

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

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

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

A. Yes.

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

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

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

A. Yes.

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

A. Correct.

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

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

A. Yes.

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

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

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

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

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

A. Yes.

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

A. I believe it is, yes.

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

A. That's my finding, yes.

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

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

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

A. Yes.

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

A. Yes.

MS. BAKER: I have no further questions.

JUDGE WOODRUFF: Consumers Council?

MR. COFFMAN: Yes.

CROSS-EXAMINATION BY MR. COFFMAN:

Q. Good afternoon, Mr. Gorman.

A. Good afternoon.

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

A. Yes.

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

A. Yes.

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

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

Probably more specifically from a

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

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

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

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

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

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

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

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

A. Yeah. It's one of the mechanisms that Mr. Hevert was referring to as a regulatory mechanism. So it is common throughout the industry, in my judgment, that deferred accounting is one of those regulatory mechanisms.

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

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

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

A. Well --

Q. -- going forward?

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

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

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

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

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

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

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

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

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

And the reason it would be favorable, even if the deferral subsequently was determined to not be allowed to be included in the development of rates because the revenues at the time that the deferrals were recorded were adequate to allow for recovery of those expenses, it would still be reviewed favorably, in my judgment, because the Commission's actions would be predictable.

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

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

MR. COFFMAN: That's all I have.

JUDGE WOODRUFF: All right. Then for Staff?

MR. THOMPSON: Thank you, Judge.

CROSS-EXAMINATION BY MR. THOMPSON:

Q. Good afternoon, Mr. Gorman.

A. Good afternoon.

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

A. Well, it wouldn't meet the standards

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

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

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

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

Q. Okay.

A. Something below 9 percent.

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

A. I do.

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

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

MR. THOMPSON: Thank you. No further

questions.

JUDGE WOODRUFF: MECG?

MR. WOODSMALL: Yes, very briefly.

CROSS-EXAMINATION BY MR. WOODSMALL:

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

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

Q. And have you done that in this case?

A. I have.

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

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

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

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

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

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

So in my judgment, it's imbalance to give the utility a higher rate of return in order to -- to support their access to capital because that can erode the competitive position of the utility's rates, which can detrimentally impact the utility's customers' ability to make investments in their own businesses or homes.

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

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

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

A. I'm not aware of an explicit upgrade for that purpose, no.

MR. WOODSMALL: Okay. No further questions. Thank you.

JUDGE WOODRUFF: Ameren?

MR. TOMC: Thank you, your Honor.

CROSS-EXAMINATION BY MR. TOMC:

Q. Mr. Gorman, good afternoon.

A. Good afternoon.

Q. Before we begin, let me ask you, do you have a copy of your deposition that we took in this case with you?

A. Yes.

Q. I may also ask you some questions concerning past testimony and past recommendations that you've made in Ameren Missouri rate cases before this Commission. Do you have any copies of that testimony with you today?

A. You gave me one at the deposition, but I did not bring it up here with me.

Q. I do have that testimony with me, and I will bring a copy of it for your reference should you need to reference that to refresh your memory.

A. Thank you.

MR. TOMC: May I approach the witness?

JUDGE WOODRUFF: You may.

MR. TOMC: So what I have handed Mr. Gorman are copies of the complete direct testimonies he has filed in past Commission rate cases involving Ameren Missouri. To the extent we need to reference those if the witness is unable to remember, I provided the complete copies of testimony to Mr. Gorman, but for the remainder of us, I do have handouts to the specific pages that I will be talking about.

BY MR. TOMC:

Q. Mr. Gorman, would you agree that an electric utility is a capital intensive business?

A. Yes.

Q. You testified in jurisdictions across the country on behalf of industrial consumers and other intervenors; is that right?

A. Yes.

Q. And when I use the term vertically integrated electric utility, do you understand what I mean?

A. Yes.

Q. What do I mean?

A. It's an electric utility that owns all three functions of electric utility service: Generation, transmission and distribution.

Q. Such as Ameren Missouri?

A. Correct.

Q. Would you agree with me that today vertically integrated electric utilities are currently making substantial capital investments to comply with environmental laws and regulations, as a general matter?

A. Yes.

Q. And you would agree that Ameren Missouri is one of those utilities?

A. Yes.

Q. Are you aware that the Environmental Protection Agency has proposed carbon regulations that would impact utilities like Ameren Missouri that own coal-fired generation assets?

A. I know such a legislation has been proposed. I don't believe the implementation date has been set or it has been approved for implementation.

Q. To the extent regulations are imposed, capital investment would be required, would you agree?

A. I haven't looked at Ameren's plan, integrated resource plan in a while. Generally speaking, coal-fired utilities will have to either make some sort -- depends on the compliance objective. But if they have to reduce carbon emissions, likely capital investment will be necessary. However, if there is a cap and trade, then there may be a tax for carbon emissions. Or if there's a trading mechanism, they may be able to buy allowances from other utilities.

But I think the point of your question is, will there be costs associated with a carbon legislation? And the answer would be -- my understanding, it's yes.

Q. Do you think that investment analysts and investors themselves are aware of this fact?

A. I'm confident they are, yes.

Q. That is operating risk that investors would consider in making investment choices?

A. It's an investment risk which would consume both operating and financial aspects of the utility.

Q. In general, are utilities in the United States currently making investments to replace aging infrastructure?

A. Yes.

Q. Would you agree with me that the replacement of aging infrastructure is an industry-wide phenomena?

A. I do.

Q. This is prevalent in the water, gas and electric utility industries, correct?

A. Yes.

Q. And these expenditures have been going on for at least the last decade?

A. Yes.

Q. You would also agree that fuel adjustment clauses or similar mechanisms are common among vertically integrated electric utilities throughout the United States?

A. Yes. Some form of them generally is fairly common, and it's not always a -- a rider mechanism. Some utilities have some form of tracker mechanisms. But they are common, yes.

Q. Capital markets are competitive. You would certainly agree with that, correct?

A. That's the premise of all the financial models. It's an efficient competitive marketplace.

Q. And certainly Ameren Missouri must compete for the capital it requires including equity capital, correct?

A. Correct.

Q. And Ameren Missouri competes with other utilities for capital, right?

A. Yes.

Q. Ameren Missouri competes with other equity investments, including non-utility businesses in the S&P 500, right?

A. It's a different kind of investment, but yeah, those are all investment options available to investors.

Q. Are investors diversified?

A. Institutional investors probably are, yes. Individual investors may be if they buy mutual funds or if they're sophisticated enough to develop a diversified portfolio on their own.

Q. For the purposes of preparing your capital asset pricing model, is the underlying assumption that investors are diversified?

A. All capital market models are based on the assumption that utilities are able to diversify away risk that they don't have to hold within a diversified portfolio.

Q. Diversified investors have choices in the stocks they include in their portfolios; is that right?

A. Yes. They have choices and they structure the portfolio in order to accomplish that risk diversification, yes.

Q. Given the capital markets are competitive, you would agree with me there are consequences if the Commission sets return on equity too low?

A. There are consequences if the Commission sets it too high or too low for the reasons I went over just a little while ago.

Q. Is it true that in the long run an insufficient return could impair the service quality of a utility?

A. It is possible, yes, if that would cause the utility to choose not to make capital improvements or would limit its access to capital to fund such improvements.

Q. How might it limit its access to capital, Mr. Gorman?

A. If its credit rating is eroded to a level, it may not be able to sell additional stocks to mutual investors, and there may be a limited market for its debt securities.

Q. Your recommendation in this case is for the Commission to approve a return on equity equal to 9.3 percent; is that right?

A. That is.

Q. That's the same recommendation that

you made in Ameren Missouri's last case, docket ER-2012-0166; isn't that correct?

A. Yes.

Q. In the last case, if I remember correctly, and we can check this, you used a 3.7 percent risk-free rate of return. In this case, you identified a 4.1 percent risk-free rate of return; isn't that right?

A. Are you suggesting I used that risk-free rate to form my recommended return on equity range in the last case?

Q. I'm making no such suggestion. I'm just asking, for the purposes of your CAPM, you used at 3.7 percent risk-free rate of return, and in this case you used a 4.1 percent risk-free rate of return; isn't that right?

A. If you're only referring to the development of CAPM, that probably is right, but --

Q. That value is based upon the Blue Chip projected 30-year treasury rate, correct?

A. To be clear, though, that CAPM treatment in the last case was not the same as the treatment in this case.

Q. The value is based upon the Blue Chip projected 30-year treasury rate, correct?

A. Yes.

Q. So at least for the purposes of your CAPM, you would agree that your measure of the risk-free rate of return based on treasury rates since the last case has increased, correct?

A. The CAPM return in this case is higher than the CAPM return --

Q. I didn't ask you about the CAPM return. I asked you, for the purposes of your CAPM, you would agree with me that your measure of the risk-free rate of return since the last case has increased; isn't that right?

A. You are asking about the CAPM, but if you're only asking about the risk-free rate, the risk-free rate increased, as did the CAPM rate.

Q. You conducted a constant growth discounted cash flow analysis; is that right?

A. In this case, yes.

Q. If you would please refer to page 15, your direct testimony.

A. I'm there.

Q. Discounted cash flow constant growth analysis is a calculation that estimates investor expected return on equity based upon the present value of dividends and capital growth of

appreciation. Is that a fair characterization of what that model does?

A. Well, I mean, a mathematical makeup of the model is dividend growth into perpetuity, but shortened versions of that cash flow stream can be dividend growth over time and stock sale at some point in the future, which would reflect some expectation of capital appreciation of stock during the holding period. So, yes and no to your answer. It does reflect future cash flows to the investor.

Q. You relied upon Zacks, SNL and Reuters to calculate your constant growth DCF; is that right?

A. Referring to the growth rate?

Q. Yes.

A. That's correct.

Q. Are those sources reliable, in your opinion?

A. Yes.

Q. Have you relied upon the specific analysts and their growth rates in other rate cases, the specific ones that we mentioned?

A. I have relied on those in other rate cases, yes.

Q. Are they recognized in the finance

industry as credible sources of information?

A. Well, the finance community, many textbooks recognize that no individual security analyst reflects generally the population of investors. So a consensus analyst projection, which reflects a survey of many buy side holder analysts, which the source then takes together and publishes an average growth rate of all the analysts that respond to the survey, captures a greater breadth of what analysts are informing investors growth rate will be, and then the consensus growth rate estimate then is a better reflection of what investors as a whole believe future growth will be.

Q. Would an investor or an analyst that provides guidance to investors, would they potentially consider the sources of information from Zacks, SNL and Reuters?

A. I'm sure investors have their reference for analysts that they'd prefer to follow, yes.

Q. And that would include Zacks, SNL and Reuters?

A. I would expect it would, yes.

Q. These are credible sources?

A. I believe so.

Q. Now, the consensus analyst growth rates that you observed in this case are, in fact, higher than Ameren Missouri's last rate case ER-2012-0166 as based on -- as your analysis provides; is that correct?

A. Three to five-year growth rates are higher in this case than in the last case, based on review of my proxy group in this case relative to the proxy group in the last case.

Q. If you would look at your direct testimony on page 18. Let's look specifically at line 13.

A. I'm there.

Q. The average consensus growth rates that you identified in your analysis here are equal to 5.50 percent; is that right?

A. Yes.

Q. That is the average of Zacks, SNL and Reuters' growth rates for the proxy group, correct?

A. Yes.

Q. Change gears for just a minute. In the past 24 months, in your opinion, is the United States economy improving?

A. I think there's been some positive

comments made by the Federal Reserve and improvements in unemployment rates and there's been periods of strong economic growth. So I believe it has improved in the last few years.

Q. In the last 24 months unemployment has declined, correct?

A. Yes.

Q. Back to your analysis on page 18, you believe that the growth rate, 5.05 percent consensus analyst average, is higher than your estimate of sustainable long-term growth which you identify as 4.6 percent; is that right?

A. Yes.

Q. Now, that is your estimate based on Blue Chip information and not an estimate provided by Zacks, SNL or Reuters, correct?

A. Well, Blue Chip is a publication that publishes consensus economist projections of future GDP growth rate. So similar to Zacks, SNL and Reuters, it is a consensus analyst projections of future GDP growth.

Q. The data that you have is from Blue Chips, and you use that data to formulate your estimate of long-term growth; is that right?

A. It is a consensus projection of

long-term GDP growth that I have used as a proxy for maximum sustainable long-term growth rate for utilities.

Q. It is a proxy value, then; is that correct?

A. It is.

Q. The proxy value that you selected for your analysis, right?

A. Based on the academic and practitioner support I cite in my testimony, yes.

Q. Now, if you recall, in your deposition I believe you told me that today analyst growth rates are higher than GDP projections due to the fact that capital expenditures will decline after three to five years. Do you recall that? Would you like a page number reference?

A. Yeah, if you would, please.

Q. Turn to page 87 of your deposition transcript. Look at line 16. The sentence begins in the middle. After that -- after that, the level of capital investment will decline to more normal levels. And the preceding sentence indicated that after that you were referring to over the next five years.

A. Well, I didn't like the way you

phrased the question. I don't think that was correct. But my testimony in my deposition, it is also described in this testimony. The idea of long-term sustainable growth rate for utility relates to customers' demand for utility service. And that's proxied by economic growth in the utility service territory. The most widely recognized measure of economic growth is U.S. GDP.

Utilities make investments to meet demand for utility service. As a rate base -- as demand grows, the rate base grows and the earnings grow and their dividend paying ability grows. There's a tie between economic activity in the utility service territory and the utility's ability to lower its rate base, its earnings and its dividends.

Q. Referring back to your deposition, look at page 86 on line 12. I asked you this question: Why have the analysts calculated a higher value for their growth rate than the sustainable growth rate you have here? Please just explain to me as a layperson in general terms.

Answer: Well, analysts are projecting growth over the next three to five years. Analysts are not projecting a long-term

sustainable growth rate. And over the next three to five years, analysts have estimated what their growth rate outlooks for the industry and the company specific will be.

During the next five years, rate base investments will continue to be relatively high levels for the electric utility industry as they complete the environmental compliance, with generation portfolios, with the modernization of their delivery wire service, and that will cause elevated levels of rate base growth over the next five years.

Did I read that correctly?

A. You did.

Q. That was your answer in the deposition, was it not?

A. It's similar to the testimony prefiled, yes.

Q. Now, with respect to your past testimony, I have a few questions for you specifically with respect to growth rates. I am going to mark an exhibit at this time.

JUDGE WOODRUFF: Your next exhibit number is 59.

(AMEREN MISSOURI EXHIBIT NO. 59 WAS

MARKED FOR IDENTIFICATION BY THE REPORTER.)
BY MR. TOMC:
Q. Now, Mr. Gorman, I've handed you what's been marked as Exhibit 59. This is a document prepared by me. I represent to you that this contains excerpts from your direct testimony in the past Ameren Missouri rate cases starting in 2007.
MS. ILES: Your Honor, I'm going to object to the use of this exhibit unless there's some prior inconsistency. There's no basis for introducing this hearsay testimony at this time.
MR. TOMC: I'm not -- sorry, your Honor.
JUDGE WOODRUFF: I'll wait until he's actually asked questions to establish what the purpose of offering it is, and then you may wish to renew your objection.
BY MR. TOMC:
Q. Now, in the 2007 Ameren Missouri rate case, you found that growth -- analyst growth rates were at 5.16 percent as an average; is that right?
A. Yes.
Q. And you found these to be consistent with GDP projections of 5.1 percent; is that right?

A. Yeah. It's fairly similar, yes.

Q. And that direct testimony was filed in December of 2006; is that correct?

A. Appears to be, yes.

Q. In 2008, which is the testimony that follows in the handout -- feel free to reference whichever versions you feel are appropriate.

MR. TOMC: And for those that are following along, I'm looking at page 5 of the Gorman cross exhibit, which is page 18 of that testimony in 2008.

THE WITNESS: Okay. Thank you.

BY MR. TOMC:

Q. In this case you identified growth rates of 6.8 percent, 7.25 percent, 8.03 percent, and those growth rates exceeded your long-term estimate of growth as well; is that correct?

A. Sorry. What page were you on again?

Q. Look at page 5 of 45 on the cross exhibit.

A. In Docket 2008-0318?

Q. That's correct.

A. Can you repeat your question, please?

Q. You found that there were average three to five growth rates for your proxy group at

6.8 percent, 7.25 percent and 8.03 percent; is that right?

A. Referring to page 18? Sorry. I thought you said page 8.

Q. Yes, 18. Look at line 21 on your testimony in 2008.

A. Yes. That's correct.

Q. And in those values they did exceed what you considered to be the long-term estimate of growth; is that right?

A. Yes.

Q. And if you look at page 26 of that testimony, I believe it was 4.9 percent was the long-term sustainable rate of growth that you use for your three-stage DCF, right?

A. Page 26, line 6, it's identified, yes, it's 4.9 percent.

Q. That's right then?

A. Yeah. Yes, it is, at the page I just mentioned.

Q. This testimony was filed in 2008, as I recall?

A. It was.

Q. If you look at page 22 of your testimony, line 30. You told this Commission, this

elevated capital spending level may continue over a relatively long period of time. This indicates that rate base growth will drive earnings growth over the next three to five years. Do you see that?

A. I do.

Q. If you refer to the 2010 case, your testimony in that case you identified an average growth rate of 6.74 percent and a median of 5.50 percent.

A. Case No. ER-2010-0036?

Q. Yes.

A. I'm sorry. Can you repeat that question?

Q. Sure. Look at page 24, line 15. You identify median growth rate of approximately 5.16 to 5.67 percent; is that right?

A. Yes.

Q. In that case, that value also exceeds your long-term estimated maximum growth rate of 4.7 percent; is that right? It's on page 33 of your testimony in that case, line 10.

A. Yes.

Q. Now, moving to the 2011 case that follows, if we look at page 18 of that testimony --

I'm sorry -- page 17, line 14, the average median consensus growth rates for the proxy group are 5.59 and 5.13 percent respectively; is that true?

A. Yes.

Q. In that case your long-term estimated maximum growth rate was 4.7 percent. I would direct your attention to page 18. Is that right?

A. 4.7 to 4.8, yes.

Q. Now, we've already spoken about your testimony in the last case, which was the 0166 docket. Isn't it true that in every Ameren Missouri rate case since 2006, the average consensus analyst growth rates that you have provided have either been consistent with or in excess of your estimated long-term growth rates?

A. The projected growth by the analysts have consistently exceeded the long-term GDP growth rate outlooks as published by security analysts and by consensus of economists. Those are not actual growth rates. Those are projections.

Q. Your maximum long-term sustainable growth rates are based upon five- and ten-year nominal GDP projections. Those are based on a publication, as we have discussed, referred to as Blue Chips; is that right?

A. Yes. Blue Chip Financial Forecast has a long-term GDP consensus forecast ranging out to ten years. That is correct.

MR. TOMC: May I approach the witness, your Honor?

JUDGE WOODRUFF: You may. Will this be an exhibit also?

MR. TOMC: It will.

JUDGE WOODRUFF: This will be No. 60.

(AMEREN MISSOURI EXHIBIT NO. 60 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. TOMC:

Q. I caused to be presented to you what's been marked as Exhibit No. 60, Ameren Missouri. Do you recognize this document?

A. Recognize the front page, yes.

Q. Can you turn to the back page? Do you see data there?

A. I see data there, yes.

Q. Is this the document you relied upon in preparation of your analysis in this case, do you know?

A. Well, the column headings are blacked out here, so you can't read what data is being offered in this. But the footnote above talks about projections for 2016 through 2020. Generally, I rely on a different page of this document.

Q. You rely upon nominal GDP projections with respect to your calculation of long-term sustainability growth rate; is that right?

A. I rely on Blue Chips consensus analyst projections and nominal GDP, yes.

Q. And the Blue Chips analyst consensus growth or GDP values that you rely upon, those are five year -- those are five-year average values; is that correct?

A. The GDP growth?

Q. Yes.

A. They're five and ten year.

Q. Five and ten year.

A. Well, first it gives two projections. One is over the first five years, and the other projection is years six through ten.

Q. And typically you rely upon years six through ten for your long-term sustainable growth estimate; is that right?

A. No. Actually, year six through ten is usually lower than years one through five because economists project that as the U.S. economy recovers, it will have a period of accelerated growth and then the growth will slow over time. The same assumption I'm making for my DCF model for utility's cash flow streams.

To be conservative, I average the two growth rate periods together, which produces a higher number, and then use that average growth rate as my long-term sustainable growth.

Q. Did you reference the nominal GDP Blue Chips consensus for the period 2021 to 2025 in estimating your third-stage growth rate?

A. I'm sorry. Can you repeat that?

Q. Sure. Did you rely upon Blue Chips' projected GDP for the years 2021 through 2025 for your third stage of your DCF?

A. You said Blue Chips GDP projections?

Q. Yes. Do you recall?

A. It's their five- and ten-year projections. I'm trying to identify specific years. It would be five years out from the publication date and then ten years out from the publication date. So it sounds like that's pretty close.

Q. So if the publication date is in 2014, it would be five years, 2021 to 2025, right?

A. That's about right, yes.

Q. When does the third stage in your model, what year would that begin?

A. Year 11.

Q. Which would be 2026, right?

A. Be year 11, yeah. Using data as of 2014, that would be about right.

Q. Why not reference a Blue Chip projected GDP for 2026 and beyond?

A. Well, I did do that to support the reasonableness of my five- and ten-year consensus, economist projections of future GDP. There is no consensus beyond year ten, but there are individual economist projections.

So I did -- did compare the individual economist projections of future GDP growth and compare that to those growths made by the Blue Chip Financial Forecast. And that's discussed at page 22 and 23 of my direct testimony. And I found that those individual economist projections of longer term growth are largely consistent with Blue Chips' financial projections over the next ten years.

Q. Blue Chips does not offer such projections in their publications at this time, do

they, at this time?

A. They would if investors required those to make investment decisions. So it's my belief that since they're in the business to provide investors the information they're looking for to make investment, that this is the information investors are looking at to draw expectations of long-term GDP growth.

Q. So investors and investment analysts would review Blue Chip publications such as a document like this; is that your testimony?

A. I believe, yes, they would consider consensus analyst projections, and the consensus projections are more likely reflective of the market in general.

Q. Is it possible that the reason that Blue Chips does not publish GDP projections beyond the ten-year period as we've discussed here is because investors do not find this information useful to them?

A. It's -- investors require information to make investment decisions. If they wanted projections and were willing to pay for projections longer than ten years, I would think Blue Chip would publish that information.

But investors recognize that the longer the projection is, the more uncertain the projection is. So for any given period of time, investors generally look at the most reliable outlook for longer-term projections, and that is best approximated by the consensus ten-year outlooks.

Q. Referring again to the exhibit, Ameren Missouri Exhibit 60 cross exhibit, if you look at the nominal GDP column No. 3, I know you can't see the headings, the far right indicates a value of 4.4. Can you tell me, is that the basis for your long-term estimated growth rate that you replied upon in your multistage DCF in this case?

MS. ILES: Objection. The witness has already said he doesn't rely on this page of the publication.

JUDGE WOODRUFF: I'll overrule that objection. The witness can answer if he can.

THE WITNESS: Give me one second to review my testimony on that.

BY MR. TOMC:

Q. Look at, Mr. Gorman, page 24 of your direct testimony, line 9.

A. Yeah. That's what I was looking at.

I suspect that the last two columns might be the five- and ten-year projections, but I had 4.4 to 4.8, and this is showing 4.4 to 4.7.

Q. **Now, if you look below, and it's Item No. 9 titled corporate profits pretax, No. 9 there, if you look over there on the far-right column, it has a 5 percent value. Do you see that?**

A. I do.

Q. **That 5 percent is higher than 4.4; is that right?**

A. It is. It's a different forecast.

Q. **Are the Blue Chip analyst projections of corporate profits pretax, are those sustainable, Mr. Gorman?**

A. Over the next five and ten years, I would think those profit projections, which are simply earnings projections, may be subject to what the outlook is over the next five- and ten-year period.

Q. **Did you say profits are essentially earnings projections, Mr. Gorman?**

A. Pretax corporate profits.

Q. **I'm asking you about your response. Did you say that profits are essentially earnings projections? Is that what you said?**

A. The earnings are encapsulated in that pretax profit, yes.

Q. I'd like to ask you a few questions about your review of data concerning authorized rates of return as provided by RRA. Are you prepared to discuss that today?

A. I am.

Q. Refer to page 4 of your surrebuttal testimony.

A. I'm there.

Q. Beginning on line 11, you begin a clause that states, investors would expect an authorized return on equity of approximately 9.63 percent. Do you see that?

A. That's part of that sentence, yes.

Q. That 9.63 percent is based on your review of the 2014 electric utility rate decisions that are detailed in your Schedule MPG-SR-1; is that right?

A. It is.

Q. Now, specifically you examined both distribution utilities and vertically integrated utilities together; is that correct?

A. I review it as an industry and draw observations about what commissions are authorizing for electric utility companies that have reasonably similar investment risk.

Q. For the purposes of this exhibit here, Mr. Gorman, and you've included an analysis of distribution utilities and vertically integrated utilities on page 1, and then on page 2 you've included only vertically integrated utilities; is that right?

A. That's correct.

Q. And distribution utilities would include such utilities as ConEd up in New York or ConEd in Chicago or Ameren Illinois in metro east, right?

A. Correct.

Q. And those utilities do not own generation assets, do they?

A. Distribution companies do not, correct.

Q. This --

A. Well, I mean, ConEd does.

Q. ConEd generates steam; is that right?

A. They generate steam and they also have some onsite ancillary service support.

Q. Correct. But for the most part those companies do not own generation in the United

States?

A. For the most part, but it's more complicated than simply categorizing them as vertically integrated delivery companies.

Q. Let's take ConEd and Ameren Illinois over on the Illinois side. Those utilities do not own generation, do they, Mr. Gorman?

A. No. Correct.

Q. Now, utilities that do not own generation do not have the asset risk of operating generation assets, do they?

A. You don't have that risk, that's correct.

Q. You don't have the commodity risk of producing electricity from generation resources; is that right?

A. Not entirely, no. They don't have to buy commodity to make the electricity, but they often have to buy power to resell to customers that take service on a fully bundled basis from the wires company. So from that standpoint they may have commodity risk.

Q. I want to refer you to your deposition on page 39. Beginning on line 15, you told me, so it's a complicated question. Generally

distribution companies don't have the asset risk of owning generation resources, don't have the commodity risk of producing electricity from those sources, and they may not have the purchased power agreement contractual risk associated with meeting their entire native load power demands. Is that what you told me in the deposition?

A. Well, I think we went through this in detail, and I did explain in this same deposition that a wires company can have commodity risk if they're buying power for resale or retail customers on a public service basis.

Q. My question is, Mr. Gorman, do they have the commodity risk of producing electricity, and they do not, do they?

A. They don't produce the electricity, that's correct. But that's not to say that there's no commodity risk included in the total investment risk characteristics of a wires company.

MR. TOMC: May I approach the witness, your Honor?

JUDGE WOODRUFF: You may.

MR. TOMC: This will be Exhibit 61.

(AMEREN MISSOURI EXHIBIT NO. 61 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. TOMC:

Q. Mr. Gorman, I've handed you what's been marked as Exhibit 61. Do you recognize this document?

A. Yes.

Q. This is the most recent Moody's Investor Service credit opinion for Ameren Missouri, is it not?

A. It's the most recent one I'm aware of.

Q. Now, investors would review this type of document, would they not, in making investment decisions?

A. Well, it's a subscription-based document. I would think that most institutional investors would have access to it. If they had access to it, I would think they'd want to review it.

Q. Mr. Gorman, I would refer you to the second page of this document. Do you see the heading marked details ratings consideration?

A. Yes.

Q. Okay. And the first item listed there is environmental compliance in investment becoming a bigger focus. Do you see that?

A. I do.

Q. And if you look in the second paragraph, about the third line, it indicates, its integrated resource plan lays out a proposed investment to achieve CO2 emissions reductions proposed by the EPA by 2035. Do you see that?

A. I do.

Q. We would not expect a wires company with no generating assets to have a similar such statement in it's credit report, would we?

A. I wouldn't expect you would, no.

Q. Given that it's at the top of the detail ratings considerations, is it reasonable to believe that Moody's found this potential operating risk to be something that they would be focusing closely on in the future?

A. I would think that carbon regulation is a concern to credit analysts and they would be looking at all coal-fired utilities in compliance requirements if carbon legislation and carbon rules are placed into effect.

Q. Now, referring back to your exhibit, MPG-SR-1, page 1, the value, the 9.63 percent that you identified in your testimony that we discussed earlier, that is derived from your examination of

this fully litigated rate case column; is that correct?

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

Q. Sure. Let's walk through it step by step here. You see the average 9.63, the bottom right-hand corner of your schedule?

A. Yes.

Q. Is that the source of the 9.63 value you cited on page 4 of your testimony?

A. Yes.

Q. And that is a product of your average of what you've identified here as the fully litigated rate cases average?

A. Under column 12, yes.

Q. And you've included both Ameren Illinois and ConEd return on equity values in your fully litigated column; is that right?

A. I did.

Q. Both of those utilities, as we've discussed, are distribution utilities, correct?

A. Correct.

Q. Both of those utilities are participants in the special formula rate plan that corresponds to the Illinois Energy Infrastructure

Modernization Act, correct?

A. I'm wondering why you put special in there, but they're subject to rate setting based on a formula rate plan based on that infrastructure -- infrastructure regulatory plan in Illinois.

Q. And that's a formula rate plan, correct?

A. It is.

Q. And under that law the return on equity is determined annually by a formula, correct?

A. A market-based formula, that's correct.

Q. And you have been involved in all of those formula rate cases filed by both ConEd and Illinois?

A. Yes.

Q. And you have testified on behalf of industrial consumers in those cases, correct?

A. Industrials, consumer advocates and the Attorney General.

Q. No party has ever contested the rate of -- the return on equity for either ConEd or Ameren Illinois in any formula rate update filing in Illinois; is that correct?

A. Did you say rate of return or return on equity?

Q. No party has ever contested the return on equity of either ConEd or Ameren Illinois in any formula rate update filing in Illinois; is that correct?

A. That's generally correct, unless there was some dispute over whether or not the formula was properly implemented. And I don't recall a dispute of that nature.

Q. There's nothing to litigate because the value is prescribed by formula; is that correct?

A. There's nothing to litigate because the risk premium model is clearly defined and it states the utility will use that rate whether it believes it's too high or too low, and the consumers are obligated to accept it as well.

Q. The 2014 cases that are cited here in your schedule, these were included in your RRA report for 2014 as they were decided in the fourth quarter of that year; is that correct?

A. Yes.

Q. If we were to exclude the ConEd and Ameren Illinois ROE values, the average calculated

9.63 would increase; is that true?

A. Well, it would because those -- both those authorized returns on equity are below the average. So, yes, it would.

Q. Now, if I understand correctly, you were recently involved in a rate case that was settled in Colorado; is that right?

A. Yes.

Q. That was Docket No. 14AL-0663. That was the Public Service of Colorado rate case; is that right?

A. I don't remember the docket number, but there was a settlement with Public Service of Colorado recently, yes.

Q. That was a vertically integrated utility, correct?

A. Correct.

Q. Does the Public Service Company of Colorado have an FAC or similar mechanism?

A. It does.

Q. And the settlement included a 56 percent equity ratio for the cap structure; is that correct?

A. Based on the unique circumstances of that company, that was part of the settlement, yes.

Q. In that rate case the ROE was settled at 9.83 percent; is that right?

A. That was stated in the settlement, yes.

Q. Recovery in that state is allowed for CWIP, correct, structural progress?

A. Not that broadly. There is a new clean air, clean job mechanism that allows for a current return on CWIP.

Q. And you speak of the clean air, clean jobs legislation. That particular legislation provides for recovery of qualifying infrastructure investments and generation retrofits between rate cases, correct?

A. I think that's generally correct. I'd have to check your specific language there, but that's my understanding.

Q. That's recovery pursuant to a rider mechanism, right?

A. It is.

Q. So what kind of investments are recovered between rate cases under the clean air, clean jobs legislation in Colorado?

A. Qualifying investments.

Q. What would those be? Can you give an

example?

A. Not as I sit here, but I think your description of qualifying investments sounds correct.

Q. Isn't it true that you advised your client that the settlement was reasonable and your client agreed with you?

A. It is, based on the final rates included in that settlement, yes.

Q. You were also involved in a settled rate case from last year for Nevada Power and Sierra Pacific Resources, Docket No. 14-05004. Do you recall that?

A. Yes.

Q. And those are the electric utilities that serve Las Vegas, Reno and Tahoe, Nevada, correct?

A. Amongst other -- those are within their service territory, yes.

Q. In that case, your clients also signed on to the settlement; is that right?

A. Yes.

Q. And the return on equity agreed to was 9.8 percent; is that right?

A. It was.

Q. And in Nevada there is similar regulatory treatment for fuel costs comparable to Ameren Missouri's FAC; would you agree?

A. Well, they have a fuel adjustment mechanism there. I have not made a specific comparison to Ameren Missouri.

Q. You believe that riders and fuel adjustment mechanisms shift risk; that is your opinion, right?

A. Absolutely it is, yes.

Q. And if a utility does not have a particular rider, that risk remains with the utility; is that your logic?

A. Well, the rider certainly shifts risk, if that's a risk that is shown to be material.

Q. So if the risk isn't shifted, it stays with the utility, correct?

A. Yes. And the risk is material.

Q. Does Ameren Missouri today on its current tariff books have any kind of infrastructure rider that allows it to recover capital costs between rate cases?

A. I know it has the right to ask for --

Q. I didn't ask you about whether or not

it has the right to ask you for a rider. I asked you, today, does it have a rider mechanism on its books that allows it to recover capital costs between rate cases?

A. I'm not aware of one.

Q. Does Ameren Missouri have a 56 percent equity ratio?

A. Not in this rate case.

Q. Does it have any ability to recover CWIP or any costs associated with CWIP in its rates in the state of Missouri?

A. It has the -- potentially if it can demonstrate a financial need, not necessarily for a current return on CWIP, but what is economically the equivalent. Kansas City Power & Light had a --

Q. Mr. Gorman, if I may, I'm not asking you about the equivalent to CWIP. I'm asking you about construction work in progress. Today, can Ameren Missouri ask this Commission to approve its inclusion of recovery on CWIP in its rates?

A. In order to answer that question, I have to understand what you mean by it. And generally speaking, when you're asking for a current return on CWIP, it's generally to improve the cash position of the utility during a major construction period. And if you're asking whether or not that's possible for a utility within Missouri, my answer is it is possible, because such a regulatory mechanism was approved for Kansas City Power & Light.

Q. I would refer you to your Table 1 on page 6 of your testimony.

A. Direct testimony? Are you in my direct?

Q. I'm sorry. I'm in your surrebuttal testimony. Table 1, page 6 of your surrebuttal.

A. I'm there.

Q. Okay. Mr. Gorman, Table 1 you've titled Ameren Missouri bond yields; is that right?

A. Yeah. It's not a very good title. It's utility bond yield. Thank you.

Q. These figures are not Ameren Missouri's bonds, they're Moody's averages of bonds issued by other utilities, correct?

A. That's correct. Moody's public utility bond yield averages, correct.

Q. My return on equity witness referred to gas utility, so we'll take this correction here for you, Mr. Gorman. Would it be possible -- would it be more accurate to refer to this as a Moody's

average bond yields as an appropriate title?

A. Yes. Thank you.

Q. Okay. Please refer to MPG-SR-2. This is a exhibit that's attached to your surrebuttal testimony.

A. I'm there.

Q. Now, these values listed here, again, they're Moody's average values; is that right?

A. Yes.

Q. And the bonds themselves were issued by various utilities; is that correct?

A. Correct.

Q. And those actual bonds have different covenants, and it has the covenants that are specific to the companies that issued them, right?

A. Yes.

Q. And the bonds would have different terms ranging from 15 to 30 years; is that right?

A. To my understanding, yes.

Q. Now, at the time you prepared your surrebuttal, you did not research the specific issuances included in Moody's; is that right?

A. That's correct.

Q. Now, Mr. Gorman, let me ask you with respect to this data, you did examine more current

data after filing your testimony; is that right?

A. Filing the surrebuttal testimony?

Q. Yes.

A. Yeah. We have that updated study since I filed this testimony.

Q. And if it appears to me by the dates here that Moody's releases this information weekly, would you agree?

A. Yes.

Q. And in recent weeks, Moody's average bond yields have increased, haven't they?

A. Yes. Actually, we responded to a data request from the company that updated this to February.

Q. And that data request showed an increase in Moody's average bond yields; is that right?

A. Small increase, yes.

MR. TOMC: Your Honor, this would be 62; is that correct?

JUDGE WOODRUFF: That is correct.

(AMEREN MISSOURI EXHIBIT NO. 62 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. TOMC:

Q. I've handed you what has been marked

as Ameren Missouri Cross Exhibit No. 62. Do you recognize that document?

A. I do, yes.

Q. Is this the data request that you just mentioned?

A. It is. And thank you for providing this because the yields actually went down, not up. And also, there is a typo on page 1 of this data response. I apologize for it. But in response to bullet A, on the 13K average should be through February 13, not January 23rd. May I make that correction on this schedule?

Q. Point to me again. Is that the --

A. Response A, the yield reflected 13-week average ending -- I'm sorry. I'm sorry. My mistake. I was thinking that was referring to the date on the attachment, but it's not.

Q. Okay. Let's compare this to the surrebuttal exhibit just for a moment. And I see that the last observation in terms of the Moody's average was 1/23/2015?

A. Yes.

Q. Okay. And your updated analysis here provided in discovery in response to the DR, that includes the week ending 1/30/2015, week ending

2/6/2015, the week ending 2/13/2015. Do you see that?

A. Yes.

Q. So the week ending on January 23rd, I see BAA rated yields at 4.33 percent. Do you see that?

A. I do.

Q. And on 2/13/2015, I see BAA rated yields at 4.5 percent. Do you see that?

A. Yes.

Q. 4.5 percent is higher than 4.33 percent, correct?

A. It is, but it's lower than the 13-week average of 4.55. It's also lower than the 13-week average shown in my surrebuttal testimony.

Q. Mr. Gorman, since the time that you filed your surrebuttal testimony, the bond yields that were current as of that date, the average now increased above that value; isn't that correct?

A. Above 4.5?

Q. Above 4.33 percent.

A. For BAA utility bond yields, yeah, I believe that's correct.

MR. TOMC: Your Honor, will this be 63?

JUDGE WOODRUFF: It would be 63.

(AMEREN MISSOURI EXHIBIT NO. 63 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. TOMC:

Q. Mr. Gorman, we have marked for identification a color copy of the Blue Chips document. Do you see that?

A. I do, yes.

Q. And if you turn to the second page of what's been marked as Ameren Missouri Cross Exhibit No. 63, you will see that the blacked-out titles are no longer blacked out.

A. I do.

Q. Do you recognize this document?

A. Yes.

Q. Is this the document you relied upon in the preparation of your testimony?

A. It has the same data I relied on from the same document. So it is the source that I relied on for my testimony.

Q. Thank you. Okay. Now, in January of this year, you offered testimony before the Illinois Commerce Commission concerning the acquisition of People's and North Shore Gas Companies by a company called Wisconsin Electric;

is that right?

A. Wisconsin Electric Corp, yes.

Q. That's a holding company, right?

A. It is, yes.

MR. TOMC: Your Honor, at this time I would like to discuss some highly confidential information. I would ask that we go in-camera.

JUDGE WOODRUFF: At this point we will go in-camera then. If there is anyone in the room that needs to leave, please do so.

(REPORTER'S NOTE: At this point, an in-camera session was held, which is contained in Volume 22, pages 1259 through 1261 of the transcript.)

JUDGE WOODRUFF: All right. We're back in regular session.

MR. TOMC: Thank you, your Honor.

BY MR. TOMC:

Q. Now, Mr. Gorman, I want to ask you a clarifying question with respect to something you said earlier. You said if your analysis was adopted, it would continue to support investment credit rating for Ameren Missouri; is that right?

A. My recommended return on equity and overall rate of return, I believe, yes.

Q. Now, currently Ameren Missouri's investment grade is two notches above speculative; is that correct?

A. Standard & Poor's bond rating now I believe is BBB+.

Q. How many notches?

A. Would be three notches.

Q. Three notches. So there's two notches below it, correct?

A. Yes. Investment grade notches, yes.

Q. Would you agree with me, Mr. Gorman, that it's important that a company not be on the edge of junk bond status?

A. That a company or a utility?

Q. A utility.

A. A utility company to the extent they have not engaged in imprudent or unlawful practices but generally conducted themselves reasonably and prudently, I believe the rate setting process should provide that utility an opportunity to maintain strong credit in its financial integrity.

So there can be situations where I don't believe the customer should be asked to bail out the utility for inappropriate or illegal activity. But with that caveat, I would generally agree with that statement.

Q. And there is no bailout request in this proceeding, at least by the utility in this rate case; is that right?

A. Correct.

MR. TOMC: I have no further questions.

JUDGE WOODRUFF: Okay. Again, we've been going for almost two hours. We'll take a break before we come back for questions from the Bench, and we'll come back at 3:40.

(A BREAK WAS TAKEN.)

JUDGE WOODRUFF: Let's come back to order. We're back from break. Before we do anything else, I wanted to go back to Mr. Tomc and ask him if he wanted to offer 59 through 63.

MR. TOMC: I did want to offer certain exhibits into the record, your Honor, but not all of them. Those would be Ameren Missouri Cross Exhibits 61, 62 and 63. And to tell you what those documents are, I know that there were a number of them proffered, 61 would be the Moody's credit report for Ameren Missouri. 62 would be the Ameren MIEC DR response that is designated as 011. And then 63 is the Blue Chips document that was identified.

JUDGE WOODRUFF: So you're not going to offer 59 and 60?

MR. TOMC: That's correct.

JUDGE WOODRUFF: Just for clarification, I understand 60 is the same as 63 without the blackouts, the unfortunate blackouts?

MR. TOMC: That's correct, your Honor.

JUDGE WOODRUFF: All right.

MS. ILES: Your Honor, I'd object to 61, but no objection to 63 and 60.

JUDGE WOODRUFF: All right. Are we clear?

MS. ILES: I'm sorry. 62 I have no objection to. The only one I'm trying to object to on the basis of hearsay is Exhibit 61, and improper foundation. Have I got it wrong again? That's the Moody's credit opinion.

JUDGE WOODRUFF: 61 is the Moody's credit opinion.

MS. ILES: That's the one I'm objecting to. I'm sorry.

MR. TOMC: Your Honor, I did ask the witness if he was familiar with the document. He indicated he was. The document is probative as to the issues discussed in testimony, and I would submit that it's relevant evidence.

JUDGE WOODRUFF: I'll rule first on 62 and 63. There is no objection to those. They will be received.

(AMERENUE EXHIBIT NOS. 62 AND 63 WERE RECEIVED INTO EVIDENCE.)

JUDGE WOODRUFF: On 61, which is the Moody's credit opinion, I'm going to overrule the objection and allow it into evidence. So it will be received.

(AMERENUE EXHIBIT NO. 61 WAS RECEIVED INTO EVIDENCE.)

JUDGE WOODRUFF: All right. We had some off-the-record discussions before we went back on the record about possibly rescheduling items for tomorrow. Are the parties ready to talk about that on the record?

MR. WOODSMALL: I think in very general terms, and I'll allow others to jump in because things are definitely in a state of flux here. The issues for tomorrow are, as it currently stands, are the non-Noranda class cost of service rate design issues, and there have been discussions along those lines amongst the consumer groups. They haven't been shared yet with Ameren and Staff. We're hopeful of sharing that with them tonight. I don't expect them to be able to give us an answer on that tonight.

So we were hoping to possibly start tomorrow later, maybe after lunch, so we can try to tie those down. The hope is that that won't cause a pinch for anybody because there are other issues in the latter half of this week, specifically depreciation and fuel, that are also close to settlement, and I think Wendy might be able to give more guidance on that.

MS. TATRO: Yes. We've been working

on the depreciation and the net base energy costs for a while, and I think we're just waiting on a couple parties to confirm that they either support or don't oppose those. So hopefully we'll have those and be able to file those shortly.

MR. WOODSMALL: So the long and short is, I think, given the way things are going, we'll have plenty of time in this week even if we don't get tomorrow's issue fully settled.

JUDGE WOODRUFF: Okay.

MR. WOODSMALL: So I guess all we're asking for is to start at one o'clock tomorrow if it is the Commission's desire.

JUDGE WOODRUFF: That sounds reasonable.

MS. TATRO: And you're assuming we get through ROE today, correct?

MR. WOODSMALL: That was my assumption.

JUDGE WOODRUFF: Well, my assumption is we'll push on and finish ROE.

MS. TATRO: That gets it done.

JUDGE WOODRUFF: That will get that done. We'll be out of here by 11:45 at the latest. Okay. I would hope it won't actually go that late.

Okay. We're ready for questions from the Bench for Mr. Gorman. Mr. Chairman.

QUESTIONS BY CHAIRMAN KENNEY:

Q. Mr. Gorman, good to see you again.

A. Nice to see, Chairman.

Q. You were in the room for some of the questions that I asked Mr. Hevert, right?

A. I was, yes.

Q. And I asked him a question about stock prices increasing and what that was indicative of, dividend yields decreasing and interest rates declining. So let me ask you the same questions that I asked him. I think he disagreed with me. So is there -- in your opinion, when stock prices increase, do ROEs decrease?

A. Well, in this instance, I think that is the reasonable conclusion.

Q. Why is that?

A. Let me explain a little bit just to show that some of the parameters identified by Mr. Hevert I agree with.

Q. Okay.

A. Stock prices can increase if there's a significant increase in the expected growth outlook for that stock. So the cash flow outlooks could increase. The discount rate or the cost of capital may not change. But that's not the case here. Growth has increased a little bit, my testimony relative to the last case, but not much. Dividend yields have gone down quite a bit.

Because the price of stock has gone up and the other parameters of the stock have not significantly changed, that's a clear indication that investors have reduced their required cost of capital which has bid up the stock price. So they're willing to pay more for stock for the cash flows expected to be produced from those stocks, from that stock.

It's similar to a bond yield where the utility investor will pay more for a bond at a stated coupon rate, say 6 percent. They may -- the 6 percent is above market. The utility may price that bond up to a price that has an effective yield something closer to market level, something less then 6 percent.

So as the cash flows remain stable, the price goes up, the expected return on the investment comes down. And that same principal holds for common stock.

Q. And is that because there's a

perception of, I don't know, less risk associated with that security?

A. The risk I think is what is attracting so many investors to utility security investments.

Q. Okay.

A. And that competition to buy them is bidding up the price.

Q. I see.

A. Which is making the expected return on those investments come down.

Q. All right. That makes sense. Let me ask the same questions that I asked of Mr. Hevert. Have you testified -- I know you worked for the ICC after college, right?

A. Yes.

Q. And then for Merrill Lynch after that?

A. For one year, yes.

Q. And then with Mr. Brubaker's company?

A. Correct.

Q. Since you've been with Mr. Brubaker's company, have you testified with respect to ROE issues on behalf of a utility?

A. Yes.

Q. How many times?

A. Twice.

Q. And out of how many times total?

A. Over 100.

Q. So less than 2 percent of the time?

A. Yes.

Q. When were those two times?

A. One was for a Wyoming gas company case a number of years ago, and more recently it was a capital structure issue on behalf of a Missouri water utility.

Q. It was a capital structure issue?

A. Yes.

Q. But upwards of 98 percent of the time, though, your ROE testimony is on behalf of an industrial consumer or a consumer organization of some sort?

A. Yes. Generally large industrial or federal executive agencies.

Q. And what's your hourly rate for being here?

A. $235.

Q. And is that the same for your prefiled testimony as for your testimony here at trial?

A. Yes.

Q. At hearing. There's no markup for being here?

A. No.

Q. And I didn't ask this of Mr. Hevert but somebody else did, and I should have asked it. What's your total bill so far for your client, if you can estimate it?

A. Generally, I -- it's between 25 and $30,000.

CHAIRMAN KENNEY: I don't actually have any other questions. I think everybody exhausted all the ones I was going to ask. Thanks for your time.

THE WITNESS: Thank you.

JUDGE WOODRUFF: Commissioner Kenney?

COMMISSIONER W. KENNEY: I just have a couple.

QUESTIONS BY COMMISSIONER W. KENNEY:

Q. Hello, sir. How are you?

A. Good. And you?

Q. Great. I just had a little clarification. I'm trying to understand this. On your surrebuttal testimony on page No. 3, line 17, I think we might have already talked about this.

Someone might have brought it up. As shown in the attached Schedule MPG-SR-1, the authorized returns on equity for electric utility companies, both integrated and delivery companies, range from 9.17 to 10.4 with an average of 9.76. That's for 2014, correct?

A. That is, yes.

Q. Did you hear when I asked Mr. Hevert regarding the average rate of return between 2012 to current and he said it was -- ranged between 9.96 and 10.03? Without having to look at numbers, would you say that's probably a correct number?

A. I actually have it in my testimony.

Q. Oh, you did? I didn't see it. From 2012 on?

A. Yes. Actually, it goes back for a number of years. It's on my Exhibit MPG-11, first column, authorized returns for electric utilities. These are both delivery and integrated. And in 2011 and '12, because that kind of overlaps the last rate case, authorized returns on equity for electric utilities ranged from about 10.07 to 10.01. They dropped by about 25 basis points in 2014 since that time.

Q. Okay. So it was 10.07 to 10.01.

They dropped about 20 basis points?

A. 20, 25, yes.

Q. Okay. So that range of saying maybe between for the cumulative average for '12 to '14 he said 9.96 to 10.03, might be a little high, might be a little -- probably within eight or ten basis points?

A. That's his testimony, but he doesn't limit that to all observations of authorized returns on equity.

Q. All right. And then you went on to say on line 19, as shown on page 1 of Schedule MPG-SR-1, I excluded authorized returns on equity for utility rate cases where the commission either approved a settlement return on equity or simply used the same return on equity in the current case as was approved in a prior case. Under these conditions, industry average return for 2014 was 9.63. Then you went on to say 9.63 is the -- a return that the investors in Ameren would be satisfied with. You said that on the next page.

A. Yeah.

Q. My question, why did you do that? Why did you separate those? What's the reason so I can understand that?

A. Well, in a -- in a settlement proceeding, you know, the customers and the utility come together and negotiate price, terms and conditions. So from the customers' standpoint, the groups I typically represent, we look at the prices within the settlement. We determine whether or not we're willing to pay those prices. The utility will look at it and look at the prices but they'll look at other factors, too, such as the suggestion of what the return on equity is that's included in the settlement.

But importantly, in a settlement you don't build up the revenue requirement by the utility and then take that revenue requirement and produce the settlement rates. In fact, there may be no connection whatsoever between the settlement rates and the stated return on equity in the settlement. May be just completely separate factors that are stated in the settlement.

But all the parties come together and agree on the rates and certain other elements within the settlement and find that that's a fair resolution of all the issues in the case.

Q. So you're saying because I might take one thing and give up another thing?

A. That is correct. That's usually the tradeoff.

Q. Tradeoff. Okay. So that's why you separated them?

A. Yes. In contrast to that, in a litigated proceeding the Commission will make findings on all elements of the revenue requirement. That revenue requirement will then be used to ultimately develop rates. So those rates will reflect all findings of the Commission. That's not the case in a settlement.

Q. Okay. And that's why -- then when you came up with, on the next page on line 5 and 6 you came with Mr. Hevert's chart information, if you removed all those other factors, his rate of return would have been 9.85 percent, if he -- if you removed the settled issues?

A. Right. If you limit it to only vertically integrated utilities rather than all utilities that have similar investment risk, and just look at the vertically integrated utilities with litigated findings, then the ROE would be 9.85.

Q. Okay. So you still believe that, I believe it is reasonable and rational for an

investor to believe that if the Commission is attempting to measure the current market cost of equity for a utility in a rate case, as I believe the Missouri Commission is attempting to do here for Ameren Missouri, investors would expect an authorized return on equity of approximately 9.63 percent?

A. Just based on that data, yes. If they're using that data to gage what other commissions have been awarding utilities based on litigated findings, based on explicit findings of what the current market cost of equity is for utility companies, I think that analysis tells us that the investors would expect something around 9.63.

Q. And that's just right outside the upper limit of your 9.60?

A. Yes.

COMMISSIONER W. KENNEY: Thank you very much. No more questions.

CHAIRMAN KENNEY: Commissioner Hall?

COMMISSIONER HALL: Yes.

QUESTIONS BY COMMISSIONER HALL:

Q. Good afternoon.

A. Good afternoon.

Q. I believe you testified earlier today that if the Commission were to set an ROE below that which you believe is reasonable, that that would have an adverse effect on the utility both in terms of cost of debt and cost of equity; is that correct?

A. It could impact its financial integrity, and it would impact both cost of debt and equity.

Q. It would impact its financial integrity in that it -- its bond rating could be downgraded, so that would increase its cost of debt, and if the ROE was below that which is reasonable, it would make it less attractive to invest in?

A. Right. And its stock price would likely fall and the yield would go up and the equity cost would be impacted as well.

Q. Has there ever been any analysis that you're aware of that looked at an ROE determination to see whether or not it that effect on any utility in any state?

A. Had the effect of increasing the cost of capital?

Q. Yes. Or are those variables too hard

to isolate?

A. Well, I mean, generally it's not based on just the awarded return on equity alone. It's usually a bigger, larger financial issue in a rate case. ROE is a huge issue in this case, but going back to -- well, considering other cases where there's major investments that plan to be brought online and major disallowances of those investments, those are some cases where we saw significant impact on utilities' financial integrity.

You know, it happened to Union Electric in the Callaway investment back in the '80s, and their sister company, Ameren Illinois' affiliate Illinois Power also had large disallowances for a Clinton nuclear plant investment. In both of those instances the utilities were temporarily downgraded below investment grade because the rate structure wasn't supporting full capital on the books. It was just supporting reasonable and prudent investments on the utility on the books.

And it took years for both of those companies and some concessions by the regulators to eventually build their rate structure up to allow them to better support the invested capital recorded on the books, including invested capital that was actually disallowed and written off after regulatory decisions.

There's smaller degrees of similar type impacts on other utilities, but that -- that was a period where we saw significant impact on utilities by designing rate structures which didn't fully reflect their cost -- their cost of service but rather only reflected reasonable and prudent cost of service.

Q. So in other words, ROE is just one of many variables that investors would take into account when evaluating whether or not to invest in the company?

A. Generally, and there's explicit statements by this by Standard & Poor's and Moody's, is the authorized return on equity is important, but the regulatory mechanisms are far more important. They want to know, does the utility have a legitimate opportunity to earn the approved or authorized return on equity. So lower return on equity with stronger regulatory mechanisms is more attractive from a credit rating and investor standpoint than weaker regulatory mechanisms and a higher return on equity.

Q. Looking at page 7 of your surrebuttal, line 16, 17, when stock prices increase, all else equal, utility's cost of capital declines.

A. Yes.

Q. When you say stock prices, you're talking about the stock of the utility? You're not talking about the stock -- not talking about stock prices generally?

A. Well, the publicly traded stock prices of the publicly traded utility company. If everything is held constant, dividend outlook and dividend growth are not expected to change but the price of the stock goes up, then utility investors are willing to receive a lower rate of return for buying that future stream of cash flows. So all else equal, when a price goes up, the cost of capital goes down.

COMMISSIONER HALL: Thank you.

JUDGE WOODRUFF: Commissioner Rupp?

COMMISSIONER RUPP: Thank you.

QUESTIONS BY COMMISSIONER RUPP:

Q. Welcome.

A. Thank you.

Q. In your opinion, what is the biggest risk that vertically integrated utilities face today?

A. There's a lot of discussions on regulatory mechanisms being important risk. You know, we've gone through carbon potential impacts on integrated utility companies. For wires companies, there is the potential for contracting for power supply to resell as a bundled service to sales customers if the state regulatory commissions required them to do that and then not being allowed to charge rates to fully recover that purchased power. That has had a significant impact on distribution utilities' risk.

So right now I don't know if there's one major risk for utility companies because there's so many variables that have significant risk implications for electric utility companies in general. But the risk for a utility is receiving rate structures that fully recover their cost of service. And from a customer standpoint, the ability to pay for utility service and support their load on the system and grow their load is also a risk for the utility and their customers, because if the utility customer can't afford to pay their bill, the utility's investment risk is not going to be very strong.

Q. You had made the statement earlier that capital investment will grow earnings, increase revenues and things of that nature in general. Do you view capital investment that is government mandated for like EPA regulations as still giving that same amount of earnings growth because of those specific type of capital investments?

A. I do, and I appreciate that question because capital investments for complying with carbon taxes and growing demands and retiring older units and replacing new ones is kind of a double-edged sword. It does reflect investment risk because utilities are required to invest. It also gives a utility an opportunity to grow their rate base, which allows them to grow their companies.

So there's risk in making those capital investments, but that's also what they're in business to do. And by doing that, they grow their rate base, they grow their earnings, they grow their dividend paying ability, and they attract investors to that segment because --

Q. Walk me through how they would grow their rate base via the environmental regulation.

A. There would be an increase in capital spending for retrofitting existing generating stations. There would be increase in capital spending if they retired older coal-fired generating stations and replaced it by newer gas-fired stations or some other more modern generation technology.

Those new investments would be added to rate base. Typically there's limited pushback by parties to rate cases because they have to do it to comply with federal or state mandates. After they're included in rate base and the rate structures are adjusted to reflect that larger rate base, the earnings of the utility increase. And as the earnings of the utility increase, the utility's ability to pay dividends will increase.

During the major construction period, there's going to be a little tradeoff and increased earnings and increased dividends because there's a need to retain a lot of earnings to fund that buildup in investment and rate base. So the dividend increase can come later, but eventually it's going to come as the capital investment program either slows down or is not as large a percentage of total capital investment as it was several years ago. And eventually at that point dividends will start to grow.

Q. Okay. And you'd stated that ROE should reflect the risk the company faces, and then it was also stated that riders would shift risk. So with a company like the one we're dealing with here today, without an infrastructure rider or an environmental rider or CWIP or things of that nature, do you believe that this company faces more risk than other companies that have those riders?

A. I don't think so. I think the record shows that with the regulatory mechanisms that are available to the companies, this company, and those which it chooses to use, that it has been able to earn more than its authorized return on equity in the last two years at least.

Back when its rate base was growing at the faster pace, it had more difficulty. But the current regulatory mechanisms have resulted in this utility being able to meet the objective of at least earning its authorized return on equity, and as others from MIEC have shown, it's actually earned more than it's authorized return on equity.

Q. Okay. Looking at the Exhibit 61, the Moody's Investor Service, on page 2, under the detailed rating considerations, end of the first paragraph states, Ameren Missouri currently does not have any specific mechanism for its environmental investment. Without a specific recovery mechanism, we believe Ameren Missouri will have to rely on its general rate cases to recover the prudently incurred environmental investment costs. Would you agree with that statement?

A. I do, but if I can explain that.

Q. Please.

A. A utility that doesn't -- isn't allowed current return on CWIP, that doesn't mean it is not allowed to recover its construction period carrying charge. There's a mechanism called allowance for funds used during construction which allows them capitalize it, include it as part of the cost, the original cost of the plant investment. Then when it's placed in service, all of the direct capital expenditures and the construction period carrying charges are included in rate case. So the rate base is larger and the rate increase is larger because customers are paying return on a larger capital investment and then paying larger depreciation expense for it.

Q. So would I find -- if I looked at other companies that had CWIP and some of these other trackers, would I find that since they have them the rate base would be higher for companies that do not? Is that -- am I following your statement there?

A. It can be, because customers that are required to pay a current return on CWIP are actually prepaying for that asset that hasn't yet been placed in service. So customers pay the same amount of money. They just pay it a lot sooner when they have to pay a current return on CWIP.

There's a factor in measuring the cost to customers known as net present value revenue requirement. Customers will pay the same net present value revenue requirement with a current return on CWIP and without a current return on CWIP. The utility earns the same amount of money over the life of the asset.

It's just customers pay it in a more level basis over the expected economic life of the asset without CWIP compared to some jurisdictions where they're required to pay for part of the asset before it's placed in service.

Q. Looking at your surrebuttal testimony, page 7, following up on a question that Commissioner Hall, had where you stated, further, utility stock -- utility stock prices have increased and their dividend yields have gone down.

Since you filed this, we've had testimony that there's been a 10 percent reduction in utility stock prices of the index, which would then do the reverse on the dividend yield. So if that is the case, would you then need to increase your numbers of what an -- for a higher ROE?

A. Well, no, because that testimony dealt with changes from January to February this year. My analysis in this case dealt with a 13-week period last summer where the prices used there are still lower than they are today. So even if I reflected those lower prices available right now, the dividend yields right now are lower than they are as reflected in my DCF studies.

Even still, the dividends in my DCF studies were lower than they were two years ago when they got a 9.8 percent return on equity. So it's important to distinguish what you're comparing it to. Stock prices got really high for utility companies in January, and they did come back down.

But even the decline in the stock price from February over January is still higher priced than what's reflected in my testimony. My testimony prices are from last year.

Q. Do you in your personal opinion view that that drop in utility stock prices is a trend or as a correction or is just a normal market glitch over the last several weeks?

A. Well, when I do the study, I try to measure what investors think, not what I think, but I think the run up in stock prices beginning in January was unsustainably high. I think the prices have come down to a level where they still might decline a little bit. But the prices I used in my study I believe reflect dividend yields that reflect current cost of capital. They weren't biased by those run up in the prices in January and February.

COMMISSIONER RUPP: That's all I have, Judge.

JUDGE WOODRUFF: All right. We'll come back for recross based on questions from the Bench, beginning with Public Counsel.

RECROSS-EXAMINATION BY MS. BAKER:

Q. I just have a couple of

clarifications. You were talking with Commissioner Hall and I believe some others about regulatory mechanisms and whether you looked at -- whether investors looked at regulatory mechanisms more and whether regulatory mechanisms were one of the biggest risks for vertically integrated utilities. Do you remember that?

A. Yeah. I think the question was, what is regarded as one of the bigger risks right now?

Q. Okay. Whenever we're talking about regulatory mechanisms, you would agree that in the way that Ameren is at the moment coming into this rate case, they do have an FAC in place; you would agree with that?

A. Yes.

Q. And you would agree that they have trackers in place?

A. Yes.

Q. And you would agree that they have the ability to have an environmental mechanism but that they have not taken advantage of that?

A. I do. Correct.

Q. Okay. And you would agree that for the AFUDC that you were speaking of, is that what you had mentioned earlier that Kansas City Power &

Light has available to it?

A. No. That was a regulatory mechanism to support its cash flows during a major construction program. KCP&L did receive what effectively from an economic perspective was the equivalent of a current return on CWIP. They paid more than traditional cost of service to enhance the utility's cash flow while Iatan 2 was being developed, and then that payment during construction period was used to offset the increase in revenue requirement for Iatan 2 after it was placed in service.

That is effectively the same economic result to the utility as giving them a current return on CWIP. KCPL, it is my understanding, does not currently have a fuel clause.

Q. And so as far as Ameren coming into this rate case is concerned, a lot of those regulatory mechanisms it has, so it does not have some of the biggest risk that is facing other vertically integrated utilities?

A. Well, yeah. It has deferred accounting also, which is a regulatory mechanism. And a regulatory mechanism is any kind of price mechanism or cost recovery assurance mechanism that's not available to a non-regulated company. A non-regulated company can't defer things and then charge customers for them later. Non-regulated company can't have line items riders typically where they will adjust the prices for the service to a customer, unless there's contractual provisions that permit.

So regulatory mechanism really describe rate-setting mechanisms that are unique to the utility, and they are all reflected in Ameren's current bond rating.

MS. BAKER: That's all the questions I have. Thank you.

JUDGE WOODRUFF: Consumers Council?

MR. COFFMAN: No questions.

JUDGE WOODRUFF: Staff?

MR. THOMPSON: No questions. Thank you.

JUDGE WOODRUFF: MECG?

MR. WOODSMALL: No questions. Thank you.

JUDGE WOODRUFF: Ameren?

MR. TOMC: Yes, your Honor. Just a couple quick questions.

RECROSS-EXAMINATION BY MR. TOMC:

Q. Just to clarify, there was some discussion about AFUDC allowance for funds used during construction; is that right?

A. Yes.

Q. And once construction is completed, that allowance stops and those carrying costs are no longer incorporated in that capital asset; would you agree?

A. Yes.

Q. And there may be a gap between the time that capital asset is completed and when new rates are approved in a rate case; would you agree?

A. There can be, yes.

Q. And additionally would ask, with respect to AFUDC, between rate cases AFUDC does not provide any cash to the utility; is that right?

A. No. That's the distinction between AFUDC. It provides the utility with the earnings. There's no earnings erosion, but it's an accrual earnings, not cash earnings.

Q. Accrual not cash; is that right?

A. That's correct.

MR. TOMC: I have no further questions.

JUDGE WOODRUFF: Redirect?

MS. ILES: Yes, your Honor.

REDIRECT EXAMINATION BY MS. ILES:

Q. You were asked by several, I think by some of the Commissioners as well as some of the other attorneys here about deferrals, and you stated that the purpose of a deferral is to enhance the likelihood of earning an authorized ROE.

So my question for you, Mr. Gorman, is, is it appropriate to allow recovery of a deferral when the utility has earned its ROE during the period that the expenses included in the deferral were incurred?

A. Generally, that's not consistent with the objective of the regulatory commission -- or the regulatory mechanism. Pardon me. If the utility can expense the costs that are being deferred and still earn its authorized return on equity, then there's really no need for a deferral.

A deferral is designed to protect the utility's earnings in the event the prices the customers are paying don't provide enough revenue to cover that cost. This cost typically wasn't incurred in the last rate case, and that provides a mechanism for the utility to recapture those costs in the next rate case if their current rates don't provide recovery of that cost.

So I don't think it would be consistent with the objective of the regulatory commission to allow a utility to defer expenses during a period where the deferral was not necessary. It could expense those expenses during that period and still earn its authorized return or equity, or some portion of that could have been expensed and still earn the authorized return on equity.

To allow them to defer expenses under those scenarios would allow the utility to essentially recover the cost of those deferrals twice, the revenue they collected during the deferral period and then revenue would be enhanced during the new rate effective period as the deferral was included in the new rate structure.

Q. And Mr. Tomc asked you about your risk-free rate that you used in the last case in your CAPM analysis.

A. Yes.

Q. Do you remember those questions? I believe you stated that the risk-free rate you used in that case was 3.7 percent. I wanted to ask you, what -- I had the impression that you wanted to

explain to us something about the significance of the difference in those rates. Could you explain to us what the significance is and does it make any difference in your analysis in this case?

A. It does, because in the last -- actually in the last few cases, I was concerned about the reliability or the reasonableness of the CAPM return estimates in forming my recommended return on equity range.

And I'm looking at what is -- was marked as one of the cross exhibits. I'm sorry. There's not a number on this, but essentially it's my testimony from the last case. My recommended range for return on equity in that case was 9.2 to 9.4, but my CAPM return estimate in the last case was 8.7 percent.

So that low treasury bond yield resulted in a CAPM return estimate that I felt was too low and, therefore, didn't recognize it when I formed my recommended return on equity range. So the implication from the cross on what the treasury bond yield and implying that somehow it was reflected in the CAPM return estimate concerned me because it suggested that I relied on the CAPM return estimate in the last case, which I did not because I felt the return was too low, and that with the treasury bond being a little higher in this case, I'm producing a CAPM return which falls within my recommended range. So I'm acknowledging somehow that capital market costs have increased in this case relative to the last case.

So I wanted to clear that up because I think that suggestion, that implication in that cross question was disingenuous, because in the last case treasury bond yields were low. They produced really low CAPM return estimates, so I disregarded them. In this case, treasury bond yields are a little higher, CAPM return estimate was a little higher and fell within my recommended range in this case.

So it's the full development of the CAPM return estimate, not just the treasury bond rate, which I consider in developing my recommended return on equity.

Q. Mr. Tomc also asked you a number of questions about your past testimony and the growth rates that you included in your analyses in those cases.

A. Yes.

Q. Do you remember those questions? I

just ask you to comment on your long-term growth rates. I think he pointed out in each one of those that you found short-term growth rates to be higher than what you ex-- what you considered a reasonable long-term growth rate to be; is that correct?

A. It is correct, yes.

Q. Is that -- would you like to comment on whether that's something unusual or is there some reason why the Commission should not take your recommendations into account because of those facts?

A. The circumstances around three to five-year analyst projected growth rates producing DCF return estimates was elevated about ten years ago when the utility industry started making significant capital improvements and the rate base was growing quite significantly.

That's the second time it's happened while I've been in this business. The first time was in the early 1990s when utilities weren't making capital investments because they were anticipating the deregulation of the industry. At that growth rates were really low and DCF returns were really low. So at that time I started using multi-growth-stage DCF to reflect the period of low capital investments followed by a return to more normal capital investments.

In this case, because utilities are making major capital investments and will start to slow over time for two reasons, but because there is an outlook for growth at an accelerated level for a relatively short period and then a decline to a lower sustainable level of growth justifies the use of a multi-growth-stage DCF analysis.

The relative differences in price to earnings ratio which Mr. Hevert was talking about made me challenge the constant growth DCF model based on that one factor also supports use of a multi-growth-stage DCF model because that can reflect the expectation of high growth followed by more sustainable growth later. So that PE ratio indicates placing more reliance on your multistage growth DCF rather than your constant growth DCF.

But the industry ten years ago, with major CAPM programs starting, created something of an overly-- in my judgment, overly optimistic view by credit analysts or security analysts on what the growth rate's going to be for utility companies over the next three to five years.

There is no uncertainty, however,

that that growth would not be sustainable. So each case we've looked at over the last ten years, the three to five year growth rates are likely higher than sustainable long-term growth rates.

What we didn't look at is whether or not the three to five year growth rates were actually achieved by security analysts. So it's not reasonable to conclude that three to five year growth rate should be recognized as long-term sustainable growth rates because there's no measure or whether or not utilities have consistently achieved those three to five year growth outlooks.

But there's significant reasons why it's reasonable and rational to expect that there will be accelerated growth for a period of time that will be followed by a period of more moderate sustainable growth.

Q. Thank you. Mr. Tomc also asked you about, and the Commissioners did, too, about your Schedule MPG-SR-1 where you talk -- where you analyze the 2014 authorized returns on equity for electric utilities.

A. Yes.

Q. Why did you include distribution companies in your analysis on page 1 of that chart?

A. Up until the time you look at this RRA data, all rate of return analysts agree that the rate of return should reflect investment risk. And all rate of return analysts in this case and everywhere I've testified measures investment risk based on bond rating.

I'm not aware of any rate of return selecting companies based on being integrated electric utilities or only distribution electric utilities. Rather, it's investment risk. There are unique operating risks for integrated utility companies, that's true. Asset ownership and some purchased commodity costs are a unique risk to an integrated company.

However, there are similar risks for distribution companies if they're obligated to enter into purchased power agreements and resell that power to its integrated -- or bundled service customers. So there is commodity risk for distribution companies.

Those risks and all other relevant risks for the utilities are encapsulated in the bond ratings of those utilities. So when looking at industry data and determining what an investor would expect for an authorized return on equity for a given level of investment risk, it's better to distinguish the authorized return on equity based on bond rating than it is for integrated utilities versus distribution utilities.

A second reason is, is there's just not that many integrated utility rate cases that weren't settled. Most integrated utility companies find a way to settle their rate cases, so we don't get a commission finding with current market cost of equity. That's not as much the case with delivery companies.

Q. And then on -- in the second half of your right side of the page of your Schedule MPG-SR-1 where you list the fully litigated rate cases, Mr. Tomc asked you about the inclusion of Ameren Illinois and Com Ed in that column, and he specifically asked you about special formula rates, or I believe you corrected him and just said they were formula ROEsthat are used -- were used in those cases.

Why did you include those formula cases? Are they truly fully litigated cases?

A. They are, and I wasn't sure why he was using special formula rates. I wasn't familiar with that term. But the Illinois cases are fully litigated cases. It is true that the return on equity is prescribed by formula, but the formula rate process requires the Commission to only approve a revenue requirement that is based on reasonable cost of service, reasonable and prudent cost of service.

While no party challenged the return one equity formula, all the parties are free to challenge it if they find that the return on equity produces rates which are not just and reasonable.

So there is -- there is some mechanism for the stakeholders in the process to argue to the Commission that the return on equity does not produce a reasonable result or at least the revenue requirement doesn't produce a reasonable result. To my knowledge, neither the utilities nor any stakeholder has requested the Commission review that formula rate process in terms of the return on equity.

There are many other aspects of the formula which have been revisited, but the return on equity mechanism was adjusted once, and I don't believe there's been a request to adjust it a second time.

Q. And do the inputs for the formulas

that are used in those cases, do they include market-based data?

A. Yes. It's a risk premium type methodology that adds a prescribed equity risk premium to average treasury bond yields. So it is based on market factors and prescribed equity risk premium.

Q. You were also asked about a Colorado rate case. Do you remember those questions?

A. Yes.

Q. And I think your testimony in that case was that you represented a client who you advised to settle the case, and the settlement included a 9.83 percent ROE; is that correct? Have I got those correct?

A. Actually, they brought up two cases. One was in Colorado. The other was in Nevada. it was 9.83 in Colorado and 9.8 in Nevada.

Q. Right. And so I think the implication was that that's much higher -- that is a higher ROE than what you're recommending in this case, in the instant case, in the Ameren case. So why did you -- why did you advise your client to accept the 9.8 and the 9.83 ROEs in those cases?

A. In those cases, the rate structure,

the settlement rate structure was judged to be reasonable. And the 9.83, while it was stated in the settlement, did not detract from our finding that we were getting rates which we felt were a balanced outcome of all the issues in the case.

It was not our finding that those rates reflected a 9.83 percent return on equity. Rather, it was just our finding that those rates appeared to be a reasonable resolution of all the issues in the case.

Q. So is this an example of the kind of case, I think when you were answering one of the questions of one of the Commissioners and explaining that there's sometimes a disconnect in a settlement between the ROE that's included in the settlement and the actual rates that are in a settlement, would this case, the Colorado and Nevada cases be examples of that?

A. From our standpoint it is, yes.

MS. ILES: No further questions.

JUDGE WOODRUFF: Okay. Then, Mr. Gorman, you can step down.

(Witness excused.)

JUDGE WOODRUFF: Call up Mr. Schafer.

(Witness sworn.)

LANCE SCHAFER testified as follows:
DIRECT EXAMINATION BY MS. BAKER:
Q. Please state and spell your name for the court reporter.
A. My name is Lance Schafer, S-c-h-a-f-e-r.
Q. And by whom are you employed?
A. I'm employed by the Office of the Public Counsel.
Q. And what position do you hold with the Office of the Public Counsel?
A. I am a Public Utility Financial Analyst.
Q. Are you the same Lance Schafer who filed direct, rebuttal and surrebuttal testimony in this case?
A. Yes, I am.
Q. Do you have any changes or corrections to your testimony?
A. No, I do not.
Q. Is your testimony true and accurate to the best of your knowledge and belief?
A. Yes, it is.
Q. And if asked the same questions today, would your answer be essentially the same?

A. Yes, they would.

MS. BAKER: Public Counsel will move for admission of Schafer direct, both NP and HC versions, 409NP, 409HC, and Schafer rebuttal, Exhibit No. 410, and Schafer surrebuttal, Exhibit 411. And I believe this is his last time to appear, so we will go ahead and offer.

JUDGE WOODRUFF: 409, 410 and 411 have been offered. Any objection to their receipt?

(No response.)

JUDGE WOODRUFF: Hearing none, they will be received.

(OPC EXHIBIT NOS. 409NP/HC, 410 AND 411 WERE RECEIVED INTO EVIDENCE.)

MS. BAKER: We will tender for cross-examination.

JUDGE WOODRUFF: Okay. And for cross, we begin with Consumers Council.

MR. COFFMAN: Welcome, but I have no questions.

JUDGE WOODRUFF: Then for Staff?

MR. THOMPSON: No questions. Thank you.

JUDGE WOODRUFF: MIEC?

MS. ILES: Just one question.

CROSS-EXAMINATION BY MS. ILES:

Q. Mr. Schafer, in your direct testimony on page 4, you provided the results of your analysis of Mr. Gorman's testimony?

A. I'm sorry. Which testimony are you speaking of?

Q. I'm sorry. Your rebuttal.

A. Page 4?

Q. Yes.

A. Thank you.

Q. Could you explain to us, isn't it true that when you made changes to his testimony which you considered to be corrections, your result was a final recommendation of 9.2 percent?

A. Yes, that is true.

MS. ILES: That's all.

JUDGE WOODRUFF: MECG?

MR. WOODSMALL: No questions. Thank you.

JUDGE WOODRUFF: Ameren?

MR. TOMC: Thank you, your Honor.

CROSS-EXAMINATION BY MR. TOMC:

Q. Good afternoon, Mr. Schafer.

A. Good afternoon.

Q. I'd just like to ask you a few

questions, Mr. Schafer, about your relevant experience, if we may.

A. Sure.

Q. I understand this is the first regulatory hearing that you have testified in?

A. Yes, it is.

Q. Welcome.

A. Thank you.

Q. The testimony you have submitted in this case, I understand you've also filed testimony in Empire, but this is the first time you've submitted your direct testimony, prefiled testimony before a regulatory commission; is that right?

A. Yes, that is correct.

Q. And I understand that you have recently graduated from the University of Missouri's MBA program last spring; is that correct?

A. Yes.

Q. Congratulations.

A. Thank you again.

Q. I also understand that you completed one of three phases of the Chartered Financial Analyst exam; is that right?

A. Yes, I have.

Q. Good luck with the next two phases.

A. Thank you again.

Q. Prior to your employment at the Office of the Public Counsel, you have not been employed as a financial analyst; is that correct?

A. That is correct, I have not.

Q. And you have not worked at an investment bank or a depositor bank; is that correct?

A. Again, correct.

Q. You have not been employed in a corporate treasury department; is that right?

A. That's right.

Q. You have not worked as a licensed broker or trader of securities?

A. That is correct.

Q. You have not worked in a position where you were involved in the issuing of debt or equity; is that correct?

A. That is correct.

Q. Now I'd like to ask you about your constant growth DCF model. Your constant growth DCF, you relied upon Value Line, Zacks, and Yahoo Finance for your constant -- or for your growth rates; is that correct?

A. Yes.

Q. And are those reliable sources, in your opinion?

A. Yes, I believe they are.

Q. Would you expect that investors would be aware and review these sources when making investment decisions?

A. Yes. They're publicly available sources that investors have access to, and I believe they would review those sources, yes.

Q. The analyst growth rates that you have identified from these sources, I understand slightly above 5?

A. Yes, that's correct.

Q. The analyst growth rates today that have been projected with respect to the proxy companies are in excess of nominal gross domestic product; would you agree?

A. Are they in excess to my, the estimate of nominal GDP that I used or Mr. --

Q. Let me rephrase the question. The growth rates that analysts are projecting today are in excess of the nominal gross domestic product projections that you rely upon for your third phase of your DCF; is that right?

A. Yes, they are.

Q. If you would refer to page 26 of your direct testimony, line 9, I believe there's a nominal GDP projection of 4.86 percent; is that right?

A. Yes, that's correct.

Q. Now, with respect to -- just for clarification, with respect to the capital asset pricing model that you prepared, you looked at approximately 90 years of financial history in developing that model; is that correct?

A. I looked at from 1926 to 2013.

Q. What was the average gross domestic product on a nominal basis during that period?

A. I looked at historical GDP from 1947 to the present based on the data I obtained from the St. Louis Federal Reserve, and I believe that's around 6.3.

Q. 6.3 percent. Now, the third stage of your DCF incorporates your perspective on what the long-term sustainable growth rate would be; is that right?

A. It actually uses the 100 percent of the nominal GDP. And as far as it is my perspective that 100 percent of the nominal GDP should be used in the third stage, then it reflects my perspective. But that is a perspective that I've adopted from other analysts, and the FERC has given their opinion that that is an appropriate rate to use for a third stage.

Q. With respect to that long-term growth rate, it is your belief, then, that we will not see a return to the 6.3 percent long-term growth rate that we've experienced in the past in this country; is that right?

A. I personally have not calculated long-term GDP. I've used estimates from analysts, estimates that were available from analysts. So whether it's my opinion it will go back to historical GDP at some point in the future, be it a hundred years from now, that didn't come into play in the analysis.

Q. It's quite possible that we could experience economic growth in this country commensurate with past experience, isn't it?

A. Is it possible? The word possible, yes, I suppose. That's simply not what is being projected, though.

Q. The dividend yield is the product of the stock's annualized dividend divided by the

stock price, correct?
A. Yes, that's correct.
Q. And dividends are declared quarterly as a per-share value; would you agree?
A. Yes.
Q. If the stock price goes up, the dividend yield goes down, all else equal, correct?
A. Yes, all else equal, if the dividend doesn't change and the stock price rises, that dividend yield is going to decrease.
Q. You use a 13-week average to measure stock prices, is that correct, for your DCF analysis?
A. Yes, that's correct.
Q. Similar to Mr. Gorman, correct?
A. Yes. Yes. Mr. Gorman also used a 13-week average.
Q. Mr. Hevert used a 30-day, 90-day and 180-day average measurement periods and provided the results of all of those periods, correct?
A. Yes, he did.
Q. Based on a historical perspective, you would agree that utility stocks typically pay a dividend of 4 and a half percent, correct?
A. Yes, I believe that is the -- very

close to the historical average.
Q. You would agree that with respect to your proxy group, the historic dividend yield is 4.37 percent, correct?
A. Yeah, that sounds correct.
Q. You would agree that the Value Line forecasted yield for the proxy group is 4.44 percent, correct?
A. Yes, 4.4 percent.
Q. In your constant growth DCF, you used a 3.5 percent yield; is that right?
A. Yes. That's the yield that was implied by the prices and the dividend that I used in that model.
Q. In your deposition, do you recall that?
A. Oh, yes.
Q. Do you have a copy of your deposition with you?
A. I can obtain one right here.
Q. Certainly. Now, if you recall, I asked you if you had followed the stock prices of your proxy companies after the filing of your surrebuttal testimony, and you indicated to me that you had done so. Do you recall that discussion?

A. Yes, I do.

Q. Your deposition was on February 19th; is that correct?

A. Yes, it was.

Q. You indicated to me in your deposition that the utility industry had traded down in recent days and weeks; is that correct?

A. That is correct.

Q. You indicated to me that the utility stocks had declined 5 to 10 percent; is that right?

A. That is around the neighborhood of where they had declined, yes.

Q. Based on the proxy companies that you looked at, your proxy companies, those company stock prices were affected as well, correct?

A. Yes, they were.

Q. A decline in stock price, all else equal, can be expected to increase dividend yield; is that correct?

A. That is correct, yes.

Q. Would you agree with me that the reason for the downturn in stock prices could potentially be the result of something called sector rotation?

A. I think -- I think we mentioned this

earlier in the deposition, and I said that as far as sector rotation being motivated by an underlying economic condition that investors are following, investors are using to base their sector rotation on, then yes, then that could be -- could be a reason why people are rotating out of one sector into another.

Q. What do you mean by the term sector rotation?

A. Well, a diversified investor is going to hold investments in different industries, different sectors, and is going to find one more favorable at a moment than a different one depending on their projections or how they believe the economy is going to play out in the future. They can literally move into -- move out of the sector they feel is not going to be in favor in the future and move into one that's going to be more favorable.

Q. In recent weeks, would you agree that we have observed swings in treasury rates upwards of 50 basis points over a short period of time?

A. Yes. That's occurred from -- certainly from January to February we've seen rates go from 2.7 to 2.-- around 2.3, then back up to

2.7. I believe at the time of our deposition they were 2.7 again. Today it's at 2.6.

Q. Can investors perceive volatility in bond markets as a risk factor to consider when they're making investment decisions?

A. I believe volatility certainly is a risk factor that investors consider.

Q. You would agree with me that you believe the Federal Reserve will move to increase rates this year?

A. This is one of the things I took in consideration in my direct testimony, and I believe that they are still online to do so, and all of the latest articles I've seen have indicated that they're still hoping for a midyear raise of interest rates.

Q. Utility stocks are typically considered income investments; would you agree?

A. That's correct. Thanks to their high payout ratio and high dividend yields, they are considered an income investment as opposed to a growth investment.

Q. Unlike income investments, growth stocks pay a relatively small dividend or no dividend at all; would you agree?

A. Yes, that is correct. Growth stock is certainly -- as you've characterized it, might not pay any dividend at all.

Q. When looking at growth stocks as compared to utility stocks, you would expect to so higher growth rates, correct?

A. Absolutely. The growth stock by definition is a growth venture.

Q. For companies that are growth stocks, is it true as a general proposition that rather than pay out earnings as dividends, these companies can reinvest earnings to achieve higher rates of growth?

A. Normally a growth company is going to identify expansion opportunities, whether that's overseas or expanding into markets. And so rather than pay out that money to investors, they'd rather capitalize on the opportunity they see to expand into other markets and to put other plant in place. And that's one of the reasons they retain that money and they don't pay it out to investors. Stock price will tend to appreciate rather than reflect -- rather than the company paying out a dividend.

Q. You conducted capital asset pricing

model analysis in this case, as we discussed, right?

A. Yes, I did.

Q. As a general matter, CAPM would measure return on equity in a manner relative to other investment choices that an investor might choose to include in an overall portfolio of investments, correct?

A. Certainly.

Q. And that would include both income and growth opportunities, correct?

A. The market risk premium that is -- the market risk component of that CAPM usually is a measure of the broad general market, the S&P 500 or the NYSE Index. And then what we do is multiply that measure of return over treasury yield by a company-specific number called beta. It measures the systematic risk of the company.

So typically I believe the beta of my proxy group was around .74. So what we do is we take the return for that market and multiply it by .74. So just the fact that that proxy group beta as you can see is lower than one means the volatility is less and the risk is less than the full S&P 500 or NYSE.

So there are measures of those other companies inside that CAPM, but there are company-specific measures also as represented by the beta.

Q. Now, if we were to look at companies in the S&P 500, you would agree with me that with respect to consensus analyst growth rates, it would not be uncommon to find companies with growth rates higher than GDP, correct?

A. Correct.

Q. If we were to examine analyst growth rates today, right now, among S&P 500 companies, it would not be hard to find growth rates of 12, 13 or 14 percent, correct?

A. That is correct.

Q. For example, Apple would be one such company with a three to five year projected growth rate of over 12 percent, right?

A. I believe it was 12.5, yes.

Q. Many companies listed in the S&P 500 are, in fact, multinational corporations; would you agree?

A. Yes.

Q. In your deposition we spoke about the company Home Depot as an example of a company

listed on the S&P 500. Do you recall that discussion?

A. Vaguely, yes.

Q. You indicated to me that -- I'll represent to you, you indicated to me that Home Depot is considering expanding into over countries and would dictate growth -- or dedicate -- I'm sorry. Let me start my question over.

You indicated to me that Home Depot is considering expanding into other countries and would dedicate growth to that end. Do you recall telling me that?

A. I believe I mentioned something about their failed attempt to expand into China.

Q. Let's look at your deposition on pages 46 to 47.

MR. COFFMAN: Your Honor, I'm going to object here. These are questions that Mr. Tomc can ask directly to the witness now. He's here. I'm not sure if this is the proper use of depositions.

JUDGE WOODRUFF: I'll overrule the objection.

BY MR. TOMC:

Q. Okay. So I'm looking on page 46 of

your deposition, beginning on line 23. So we take, just for example, a company like Home Depot. That company would pay relative speaking, in comparison to a utility, a lower dividend and would potentially reinvest more of its capital into its operation. Would you agree with that?

A. That is the question you asked there at line 23, yes.

MS. BAKER: Objection, your Honor. I don't know if he's asking does he agree that that's what it says, is he agreeing with what it means.

JUDGE WOODRUFF: If you can clarify your question. Are you asking him to agree that that was what's in the deposition or are you reasking the question at this point?

MR. TOMC: I'm asking if I read the deposition correctly, to your memory.

MS. BAKER: Your Honor, I think we're getting way beyond. I agree.

JUDGE WOODRUFF: Okay.

MS. BAKER: He can ask questions. He's here. Just ask the question.

JUDGE WOODRUFF: If you're asking the question again, that's fine. I don't think this is the proper use of the deposition in that you're not contradicting anything that he's --

MR. TOMC: I was laying foundation, your Honor. I have one more question to ask. Perhaps that would bring light to the --

JUDGE WOODRUFF: Go ahead and ask your question.

BY MR. TOMC:

Q. In your response to me, Mr. Schafer, you told me, I think Home Depot is still considering expanding into different countries and dedicating growth to that. So I think your statement is fair. Was that your deposition answer?

A. Yes, that was my answer.

Q. Now, if an S&P 500 company does, in fact, dedicate growth outside the U.S., would its growth rate be constrained by nominal U.S. gross domestic product?

A. It sounds like you're asking me how much a foreign GDP would affect an international company's operations.

Q. It's a straightforward question. If an S&P 500 company dedicates growth outside the U.S., would its growth rate be constrained by nominal U.S. GDP?

A. I believe Home Depot's performance is going to be reflected in GDP.

Q. But would the company's growth be restrained by U.S. GDP?

A. Well, to the extent that it's going to grow outside the United States, for example, if it would enter into a country like India and find success there, it's just fairly speculative.

Q. Is the market for capital today a global market?

A. Yes, it is.

Q. The capital asset pricing model estimates market risk premium based upon a calculation of the total market return, correct?

A. Yes.

Q. In your CAPM analysis, I believe you utilized both a geometric and an arithmetic average. I want to ask you about arithmetic average. The arithmetic average market return for the S&P 500 you relied upon is 12.2 percent; is that correct?

A. It was either 12.2 or 12.1.

Q. What was your source of the arithmetic average?

A. The SBBI. It's a publication by

Morningstar.

Q. **Mr. Hevert utilized several sources of data to calculate his ex-ante market risk premium. One of those sources was Value Line; would you agree?**

A. I believe Mr. Hevert used three to five year earnings growth rates in order to calculate his market risk premium from Value Line and from Bloomberg.

Q. **And one of those sources being Value Line is a source that your also relied upon, albeit for different purposes, right?**

A. Yes. I used Value Line as well.

MR. TOMC: I'm thinking, your Honor, we're at 64.

JUDGE WOODRUFF: That sounds right. Yes, 64.

MR. TOMC: May I approach the witness?

JUDGE WOODRUFF: You may.

(AMERENUE EXHIBIT NO. 64 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. TOMC:

Q. **This document that I've placed before you, do you recognize this to be a portion of**

Mr. Hevert's analysis that was included in his testimony in this case?

A. Yes, it is. It's the second half of his Schedule R-9, RBH-R-9.

Q. In looking at this Ameren Missouri Exhibit No. 64, you see at the top, ex-ante market risk premium, and it identifies Value Line at the top in the title?

A. Yes, I see that.

Q. You reviewed this document in the preparation of your testimony; is that right?

A. Yes, I did.

Q. And first let me ask you, the word ex-ante you would agree just means forward looking, right?

A. Yes, it does.

Q. And based on the Value Line consensus analyst data, that Mr. Hevert calculates a market average expected return of 12.75 percent, correct?

A. That is what he's calculated, yes.

Q. You'd agree with me, Mr. Schafer, that whether the average return is 12.1, 12.2 or 12.75, some component of that return can be attributable to growth, correct?

A. Yes.

Q. Growth rates for both income investments as well as stocks; is that right?

A. That's correct.

Q. Growth rates for both domestic corporations and international companies, correct?

A. Yes.

MR. TOMC: I have no further questions.

JUDGE WOODRUFF: Okay. Did you wish to offer 64?

MR. TOMC: Your Honor, that particular document's already in the record. It was included in Mr. Hevert's testimony.

JUDGE WOODRUFF: All right. We'll come up for questions from the Bench, then. Mr. Chairman?

CHAIRMAN KENNEY: Mr. Schafer, thanks for your time. I don't have any questions.

THE WITNESS: Thank you.

JUDGE WOODRUFF: Commissioner Hall?

COMMISSIONER HALL: I have no questions. Thank you.

JUDGE WOODRUFF: Commissioner Rupp?

COMMISSIONER RUPP: No questions, but on your time out of the gate, you did a very good job.

THE WITNESS: Thank you very much.

JUDGE WOODRUFF: Then there were no questions from the Bench, so no need for recross. Any redirect?

MS. BAKER: I do just have a couple of things.

REDIRECT EXAMINATION BY MS. BAKER:

Q. You were asked about swings in treasury rates. Did you look at treasury rates in your analysis?

A. Yes, I did. And one thing that's worth noting is that I was looking at treasury rates. I and two of the other analysts are, in fact, using a forecasted treasury rate for our analysis, because often the question I've heard come up is, well, if these things increase right now, would that necessitate a modification to your model?

Well, three of the analysts in this case have used a forecasted rate, which is up in the 4 percents. So the fact that the treasury rate right now is 2.6 or that it was 3.2 exactly when we turned in our analysis, well, that projected rate which is projected to occur from various sources over the period of sometime within the next five years, we factored that in to our models. So I would definitely not want you to have the impression that as soon as these rates start going up, that somehow the models that the analysts turned in here are invalidated. Certainly mine's already taken into consideration an increase in treasury rates.

Q. And along with that analysis, is volatility included in your analysis as well?

A. The volatility analysis -- the volatility I looked at in the analysis was one of the prime reasons that I shifted to a projected rate.

Q. And have you found -- you were asked about growth rates that exceed GDP. Do you remember that?

A. Yes.

Q. Have you found utility growth rates that exceed GDP?

A. I have certainly not found long-term, and by long-term I mean more than three to five years. These three-to-five-year estimates are alternatively referred to as long-term by certain analysts. They're referred to as three to five.

They'll be referred to as first stage growth rates, depending on what their juxtaposing those rates against.

In other words, when we're discussing GDP as a long-term estimate, three to five is no longer the long term. So I definitely recommend keeping in mind what exactly an analyst means by long-term when he or she states long-term.

Yes, I've not seen long-term projected growth rates, that is to say beyond these three to five years, that are going to significantly exceed GDP say, for example, over 40 years. In fact, we see -- we see at least recommendations to the contrary, that these should not exceed nominal GDP in the long term.

Q. And you were asked some, I'll describe them as convoluted questions about Ameren being compared to Apple and Ameren being compared to Home Depot. Is Ameren anything like Apple or Home Depot?

A. Yeah, I find those questions a little bit confusing. I suppose the best way to categorize this is, I believe what the implication is is that since there are growth companies in the S&P and, in fact, utilities do compete for capital, we somehow need to compare utilities to the -- directly to growth companies in the S&P.

This is not really the case. We use that information for the CAPM to establish a market risk premium, and then we use beta, which is the company-specific number, in order to find out what portion that we should be applying, what portion of that market risk premium we should be applying in order to determine the ROE.

So companies like Apple, high-growth companies that are in the S&P are included in the analysis we do via the CAPM.

Q. And you were asked a little bit about your choice to do both an arithmetic average and a geometric average. Could you explain why you chose to do both of those?

A. Yeah. I chose to do both because basically if -- if the arithmetic means were unflawed representations, independent representations of each year's return, basically just to set the stage a little larger, I looked at returns from 1926 to 2013 to try to discover historically what the return was.

Well, SBBI, Morningstar offers -- two numbers it offers, the geometric mean and it offers the arithmetic mean. Now, if these years were completely independent of each other, the arithmetic would probably be the perfect one to go with. The geometric is always a little bit lower.

As it turns out, there is significant negative auto correlation between these numbers. That is to say, if there's one very high year, it's typically -- there's a larger chance it will be proceeded by a low year and vice versa. In other words, these years are not independent.

So instead of relying on one, I've relied on the average of both, because it represents the most -- most investor sentiment, I believe. Analysts are relying on both of these numbers, and really to exclude one of them for the other one completely would not really give the full picture of the way analysts feel.

MS. BAKER: I have no further questions.

JUDGE WOODRUFF: Mr. Schafer, you can step down.

(Witness excused.)

JUDGE WOODRUFF: We have one more witness. We'll take a short break before we bring up Mr. Murray, and we'll come back at 5:15.

(A BREAK WAS TAKEN.)

JUDGE WOODRUFF: Let's come back to order, please. We're back from our break and Mr. Murray has taken the stand. I'll ask you to raise your hand and I'll swear you in.

(Witness sworn.)

JUDGE WOODRUFF: Thank you. You may inquire.

MR. THOMPSON: Thank you, Judge.

DAVID MURRAY testified as follows:

DIRECT EXAMINATION BY MR. THOMPSON:

Q. State your name, please.

A. David Murray.

Q. And how are you employed?

A. Utility Regulatory Manager in the Financial Analysis Unit for the Missouri Public Service Commission.

Q. Are you the same David Murray that prepared or caused to be prepared a portion of the Staff Cost of Service Revenue Requirement Report NP and HC --

A. I am.

Q. -- that has been designated as Staff Exhibit 202?

A. Yes.

Q. And also prepared or caused to be prepared what has been designated as Exhibit 227, the rebuttal testimony of David Murray, and Exhibit 228NP and HC, the surrebuttal testimony of David Murray?

A. Yes.

Q. And do you have any corrections to those testimonies?

A. I do, and please be patient. I've got a few things to go through.

Q. Which item do you need to correct?

A. In the Cost of Service Report under the rate of return section which I sponsored, on page 19, line 25, it indicates the compound average annualized return for the utilities index was 13.91 percent. That's actually 15.41 percent.

And here's the part that may pose a little more problems. For whatever reason, a section of the multistage DCF testimony explaining the overview of the test -- of the model was accidentally left out of the report.

Q. Let me --

MR. THOMPSON: May I approach?

JUDGE WOODRUFF: You may.

BY MR. THOMPSON:

Q. Let me show you a document, Mr. Murray, and ask you if you recognize that?
A. I do.
Q. What do you recognize that to be?
A. I recognize that to be the section that is missing that explains the multistage DCF and gives an overview of the results.
MR. THOMPSON: What exhibit number are we up to, Judge?
JUDGE WOODRUFF: 245.
MR. THOMPSON: This will be Staff Exhibit 245, and it is the missing section of the description of the multistage DCF method from Staff's Revenue Requirement Report.
(STAFF EXHIBIT NO. 245 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)
BY MR. THOMPSON:
Q. Do you have any other corrections?
A. I do, and I apologize. I actually left a copy of my schedules up on my desk when I just went to go use the restroom, and that has some of the other corrections I need to make. Is it all right if I be excused for -- just take a minute, just to go grab it?
JUDGE WOODRUFF: We'll go off the

record for a moment.

(AN OFF-THE-RECORD DISCUSSION WAS HELD.)

JUDGE WOODRUFF: We're back on the record. Mr. Murray is back on the stand.

MR. THOMPSON: Thank you, Judge.

BY MR. THOMPSON:

Q. Mr. Murray, did you say you had some other corrections?

A. Yes, I do. In the schedules attached to the Staff Cost of Service Report, I believe it's Appendix 2, Schedule 14-1 through 14-3, I actually -- whenever I originally had prepared these schedules, it was at a later date than whenever I had done the initial analysis in the body of the testimony. So a couple of growth rates were not updated, and so I noticed that when I was reviewing my testimony.

So I'll just go into the three companies in which the growth rate is a little bit different for growth in years one through five, which is identified in column 2. For column 2, Great Plains Energy, the growth rate should be 4.78 percent rather than 4.95 percent. For Southern Company, the growth rate should be

3.71 percent rather than 3.68 percent. And for West Star Energy, the growth rate should be 3.38 percent rather than 2.13 percent.

If you prefer, I can just tell you how that affects the final results instead of going into all the details. The final cost of equity estimate using that multistage is 7.28 percent rather than 7.25 percent, which is the average of all those companies. And then the average without Cleco and Wisconsin Energy is 7.42 percent rather than 7.38 percent. So not a material change in my opinion.

And then those same -- those same growth rates would need to be corrected in Schedules 14-2 and 14-3, and I'll just give you -- if it's okay, I'll give you the final results again. Schedule 14-2, the total average is 7.67 rather than 7.64, and the average without Cleco and Wisconsin Energy is 7.8 rather than 7.77. And for Schedule 14-3, the result is 8.9 -- or excuse me. 8.06 rather than 8.03, and then 8.19 rather than 8.15.

Again, because I looked at multiple different types of analyses to evaluate the change in the cost of equity, multiple proxy groups, I really did not consider this to be a material issue for purposes of estimating that the cost of equity had declined by about 25 to 75 basis points since Ameren Missouri's last rate case.

Q. Is that all of your corrections, Mr. Murray?

A. Let me just make sure on rebuttal and surrebuttal. I don't believe there is, but just to refresh my memory.

The only other one is in surrebuttal, on page 15, line 10, we need to delete -- there needs to be a question mark after "fairly valuing securities", and delete the "to determine the required return over securities." There's some duplication. It just doesn't make sense the way it's worded.

Those are the only corrections I need to make.

Q. Very well. With those corrections in mind, Mr. Murray, is your testimony true and correct to the best of your knowledge and belief?

A. Yes.

Q. If I were to ask you the same questions today, would your answers be the same?

A. Yes.

Q. And are you scheduled to testify again in this proceeding?

A. I am not.

MR. THOMPSON: Therefore, Staff moves to -- Staff offers Exhibit 227, Exhibit 228NP and HC and Exhibit 245 and tenders Mr. Murray for cross-examination.

JUDGE WOODRUFF: 227, 228HC and NP and 245 have been offered. Any objections to their receipt?

(No response.)

JUDGE WOODRUFF: Hearing none, they will be received.

(STAFF EXHIBIT NOS. 227, 228NP, 228HC AND 245 WERE RECEIVED INTO EVIDENCE.)

JUDGE WOODRUFF: And for cross-examination, we begin with MIEC.

MS. ILES: No questions, Judge.

JUDGE WOODRUFF: Public Counsel?

MS. BAKER: Yes.

CROSS-EXAMINATION BY MS. BAKER:

Q. Good evening?

A. Good evening.

Q. You've determined that a reasonable return on equity for Ameren Missouri is between

9.00 percent and 9.50 percent; is that correct?

A. Reasonable allowed return on equity, yes.

Q. And your recommendation for ROE is 9.25 percent; is that correct?

A. Yes.

Q. And this determination is based on your expert analysis of market-driven data using traditional analytical tools?

A. Yes.

Q. And anywhere within the range of 9.00 and 9.50 you believe is a reasonable return?

A. Yes.

Q. And you would agree that during the local public hearings, there have been a lot of customer concern over the affordability of rates; is that correct?

A. That's my understanding.

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

A. Yes.

Q. On February the 20th, 2015, just before the hearing began, Staff filed a reconciliation of the positions for various issues

in this case; is that correct?

A. I don't remember a specific date, but I do know the Staff filed a reconciliation.

Q. Have you reviewed that reconciliation?

A. I have. It's been some time.

MS. BAKER: Okay. May I approach?

JUDGE WOODRUFF: You may.

BY MS. BAKER:

Q. I have a copy of the reconciliation that was filed in the case. If you could look that over. And I realize that since the hearing began, there have been some settlement agreements that may have affected the values that are shown on Staff's February 20th reconciliation. But for demonstrative purposes, do you see that the reconciliation includes reconciliations of positions of the various parties on the issue of return on equity?

A. I do.

Q. And according to this reconciliation from Staff, Staff's recommendation of a return on equity at 9.25 percent would lower the company's revenue requirement by just over 69 million; is that correct?

A. Yes.

Q. And so the calculation of the impact of MIEC's position of 9.3 percent ROE in this reconciliation would be to lower the company's revenue requirement by just over 65.4 million?

A. Yes.

Q. And similarly, according to this reconciliation, the impact of OPC's position of 9.01 percent ROE would be to lower Ameren's revenue requirement by just over $82 million?

A. Yes.

Q. And you would agree that Public Counsel's recommended ROE of 9.01 percent is within your reasonable return on equity range for Ameren Missouri?

A. Yes.

Q. And so you would agree that at an ROE of 9.01 percent, Ameren would receive a reasonable return on equity and customers would save approximately $82 million per year?

A. If things are normal, yes.

MS. BAKER: No further questions.

JUDGE WOODRUFF: Consumers Council?

MR. COFFMAN: No questions. Thank you.

JUDGE WOODRUFF: For Ameren?

MR. TOMC: Yes, your Honor.

CROSS-EXAMINATION BY MR. TOMC:

Q. Good evening, Mr. Murray.

A. Good evening.

Q. Do you have a copy of your deposition with you?

A. I do.

Q. Now, as you took the stand today, you went through a list of corrections to your testimony, including an additional page or two. I just want to ask you for the purpose of clarification, has there been any change in your underlying recommendation in this case?

A. No.

Q. So your changes with respect to your corrections do not affect your recommendation to this Commission; is that right?

A. They do not.

Q. Now, would you agree with me that the measurement of the cost of equity is essentially a measurement of investor expectations?

A. I don't -- I think that needs to be defined a little more specifically.

Q. So in other words, the measurement of

the cost of equity is essentially a measurement of investor expectations in the sense of what is required of investors to invest in a utility?

A. I agree with the required aspect, the requirement of investors.

Q. And the requirement of investors would necessarily be a product of their expectations with respect to what their investment choices might be, right?

A. I think the requirement is going to be -- is going to be considered along with what they believe their expected returns could be for a given investment. I mean, a required return could be 6 percent and they could expect a return of 9 percent. And so if they believe that that's not factored into stock prices, then they will buy that security. I believe there should be a distinction of the definition between expectations and requirement.

Q. Staff has recommended the Commission set Ameren Missouri's return on equity equal to 9.25 percent in this case; is that right?

A. Yes.

Q. This is an increase from Staff's recommendations in the last case; is that right?

A. The point estimate, yes.

Q. And that point estimate in Ameren Missouri's last rate case was 9.0; is that correct?

A. Yes.

Q. Sitting here today, you believe that the cost of equity has declined since the last case; is that right?

A. Yes.

Q. And you do not believe Ameren Missouri's cost of equity actually is 9.25 percent, right?

A. Yes.

Q. You are not recommending that the Commission approve a return on equity equal to what you actually believe the cost of equity to be?

A. That is correct.

Q. You believe a high end estimate of the cost of Ameren Missouri's equity would be 8 percent; is that right?

A. I'd have to look at -- let me look at the multistage. Multistage is the main methodology I relied upon for estimating the cost of equity, and --

Q. Mr. Murray, if you could refer to your deposition on page 64.

MR. THOMPSON: I object. He didn't allow him to answer, finish answering that last question.

JUDGE WOODRUFF: I'll sustain that objection.

THE WITNESS: My multistage cost of equity estimate was between 7.6 and 8.37, midpoint about 8 percent. So that's my cost of equity estimate using multistage DCF.

BY MR. TOMC:

Q. Mr. Murray, if you could please refer to page 64 of your deposition, specifically line 15, or actually line 11. I asked you, the actual cost of equity that you believe to be substantially less than 9.25 percent; is that right? Your answer was yes; is that correct?

A. Yes.

Q. By at least 125 basis point; is that correct? Your answer was, let me see here. Yes. Based on multistage, the DCF results, 8 percent is what I provide for a cost of equity estimate. Was that your answer?

A. Yes. It's consistent with what I just answered, yes.

Q. And then I asked you, and you would

characterize that 8 percent estimate as conservative; is that right? And you said, conservative at the high end. Is that what your --is that how you characterize that? Confirmed your correction. Your answer on page 65 is yes; is that correct?

A. Yes.

Q. Now, you believe the cost of equity for utility companies today ranges between 6 and 8 percent with the actual cost being closer to 6 percent; is that right?

A. Yes. In the 6 percent range, that's correct.

Q. If the Commission were to actually set the company's cost of equity to 6 percent, is it fair to say that investment analysts would perceive this as a negative development?

A. Yes.

Q. You are not aware of any instance in which any commission in any jurisdiction authorized a return on equity for a vertically integrated utility between 6 and 8 percent; is that right?

MR. THOMPSON: Objection. That's not Staff's recommendation in this case either.

MR. TOMC: It's in his testimony,

your Honor.

JUDGE WOODRUFF: I'm going to overrule the objection. He didn't ask what was Staff's position.

THE WITNESS: Repeat the question, please. Sorry.

BY MR. TOMC:

Q. You are not aware of any instance in which any commission in any jurisdiction authorized a return on equity for a vertically integrated utility between 6 and 8 percent; is that right?

A. Not since 1980. That's when data's been compiled. Before then we didn't know. I believe that's what our conclusion was was data was not compiled before 1980.

Q. For clarification purposes, you're not aware of a decision in 1980 that approved a return on equity of between 6 and 8 percent?

A. I'm not aware of any period between 1980 and current where anything lower than 6 to 8 was approved. I'm just indicating that we discussed that there was no data compilation before the period of 1980. We discussed that in the deposition, I believe.

Q. And just to be clear, you're not

aware of any cases ever before 1980 where a Commission set an authorized return on equity for a vertically integrated utility between 6 and 8 percent?

A. I don't know of a source to look for for that.

Q. Refer to page 32 of the Staff Report.

A. Yes.

Q. Line 4 through 6. The average consensus long-term growth rates for the broader proxy group is currently 5.74 percent as compared to 5.6 percent for the refined proxy group; is that right?

A. That's an accurate replication of the FactSet five-year earnings per share forecast for my proxy group.

Q. You relied upon SNL Financial and a company called FactSet for your analyst growth rates; is that correct?

A. Well, I think we clarified this during the deposition as well. SNL Financial receives information from FactSet. SNL does not actually compile or does not actually produce the estimates. FactSet receives the estimates from equity analysts, provides them to SNL Financial, and through our subscription to SNL Financial, we receive the FactSet estimates.

Q. Mr. Murray, is this the type of information that investors and finance professionals would recognize as authoritative in the finance industry?

A. For looking at earnings per share forecast, sure.

Q. Would investors reference SNL and potentially FactSet information when evaluating investment choices?

A. I'm sorry. Did you say evaluating or valuating?

Q. Would investors reference SNL and/or FactSet information when evaluating investment choices?

A. If the question is evaluating with e-v-a-l-u-a-t-i-n-g as the spelling, I agree, yes.

Q. You did not use 5.74 percent or 5.6 percent in your constant growth DCF; is that correct?

A. I did not.

Q. Instead, you chose to use 3.5 percent; is that right?

A. 3 and a half to 4 and a half percent.

The point estimate would be 4 percent, midpoint.

Q. And, in fact, for Ameren Missouri you believe the current growth rate is probably closer to 3 percent; is that right?

A. (REPORTER'S NOTE: The answer was moved to the in-camera transcript.)

JUDGE WOODRUFF: If it was highly confidential, we'll have it taken out of the transcript. Just tell me.

MS. TATRO: Yes, please do that.

MR. TOMC: Can we go in camera for just a moment, your Honor?

JUDGE WOODRUFF: We can. And I'll direct the -- before we do that, I'll direct the court reporter to remove that last statement of the witness from the public transcript and put it into the highly confidential portion.

(REPORTER'S NOTE: At this point, an in-camera session was held, which is contained in Volume 22, pages 1353 through 1354 of the transcript.)

JUDGE WOODRUFF: All right. I'll come back into regular session. We are back in regular session, if somebody would let the people who just left come back in. You can inquire.

MR. TOMC: Thank you.

BY MR. TOMC:

Q. Mr. Hevert, Mr. Gorman and Mr. Schafer all relied upon consensus analyst growth rates that were greater than 5 percent in their constant growth DCF analysis; isn't that correct?

A. I don't recall if they relied on it for their estimate. I know that -- as far as their cost of equity recommendation, I know that they included it with -- they simply just added the growth rate plus the dividend yield to come up with the cost of equity estimate.

Q. Do you review commission orders with respect to return on equity for past Ameren Missouri rate cases as you prepared to testify in the proceeding?

A. Yes.

Q. In the past few cases, is it fair to say that the Commission has found your recommendation to be too low?

A. Yes.

Q. Is it also true that your recommendations are routinely below national average authorized returns generally?

A. Yes.

Q. If I understand correctly, you believe that pervasively among utility regulatory jurisdictions, including this jurisdiction, there is a hesitance to recognize the true cost of equity; is that right?

A. Yes.

Q. For those commissions that set return on equity numbers above 9 percent, you believe those jurisdictions are wrong if they believe that they are approving an ROE consistent with what the actual cost of equity is?

A. Yes.

Q. Now, you would agree that investors are aware of ROEs authorized by commissions, including this commission, right?

A. Yes.

Q. You would agree that, because of this, investors have come to expect a return between 9.5 and 10 percent; is that right?

A. Maybe last year. I think from this

point forward, 9 and a half would be more of what I think investors would expect. I think that that's pretty widely recognized. I mean, it's not real hard to understand with interest rates declining, price to earnings ratios increasing, obviously the cost to issue equity is declined for utilities.

So that past average is based on a different capital market environment. So I -- I mean, I have it in my testimony that, even from investors themselves, that they expect some compression in allowed ROEs.

Q. Would you refer to page 55 of your deposition, line 12. Question: If this commission or any other commission were to set a return equal to 6 percent as an allowed authorized rate of return, do you believe that investment analysts that you mentioned would react negatively, positively or neutral? And your answer was negatively; is that right?

A. Yes.

Q. Now, there was a follow-up question. I asked you, why would that be? And your answer, first line of your answer is, because they come to expect a 9 and a half to 10 percent return on equity; is that right?

A. Yes. That was -- that's just the first line. I said I believe there's going to be come compression in allowed ROEs due to the simple fact the capital market situation that we have right now, interest rates. Actually, I believe it's in my testimony that Ameren Missouri's own long-term utility bond yields are trading over the counter at 3 and a half percent.

So even though the average was 9 and a half to 10 percent recently, I believe that the capital market evidence supports that -- and investment commentary supports that 9 and a half is probably something that would be reasonably expected.

Q. So sitting here today, your opinion has changed since your deposition was taken, and you believe that, based on what you know, investors would expect a 9.5 percent return on equity; is that right?

A. I don't believe my position has changed. I said 9 and a half to 10 percent, and I said that they've come to expect that because that's the way the capital markets were before 2014.

Right now all the commissions

throughout the country are debating this capital market evidence. And so when, you know, when they realize that the interest rate levels have dropped significantly, price ratios have increased significantly, that going forward they would expect it to be closer to 9 and a half percent if not lower. I mean, that was based on talking about 2014 time period.

Q. Now, Mr. Murray, if we are to accept the premise that investors have come to expect a return of 9.5 percent, with that understanding, investors would then expect a return higher than what Staff is recommending in this case; is that right?

A. It's at the top end of Staff's recommended range.

Q. It would certainly be higher than the point estimate of 9.25 percent?

A. Yes, it's higher.

Q. You conducted a multistage DCF analysis, and part of that analysis contains what you believe to be the long-term growth expectations of investors, correct?

A. Yes.

Q. What was the growth rate that you

used in the third stage?

A. 3 to 4 percent.

Q. Now, I understand if I've read the Staff Report correctly, you believe the long-term rate of growth to actually be about 2 percent; is that right?

A. Most of what I've reviewed with investment analysts shows 2 to 2 and a half percent, consistent with inflation.

Q. And that is why on this corrected new portion of your testimony that was provided today on line 13 of the first page, you indicate, in fact, in Staff's experience, most DCF analysts do not assume a growth rate much higher than the expected rate of inflation, currently 2 percent to 2.5 percent; is that right?

A. That is correct.

Q. Now, 2 percent would be consistent with what we would expect in terms of rate of inflation, right?

A. Yes.

Q. Sitting here today, you believe that investors purchase stock with the expectation of no real growth, and the only compensation they would be provided would be through the dividend yield; is

that your opinion?

A. That exceeds the -- that's a real return of 3 and a half percent with bond yields of 1 and a half to 2 percent and a 2 percent nominal growth rate, I mean, they've have a nominal return of close to 6 percent. I mean, take 2 percent in inflation off that, it's a real return of 5 percent. I believe that that is a pretty good return in this environment.

Q. Now, sitting here today, in candor, you do not believe that this Commission would approve a return of equity of 6 percent, do you, Mr. Murray?

A. No, I do not.

Q. You do not believe that they would return a return of equity of 8 percent; is that right?

A. No, I do not.

MR. TOMC: Your Honor, I think Mr. Murray has answered my questions, and at this point I have no further cross-examination.

JUDGE WOODRUFF: Questions from the Bench, Mr. Chairman.

QUESTIONS BY CHAIRMAN KENNEY:

Q. Mr. Murray, good evening.

A. Good evening.

Q. Just a few quick questions. I think most of the folks in the room have used the phrase return on equity and cost of equity interchangeably. I think I even the exchange that you just had with Mr. Tomc would reveal that. You don't use those terms necessarily synonymously, correct?

A. If I did, I should not have. I think it's very important to distinguish the two.

Q. Please do.

A. The allowed return on equity, when he was talking about expected returns, there's no doubt in my mind, I've reviewed investment analyst reports that indicate that they expect commissions to allow returns of 9 and a half to 10 percent or, you know, I believe they might be -- and there's information that reveals that they believe the commissions will start lowering the allowed returns to about 9 to 9 and a half percent, somewhere in that range, because the capital market evidence just supports it.

But their cost of equity, their required return that they use to discount cash flows, there is a spread between the cost of equity and allowed return on equity. I mean, I said I've actually reviewed well-respected, qualified investment analysts in Wall Street, buy side, sell side, that indicate that they -- the allowed returns they come to -- they've gotten used to allowed returns having about a 250 to 300 basis point spread. If it gets a little too wide, they expect it to narrow.

It doesn't mean that they believe that the -- like as he mentioned, the 6 percent of cost of equity, it doesn't mean that they're going to deem that fair and reasonable. But there is -- there's very little dispute in the investment analyst world that the cost of equity is lower than allowed returns.

Q. So the 6 to 8 percent that you were just discussing, that's your estimation of the cost of Ameren or another utility to actually go out in the market and acquire equity financing?

A. On multistage it's 8 percent. I provide some what I consider commonsense tests by just looking at the bond yields and just realizing that, you know, basic characteristics of a utility stock, it's a yield -- it's a yield investment, and history has shown that about two-thirds of the returns for utility stocks come from the dividend portion of the return, not the capital appreciation.

So for a growth rate, for expected growth rate in the stock price to be higher than the dividend yield, it just -- it defies the basic characteristics of what utility stock should be. So point being is, while I have my multistage and I do have a constant growth DCF which shows about 8 percent cost of equity, what I'm saying is if you look at some of these what I consider straightforward and commonsense tests as to what would you expect to -- what would an investor really require when they go into the markets with a 3 and a half percent bond yield and they're investing in utility stock that has bond-like characteristics and you know the capital gains have been less than the dividend portion of the return, the expected return on your portfolio is going to be about 6 percent for utilities.

It's -- and that's -- like I said, that is pretty commonly understood in the investment community. That does not mean that they expect commissions to set the allowed returns at that level.

CHAIRMAN KENNEY: Okay. That's all I have. Thank you.

JUDGE WOODRUFF: Commissioner Kenney?

COMMISSIONER W. KENNEY: No questions.

CHAIRMAN KENNEY: Commissioner Hall?

QUESTIONS BY COMMISSIONER HALL:

Q. Good evening, Mr. Murray.

A. Good evening.

Q. How would you characterize the regulatory environment in Missouri compared to other states?

A. Generally, it's considered to, you know, have constructive outcomes for the report and orders. I believe there's more of a concern about the legislative aspect with -- as far as respect to the construction work in progress and the historical test year, you know, as to whether or not that is causing utilities to have some regulatory lag. One of the things I'm not sure about with the regulatory lag, that's just a matter of time value of money. It's not -- it's not a problem with the actual ultimate recovery, because if you expect to recover the cost, the lag should be just a time value of money issue.

But no, it's -- it is recognized that we're probably -- we're within the average category, and I think S&P might even do some rank order. I don't think Moody's does a rank order. But we're not -- we're not in the top of the average. We're in the lower part of the average category, and so -- but, you know --

Q. Lower part of the average, what do you mean by that?

A. We're not -- we're not the median of the average. There's a lot of states in the average. I don't have the document in front of me. But there's a lot of states in the average. FERC is in the above average because they are very generous in their regulatory ratemaking treatment. But yeah, I can't tell you exactly where we're at.

Q. I'm sorry. So we are below the median?

A. Below the median in the average category, which like I said, that's based on Standard & Poor's. But RRA has us, I believe, in the average category.

Q. Okay. Well, how significant is it that we have anti-CWIP provision in Missouri law from your perspective?

A. I think Mr. Gorman mentioned this earlier. Actually, whenever a company has faced a significant project such as building a power plant, the Iatan 2 power plant, that the parties came together and recognized the need for cash flow during the period of the investment because it was a five-year project, significant investment.

So there was -- the ratemaking was considered extra cash flow needed by just looking specifically at the credit metrics that are evaluated by rating agencies. I think that the funds flow from operations to debt was the main rating cash flow metric that drove the need or the perceived need at least for additional cash flow above and beyond what traditional ratemaking would have allowed.

So, I mean, that obviously didn't produce the amount of AFUDC that needed to be booked, but there are -- I mean, within -- within the confines of a, you know, a settlement, there have been ways in which Staff and other parties have worked with the companies to try to make things work even though there are certain statutory issues.

Q. Did you perform an average market

yield calculation?
A. A dividend yield or -- I'm sorry.
Q. I believe this was a term that Ameren's expert used to compare the dividend and stock growth of a non-regulated company to a regulated company. I may have gotten that wrong.
A. Yeah. I'm sorry. I don't recall that specific.
COMMISSIONER HALL: Okay. I have no further questions.
JUDGE WOODRUFF: Commissioner Rupp? All right. We'll come back for recross based on questions from the Bench, beginning with Public Counsel.
MS. BAKER: No questions. Thank you.
JUDGE WOODRUFF: Consumers Council?
MR. COFFMAN: No questions.
JUDGE WOODRUFF: MIEC?
MS. ILES: No questions.
JUDGE WOODRUFF: Ameren?
MR. TOMC: No questions, your Honor.
JUDGE WOODRUFF: Any redirect?
MR. THOMPSON: I think a little bit, Judge. Thank you.
REDIRECT EXAMINATION BY MR. THOMPSON:

Q. You recall you were asked by Mr. Tomc about whether you believe Ameren Missouri's cost of equity is, in fact, below the amount you have recommended that the Commission set as an allowed return on equity; is that correct?

A. Yes.

Q. I wonder if you could explain, do you believe that commission-awarded returns on equity are generally above the actual cost of equity of the companies concerned?

A. Yes.

Q. And do you believe there has been a reluctance on the part of commissions to lower their awards to reflect the changing financial market?

A. Yes. I believe that's widely recognized. I mean, sometimes it's a gradual process.

Q. So do you believe that commissions tend to look at what other commissions are awarding?

A. Yes.

Q. And does that have the effect of artificially reducing the flexibility or the volatility of awarded ROEs?

A. Yes.

Q. Now, I think you explained that you absolutely do not expect this Commission to award an ROE of 6 percent, do you?

A. No, I do not.

Q. Or 8?

A. No, I do not.

Q. If the Commission awards an ROE within the range that you have proposed, do you believe that all requirements of Hope and Bluefield will be met?

A. Yes.

MR. THOMPSON: I think that's all I have. Thank you, Mr. Murray.

JUDGE WOODRUFF: Then thank you very much, Mr. Murray. You can step down.

(Witness excused.)

JUDGE WOODRUFF: And that concludes the ROE issue. General acclaim from the audience.

MR. THOMPSON: We're happy to put that issue to bed, Judge.

JUDGE WOODRUFF: All right. And then that concludes the hearing for today. We'll resume tomorrow at 1 p.m.

I N D E X

RETURN ON EQUITY

OPC'S EVIDENCE:

LANCE SCHAFER

STAFF'S EVIDENCE:

DAVID MURRAY

AMERENUE'S EXHIBITS

	MARKED	REC'D
EXHIBIT NO. 16		
Direct Testimony of Robert B. Hevert	1062	1118
EXHIBIT NO. 17		
Rebuttal Testimony of Robert B. Hevert	1062	1118
EXHIBIT NO. 18		
Surrebuttal Testimony of Robert B. Hevert	1062	1118
EXHIBIT NO. 59		
Direct Testimony of Michael Gorman, Case No. ER-2007-00021225		
EXHIBIT NO. 60		
Blue Chip Economic Indicators	1231	
EXHIBIT NO. 61		
Moody's Investors Service Credit Opinion	1241	1265
EXHIBIT NO. 62		
Data Request No. MIEC-011	1254	1265
EXHIBIT NO. 63		
Blue Chip Economic Indicators	1257	1265
EXHIBIT NO. 64		
Ex-Ante Market Risk Premium Market DCF Method Based - Value Line	1326	

STAFF'S EXHIBITS

	MARKED	REC'D
EXHIBIT NO. 227		
Rebuttal Testimony of David Murray	18	1340
EXHIBIT NO. 228NP/HC		
Surrebuttal Testimony of David Murray	18	1340
EXHIBIT NO. 245		

C E R T I F I C A T E

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

I, Kellene K. Feddersen, Certified Shorthand Reporter with the firm of Midwest Litigation Services, do hereby certify that I was personally present at the proceedings had in the above-entitled cause at the time and place set forth in the caption sheet thereof; that I then and there took down in Stenotype the proceedings had; and that the foregoing is a full, true and correct transcript of such Stenotype notes so made at such time and place.

Given at my office in the City of Jefferson, County of Cole, State of Missouri.

____

Kellene K. Feddersen, RPR, CSR, CCR

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P