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Witness:	Billie Sue LaConte
Sponsoring Party:	Missouri Energy Group
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Case No.:	ER-2011-0028
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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a	)	
AmerenUE for Authority to File Tariffs Increasing	)	Case No. ER-2011-0028
Rates for Electric Service Provided to Customers	)	
In the Company's Missouri Service Area.	)	

REBUTTAL TESTIMONY

OF

BILLIE SUE LACONTE

ON BEHALF OF

MISSOURI ENERGY GROUP

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a AmerenUE for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers In the Company's Missouri Service Area.	))))	Case No. ER-2011-0028

Affidavit of Billie S. LaConte

STATE OF MISSOURI)
)
COUNTY OF ST. LOUIS)

Billie S. LaConte, being of lawful age and duly affirmed, states the following:

1. My name is Billie S. LaConte. I am a consultant in the field of public utility economics and regulation and a member of Drazen Consulting Group, Inc.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony consisting of Pages 1 through 22.

3. I have reviewed the attached Rebuttal Testimony and hereby affirm that my testimony is true and correct to the best of my knowledge and belief.

Billie S. LaConte

Duly affirmed before me this 25th day of March, 2011.

Notary Public

My commission expires on August 7, 2013.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

CAROL J. INSALACO
My Commission Expires
August 7, 2013
St. Louis County
Commission #09486213

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REBUTTAL TESTIMONY OF BILLIE SUE LACONTE

CASE NO. ER-2011-0028

Introduction and Overview

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A Billie S. LaConte, 8000 Maryland Avenue, Suite 1210, St. Louis, Missouri.

Q ARE YOU THE SAME BILLIE S. LACONTE THAT FILED DIRECT TESTIMONY IN THIS CASE?

A Yes.

Q ON WHOSE BEHALF ARE YOU SUBMITTING THIS TESTIMONY?

A I am presenting it on behalf of the Missouri Energy Group (MEG).

Q WHAT TOPICS ARE COVERED IN THIS EVIDENCE?

A This testimony discusses the recommended return on equity (RoE) by Ameren Missouri (AMMO) witness Robert Hevert and the recovery of energy efficiency costs discussed by AMMO witness William Davis, Missouri Public Service Commission Staff (Staff) witness John Rogers and the Department of Natural Resources (DNR) witness Laura Wolfe.

Q PLEASE SUMMARIZE THE MAIN POINTS OF YOUR TESTIMONY.

A They are:

- The return on equity proposed by AMMO's witness, Mr. Hevert, is too high. It is based on some assumptions that are unrealistic and adjustments that are unnecessary.
- The collection of energy efficiency costs should remain the same and the Company should not receive approval for a lost fixed costs recovery mechanism.

Evaluation of Company's Analysis

Q WHAT RETURN ON EQUITY (ROE) DID MR. HEVERT RECOMMEND?

A He said that the return should be in the range of 10.50% to 11.25% and recommended 10.90%. That is what AMMO has requested.

Q WHAT IS THE BASIS FOR THIS LEVEL OF RETURN?

A Mr. Hevert based his recommendation primarily on two Discounted Cash Flow (DCF) methods. He also used two Capital Asset Pricing Models (CAPM) and two Risk Premium (RP) methods to assess the reasonableness of his DCF results. He said that in choosing a specific number in the range he also "takes into consideration: (1) the regulatory

environment in which the Company operates; and (2) the Company's reliance on coal-fired generation far in excess of my proxy group" (Hevert Direct, Page 4, Lines 1-3).

Q DO YOU AGREE WITH MR. HEVERT'S METHODOLOGY AND RESULTS?

A All witnesses in this proceeding use the same methodology; DCF, CAPM and RP are all standard methods (or formulas) that have been used for years. Where people differ is in the choices of the inputs: the group of comparable companies; the time period for calculating stock price; the estimated growth rate (or rates); the stock beta and so on. Those choices affect the numerical results. Where I (and other witnesses) differ from Mr. Hevert is in the values of some inputs and, therefore, the results.

Q PLEASE SUMMARIZE THE POINTS ON WHICH YOU DIFFER WITH MR. HEVERT.

A The growth rates and payout ratios that he used in his DCF analysis are too high. In the RP analysis, his use of an "adjusted" risk premium overstates the required return. Likewise, his beta in the CAPM method is overstated.

Discounted Cash Flow Analyses

Q HOW DID MR. HEVERT PERFORM HIS DCF ANALYSES?

A Mr. Hevert used two DCF analysis methods: (1) a single stage DCF method based on a constant growth rate (based on averages of analysts' forecast growth rates); and (2) a

three-stage DCF method that uses three different growth rates for near-term, intermediate- and long-term. In each method, he used three values for analysts' growth rate: the lowest, the average and the highest.

Q WHAT ARE MR. HEVERT'S DCF RESULTS?

A The results are:

Table 1

AMMO RoE Based on DCF Analysis (Hevert)

	RoE
Constant growth	9.59%-11.93%
Three-stage growth model	10.28%-10.86%

Single Stage DCF Method

Q DO YOU HAVE ANY COMMENTS ABOUT MR. HEVERT'S SINGLE STAGE DCF?

A Yes. His DCF analysis provides a range of RoE estimates, from 9.59% - 11.93%. His growth rate estimates for this purpose were an average of estimated earnings per share growth by Value Line, Zacks.com and Thomson First Call. The low end of his range is based on the lowest forecast growth rate provided by the analysts, the average is based on the average of the analysts' forecasts and the high end is based on the highest of the analysts' forecast growth rates. The average growth rate for each range is:

Table 2

Analysts' Forecast Growth Rates (Hevert)

Low	Average	High
4.58%	5.69%	6.71%

The problem here is that the highest growth rates, 6.71%, exceed his forecast GDP growth of 5.75%. This is not sustainable. Even the average, 5.69%, is almost equal to his forecast GDP growth. Staff used a GDP rate of 4.0%-5.0%. While in the short term a company may grow faster than GDP, in the long term it is unrealistic to expect a company's growth to exceed GDP growth.

Three-Stage DCF Method

Q PLEASE DESCRIBE MR. HEVERT'S THREE-STAGE DCF ANALYSES.

A Mr. Hevert used two three-stage DCF analyses to estimate AMMO's return on equity. Both analyses use three growth estimates, as compared to one growth estimate for the single stage DCF analysis. Each estimates two different terminal values: (1) the expected dividend in the final year divided by the cost of equity less the long-term growth rate (Gordon model); and (2) the expected earnings per share in the final year multiplied by the median historical P/E ratio (Terminal P/E model).

Q WHAT IS THE ESTIMATED ROE USING HIS THREE-STAGE METHODS?

A The estimated RoEs are:

Table 3

Calculated Return on Equity (Hevert)

	Average		Median	
Avg. Stock Price	**Gordon Model**	**Terminal P/E Model**	**Gordon Model**	**Terminal P/E Model**
30 day avg.	10.69%	10.28%	10.70%	10.04%
90 day avg.	10.83%	10.56%	10.92%	10.43%
180 day avg.	10.86%	10.63%	10.86%	10.47%

Q PLEASE DESCRIBE THE ASSUMPTIONS USED IN MR. HEVERT'S THREE STAGE ANALYSIS.

A Mr. Hevert estimated the growth for each period using different methods. The first stage (near-term) growth rate is an average of analysts' forecast growth in earnings per share. The third stage (long-term) is the forecast long-term GDP growth rate of 5.75%. The second stage (intermediate-term) growth rate is the geometric average of the first stage and third stage numbers.

These estimates are used in his model to calculate future earnings per share and dividend pay-outs. Once these are calculated, the model uses these figures to estimate the return on equity.

Q DO YOU HAVE ANY OTHER COMMENTS ABOUT THE ASSUMPTIONS USED IN MR. HEVERT'S THREE STAGE ANALYSIS?

A Yes. Mr. Hevert stated that the payout ratio used in his three stage analysis represents the median historical payout ratio for his proxy group (67.5%). However, it is actually the median historical payout ratio for a much larger group of utilities than his comparable companies group (54 companies versus his comparable group of eleven companies). The median payout ratio for his proxy group is actually higher, 73%.

Q WHAT IS THE EFFECT OF THE HIGHER PAYOUT RATIO?

A It increases the estimated RoE for each of his three stage DCF analyses by about 20 basis points (using the true median payout ratio in his 90-day Gordon model produces an RoE of 10.75%, as compared to the 10.56% in his testimony).

Q SHOULD HIS RECOMMENDED ROE BE HIGHER?

A No. As Mr. Hevert pointed out in his testimony, US utilities are facing large capital expenditures in the next 10-15 years; this will likely lead to *lower* payout ratios. Payout ratio is the ratio of dividends per share to earnings per share. Companies may need to reduce their dividends to cover their increased capital expenditures and also maintain sufficient cash flow. (AmerenMissouri's parent company, Ameren Corporation, cut its

dividend nearly 40% in February, 2009.) Estimating AMMO's return on equity using a model that includes overly optimistic payout ratios results in an unrealistic RoE.

Risk Premium Method

Q WHAT RISK PREMIUM METHODS DID MR. HEVERT USE?

A He used two risk premium methods, using projected and current 30-year long-term utility debt yields plus the utility equity risk premium. These methods were used to "assess the reasonableness" of his DCF analyses.

Q WHAT ARE THE RESULTS OF HIS RISK PREMIUM ANALYSES?

A The results are:

Table 4

RoE Using Risk Premium Method (Hevert)

Projected 30-year Treasury	10.88%
Current 30-year Treasury	10.82%

Q PLEASE DESCRIBE THE RISK PREMIUM METHOD.

A The risk premium is (1) the average of electric utility authorized RoEs for each year in the period 1992-2010 (3rd quarter) (average = 11.12%), minus (2) the corresponding 30-year long-term treasury yield for the same year (average = 5.62%) to determine the

annual risk premium. This produces an average risk premium of 5.50% (11.12% - 5.62% = 5.50%). However, Mr. Hevert used an *adjusted* risk premium based on a regression analysis that shows a "strong negative relationship between risk premia and interest rates". He adjusted the risk premium upward to a range of 6.40%-6.82% (depending on the long-term, risk-free rate).

Q DO YOU AGREE WITH HIS RISK PREMIUM METHOD?

A No. The risk premium method uses actual, historical data to calculate the actual, historical equity risk premium for utilities. There is no need for adjustment. Using the historical data, the RoE is:

Table 5

Risk Premium Method to Estimate AMMO's RoE

	Using Current Bond Yield	Using Forecast Bond Yield
Bond yield	4.00%	4.48%
Utility risk premium	5.50	5.50
RoE	9.50%	9.98%

CAPM Method

Q PLEASE COMMENT ON MR. HEVERT'S CAPM ANALYSES.

A Mr. Hevert estimated AMMO's RoE using two CAPM methods. Again, he said that these analyses were calculated to "demonstrate the reasonableness" of his DCF analyses. CAPM is also a risk premium method, but it uses the historical *average market risk* premium (MRP) for all stocks instead of a utility risk premium. It then adjusts the market risk premium by the utility's beta (degree of variability relative to the market as a whole).

Q WHAT ARE THE RESULTS OF MR. HEVERT'S CAPM ANALYSES?

A The estimated RoEs are:

Table 6

AMMO RoE Using CAPM (Hevert)

	Sharpe MRP	**Ex-Ante MRP**
Current Beta		
Current 30-year rate	12.93%	12.26%
Near term 30-year rate	13.41%	12.74%
Historic Beta		
Current 30-year rate	11.15%	10.61%
Near term 30-year rate	11.63%	11.09%

Q WHAT IS THE RISK-FREE RATE USED BY MR. HEVERT?

A He used the same risk-free rates as in his Risk Premium analyses.

Q WHAT IS THE MARKET RISK PREMIUM USED BY MR. HEVERT?

A Mr. Hevert estimated the market risk premium using two forward looking (ex-ante) estimates. Typically the market risk premium is the historical difference between the return on the market *on average* and the risk-free rate. The market risk premium calculated by Mr. Hevert ranges from 9.32% to 10.08%, compared to the historical market risk premium of 6.7%.

Q WHY DID MR. HEVERT USE EX-ANTE ESTIMATES OF THE MRP?

A Mr. Hevert states:

> *In addition, as a result of the extraordinary loss in equity values during 2008, the Market Risk Premium, when measured on a historical basis, actually decreased from the prior year, even though other measures of investor sentiments, including market volatility and credit spreads, indicated extremely high levels of risk aversion. That result is, of course, counter-intuitive. While the 2009 market rally resulted in a somewhat higher Market Risk Premium, it still remains below its pre-financial crisis level.* (Hevert Direct, Page 34, Lines 15-20)

Although the decrease in the MRP in 2008 may be "counter-intuitive to investor sentiments," this does not discredit the validity of all of the historical market risk

premium data. His estimated MRPs far exceed the historical market risk premium and, therefore, over-estimate the return on equity using the CAPM analysis.

Q WHAT BETA DID MR. HEVERT USE?

A Mr. Hevert estimated the beta using six months of data for each utility in his proxy group. The average of this calculation is 0.886. He also employed the average of the betas calculated by Bloomberg (which represents two years of data) and Value Line (which represents five years of data), or 0.709.

Q WHY DID MR. HEVERT ESTIMATE BETA USING SIX MONTHS OF DATA?

A He states:

> *Current market conditions are such that the volatility of the proxy group stock prices has been increasing relative to the broad market. Consequently, Betas calculated over a more recent time period provide a more current view as to investors' perspectives with respect to 'systematic' risk.* (Hevert Direct, Page 37, Lines 19-23)

Q DO YOU AGREE?

A No. The average beta of his comparable group was 1.00 in September, 2007 (as reported by Value Line, which represents five years of data) and in July, 2008, the average was 0.836. The average beta as reported by Bloomberg and Value Line (as shown above) is now 0.709. Although his six month analysis shows a convergence of the

covariance between the S & P 500 and his comparable group, the Value Line/Bloomberg data shows the opposite, i.e., the comparable group is *not* as volatile as the broader market. Therefore, the 0.886 beta should not be used.

Q BASED ON YOUR RECOMMENDED CHANGES, WHAT IS THE RETURN ON EQUITY FOR AMMO USING THE CAPM?

A The return on equity for AMMO, using the CAPM and Bloomberg/Value Line beta is:

Table 7

AMMO RoE Using CAPM

		Current 30-Day Treasury	Projected 30-Day Treasury	Average
1	Risk-free rate	4.0%	4.5%	
2	Market risk premium	6.7%	6.7%	
3	Beta	x 0.709	x 0.709	
4	MRP times beta	4.8%	4.8%	
5	Return on equity	8.8%	9.2%	9.0%

Line 5 equals Line 1 + Line 4.

Since CAPM is used to assess the reasonableness of the DCF results, this analysis shows that his recommendation of 10.90% is, in fact, not reasonable and should be lower.

Relative Risk

Q PLEASE COMMENT ON MR. HEVERT'S DISCUSSION OF AMMO'S RISK AS IT RELATES TO ITS REGULATORY ENVIRONMENT AND GENERATION PROFILE.

A Mr. Hevert states that Missouri's regulatory environment and AMMO's amount of coal-fired generation, as compared to the comparable group, increase AMMO's risk. Therefore, he recommends a higher RoE of 10.9%, to compensate the Company for this additional risk.

Q DO YOU AGREE WITH HIS ASSESSMENT?

A No. Mr. Hevert compares AMMO to his group of comparable companies based on S & P's ranking of credit supportiveness (Hevert Direct, Schedule RBH-E7). Based on this rating, he shows that AMMO's rating of 2 (less credit supportive) is below the average of his comparable group, 2.87 (which is between less credit supportive and credit supportive). However, response to MIEC 5-2, Attachment 22, Fitch Ratings-U.S. Utilities, Power, and Gas Outlook 2010 December 4, 2009, Page 22, shows that Union Electric Company is rated above the segment median (segment median includes investor-owned integrated electric utilities).

Q DOES THIS MEAN THAT AMMO IS LESS RISKY THAN ITS COMPARABLE GROUP?

A Not necessarily. It merely points out that while S & P interprets AMMO's regulatory risk as higher than average, Fitch interprets AMMO's overall risk as below the median risk. Therefore, an upward adjustment to AMMO's return on equity due to its risk profile is not needed.

Q PLEASE COMMENT ON MR. HEVERT'S DISCUSSION REGARDING AMMO'S GENERATION PORTFOLIO.

A Mr. Hevert states that due to AMMO's high concentration of coal units in generation portfolio, the Company has greater risk than those in his comparable group and should therefore be compensated for this in its return on equity. He points out that in 2008, 76.6% of AMMO's net generation was from its coal units, as compared to the proxy group's average of 63.7%. Furthermore, he points to the likelihood of carbon emission regulation as another factor that affects AMMO's risk.

AMMO's net coal generation was about 77% of its total generation in 2008; however, its coal plants represent 52% of its operating capacity (MIEC 5.1). AMMO has other options available to supply its customers if carbon emission regulation would increase the cost to operate its coal plants; furthermore, AMMO may pursue upgrades to its coal plants that would reduce its carbon emissions. While the upgrades may be

costly, AMMO may pass through the costs of those upgrades in between rate cases via an environmental cost recovery mechanism, of which the Company is currently seeking approval. Therefore, no adjustment to AMMO's return on equity is needed due to its concentration of coal plants.

Q PLEASE SUMMARIZE YOUR ANALYSIS OF MR. HEVERT'S RECOMMENDED RETURN ON EQUITY.

A Mr. Hevert's recommended RoE for AMMO of 10.9% is too high. His DCF analyses include growth rates that are too high, are based on incorrect data, and include overly optimistic assumptions about payout ratios for utilities that will be facing higher capital expenditures in the next 10 years. These assumptions produce a recommended RoE that is too high. Mr. Hevert's Risk Premium and CAPM analyses, which are used to determine the reasonableness of his DCF analyses, over-estimate the risk associated with utilities, which results in RoEs that are too high. After adjusting the risk component to better reflect the risk faced by utilities, the risk premium and CAPM analyses demonstrate that the results of his DCF analyses are not reasonable and should be lower. AMMO does not have higher risk due to its regulatory environment or higher concentration of coal generation. Therefore, Mr. Hevert's recommendation of a 10.9% RoE for AMMO should be rejected.

Energy Efficiency Costs

Q BRIEFLY DESCRIBE THE MISSOURI ENERGY EFFICIENCY INVESTMENT ACT (SB 376).

A The Missouri Energy Efficiency Investment Act (MEEIA) is located in Section 393.1124 of Senate Bill 376 (SB 376) that was signed by Governor Nixon on July 13, 2009. The law was passed to, among other things, "provide timely cost recovery for utilities" of investments in cost effective, energy efficiency and/or demand side programs.

Q HOW DOES THE MEEIA AFFECT THIS CASE?

A The utility must use a method to collect its energy efficiency costs that meets the requirements of the MEEIA. Specifically, the MEEIA provides for the utilities to collect energy efficiency costs the same way it would collect supply side costs; i.e., energy efficiency costs are amortized over a period of time and the utility is allowed to collect a return on the unamortized portion.

Q WHAT IS AMMO'S PROPOSAL?

A It proposes that the amortization period for the collection of its energy efficiency costs be shortened from six years to three years and also requests the approval of a lost Fixed Cost Recovery Mechanism (FCRM).

Q WHAT IS THE FCRM?

A The FCRM "seeks to recover fixed costs that the utility would normally expect to recover through the sale of energy absent the implementation of energy efficiency programs" (Davis Direct, Page 8, Lines 9-11).

Q HOW WILL THE FCRM AMOUNTS BE CALCULATED?

A The FCRM will equal the overall revenue requirement by class, less revenues from customer charges and net fuel costs. The remainder represents fixed costs that are collected through volumetric and/or demand rates. This will be expressed as a cents/kWh rate and would be multiplied by the energy efficiency impacts.

Q WHAT ARE THE ENERGY EFFICIENCY IMPACTS?

A In his testimony, Mr. Davis states that the FCRM should not be based on the performance of its energy efficiency programs, but "should be made whole for the reductions in fixed cost recovery created by the *existence* of its energy efficiency programs, regardless of the performance of any particular program" (Davis Direct, Page 10, Lines 5-7, emphasis added).

Q PLEASE EXPLAIN.

A The Company will estimate the impact of its energy efficiency programs. Whether those programs are effective or not is of no consequence. At the end of the year, based on AMMO's estimates, the FCRM cents/kWh rate will be multiplied by the estimated impact of its programs and those additional revenues will be collected from customers.

Q WHAT IF AMMO INCREASES SALES DURING THE YEAR?

A According to AMMO, even if sales increase, whether based on weather or additional customers, it should recover its estimated lost fixed costs.

Q WILL THE REDUCTION IN USAGE AFFECT ANY OF AMMO'S OTHER COSTS?

A Yes. Fuel costs will be reduced, but 95% of any fuel cost saving will be passed through AMMO's fuel adjustment cost (FAC) mechanism, while the Company will retain 5% of any fuel cost saving due to reduced usage. Over the long run, there will be reductions in fixed costs, too, which the Company will retain. Any reductions in non-fuel variable costs will be retained 100% by the Company.

Q IS A LOST FIXED COST RECOVERY METHOD CONSISTENT WITH THE WAY OTHER COSTS ARE RECOVERED?

A No. The utility believes that energy efficiency programs will reduce sales and, thereby, reduce contributions to fixed costs. By the same reasoning, one could argue that every time a utility adds a customer, it will increase sales and increase the contribution to fixed cost, so there should be a refund to customers in that class as a result.

Q IS IT DIFFICULT TO ESTIMATE LOST FIXED COSTS?

A Yes. To estimate the lost revenues, engineering estimates of savings for each energy efficiency program must be assumed. There is no way to determine the actual effect of the various energy efficiency programs. If actual sales are higher than forecast sales, the utility will collect lost revenues. If customers reduce their energy consumption of their own volition without using any of the utilities' energy efficiency programs, should the utility recover the lost fixed cost due to that reduction?

Q HOW CAN THE COMMISSION REDUCE THE THROUGHPUT DISINCENTIVE?

A The MEEIA already provides a mechanism that will reduce the throughput disincentive. It allows a utility to collect not only the cost of its energy efficiency programs, but also

allows the utility to collect a return on the cost, as well, similar to a supply-side investment.

Q PLEASE COMMENT ON STAFF WITNESS JOHN ROGERS' TESTIMONY.

A Mr. Rogers states that due to the expected approval of the MEEIA rulemaking in June, 2011, the Commission should continue AMMO's current method of collecting energy efficiency costs. Once the rulemaking is approved by the Joint Committee, the utility can make an application to change the method of collection.

Q DO YOU AGREE WITH MR. ROGER'S RECOMMENDATION?

A Yes. The parties will have better information and will be able to make informed recommendations regarding the collection of energy efficiency costs.

Q PLEASE COMMENT ON DNR WITNESS LAURA WOLFE'S TESTIMONY.

A Ms. Wolfe recommends that AMMO's energy efficiency costs should be expensed rather than amortized.

Q DO YOU AGREE WITH HER RECOMMENDATION?

A No. As stated above, the MEEIA specifically states that energy efficiency expenditures should be treated the same as supply side expenditures. Supply-side expenditures are

depreciated over the lifetime of the plant and also earn a return on the investment. Currently, AMMO's energy efficiency costs are treated the same way, i.e., the energy efficiency investment cost is amortized and the Company also receives a return on its energy efficiency investments. Expensing these costs will violate the principle that energy efficiency costs be treated the same as supply-side investments.

Q DOES THIS CONCLUDE YOUR TESTIMONY?

A Yes.