

Exhibit No.:	Revenue Requirement
Issue:	Michael P. Gorman
Witness:	Surrebuttal Testimony
Type of Exhibit:	Missouri Industrial Energy Consumers
Sponsoring Party:	ER-2014-0258
Case No.:	February 6, 2015
Date Testimony Prepared:	

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

Filed  
March 23, 2015  
Data Center  
Missouri Public  
Service Commission

<b>In the Matter of Union Electric Company, d/b/a Ameren Missouri's Tariff to Increase Its Revenues for Electric Service</b>	) ) ) ) ) )	<b>Case No. ER-2014-0258</b>
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Surrebuttal Testimony and Schedules of  
**Michael P. Gorman**  
Regarding Revenue Requirement Issues

On behalf of  
**Missouri Industrial Energy Consumers**

February 6, 2015



Project 9913

MIEC Exhibit No. 512  
Date 3-02-15 Reporter XF  
File No. ER-2014-0258

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company,  
d/b/a Ameren Missouri's Tariff to Increase  
Its Revenues for Electric Service

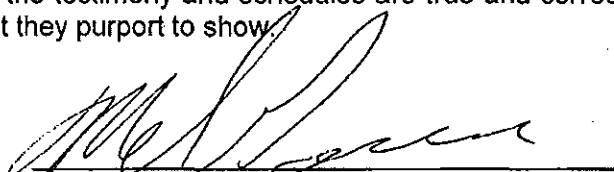
Case No. ER-2014-0258

STATE OF MISSOURI )  
COUNTY OF ST. LOUIS ) SS

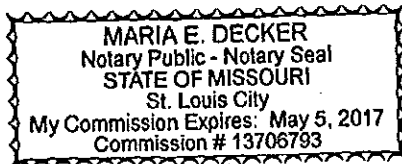
Affidavit of Michael P. Gorman

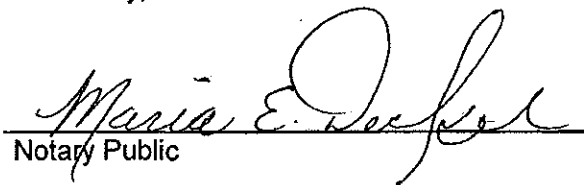
Michael P. Gorman, being first duly sworn, on his oath states:

1. My name is Michael P. Gorman. I am a consultant with Brubaker & Associates, Inc., having its principal place of business at 16690 Swingley Ridge Road, Suite 140, Chesterfield, Missouri 63017. We have been retained by the Missouri Industrial Energy Consumers in this proceeding on their behalf.
2. Attached hereto and made a part hereof for all purposes are my surrebuttal testimony and schedules which were prepared in written form for introduction into evidence in Missouri Public Service Commission Case No. ER-2014-0258.
3. I hereby swear and affirm that the testimony and schedules are true and correct and that they show the matters and things that they purport to show.

  
Michael P. Gorman

Subscribed and sworn to before me this 5<sup>th</sup> day of February, 2015.



  
Notary Public

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

**In the Matter of Union Electric Company,  
d/b/a Ameren Missouri's Tariff to Increase  
Its Revenues for Electric Service**

**Case No. ER-2014-0258**

**Surrebuttal Testimony of Michael P. Gorman**

1    **Q     PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2    **A     Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140,**  
3    **Chesterfield, MO 63017.**

4    **Q     ARE YOU THE SAME MICHAEL P. GORMAN WHO HAS PREVIOUSLY FILED**  
5    **TESTIMONY IN THIS PROCEEDING?**

6    **A     Yes. I have previously filed both direct and rebuttal testimony on revenue**  
7    **requirement issues presented in this proceeding.**

8    **Q     ARE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE OUTLINED IN**  
9    **YOUR PRIOR TESTIMONY?**

10   **A     Yes. This information is included in Appendix A to my direct testimony filed**  
11   **December 5, 2014.**

12   **Q     ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

13   **A     This testimony is presented on behalf of the Missouri Industrial Energy Consumers**  
14   **("MIEC").**

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1 Q WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

2 A I will respond to the rebuttal testimony of Ameren Missouri witness Robert B. Hevert.

3 Q DID AMEREN WITNESS HEVERT SUMMARIZE THE RECOMMENDATIONS OF  
4 THE OTHER RATE OF RETURN WITNESSES?

5 A Yes. At pages 3 and 4 of Mr. Hevert's rebuttal testimony, he states that the opposing  
6 return on equity witnesses (which include Staff witness David Murray, Office of Public  
7 Counsel witness Lance Schafer, Wal-Mart witness Steve Chriss and me), offer  
8 recommendations that individually and as a group are far below the returns that  
9 investors would expect for a vertically integrated electric utility company. As support  
10 for this assertion, he outlines recent authorized returns on equity for electric utility  
11 companies as published in *Regulatory Research Associates* ("RRA").

12 Q PLEASE RESPOND TO MR. HEVERT'S COMMENTS REGARDING THE  
13 RECOMMENDED RETURNS ON EQUITY OFFERED BY OPPOSING RETURN ON  
14 EQUITY WITNESSES.

15 A Mr. Hevert's findings are based on incomplete or inaccurate data, and reflect a bias  
16 toward a higher return on equity recommendation. I base this conclusion on the  
17 following.

18 First, Mr. Hevert's evaluation of authorized returns on equity limits the amount  
19 of information available to investors to inform an outlook on expected commission  
20 authorized returns on equity. Mr. Hevert's analysis does not compare authorized  
21 returns on equity based on comparable investment risk, nor does he consider  
22 whether or not the most recent authorized returns on equity are commissions' findings  
23 for the current market cost of equity for the utilities. Indeed, some reported returns on

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1 equity are based on a settlement, or finding by a commission to use the same  
2 authorized return on equity from a prior rate case rather than adjust the return to the  
3 current cost of capital.

4 If investors are relying on this data to form expectations for commission  
5 findings, then it is reasonable to believe that investors would expect risk comparable  
6 returns consistent with traditional regulatory practices, and are able to distinguish the  
7 difference between a commission finding for a current market cost of equity, from a  
8 commission finding that it will not change a return on equity approved in a prior case.

9 A commission finding on the current market cost of equity is an indication of  
10 the utility's current cost of service. In comparison, if a commission chooses to again  
11 award the same rate of return found appropriate in a prior proceeding, that is an  
12 indication that the commission is only considering limited issues in revising the utility's  
13 revenue requirement and rate structure. They are not comparable findings.

14 **Q BASED ON A COMPLETE REVIEW OF ALL AUTHORIZED RETURNS ON EQUITY**  
15 **FOR CALENDAR YEAR 2014, WOULD THE OPPOSING WITNESSES' RETURNS**  
16 **ON EQUITY BE REASONABLE?**

17 **A** Yes. As shown on the attached Schedule MPG-SR-1, the authorized returns on  
18 equity for electric utility companies, both integrated and delivery companies, range  
19 from 9.17% to 10.4%, with an average of 9.76%.<sup>1</sup> As shown on page 1 of Schedule  
20 MPG-SR-1, I excluded authorized returns on equity for utility rate cases where the  
21 commission either approved a settlement return on equity, or simply used the same  
22 return on equity in the current case as was approved in a prior case. Under these  
23 conditions, the industry average return for 2014 was 9.63%.

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<sup>1</sup>Excluding Virginia rider cases.

1 Further, I also show only the integrated electric utility companies used by  
2 Mr. Hevert in his testimony in Chart 1. However, I excluded returns on equity for  
3 utilities where the commission did not make a return on equity finding, but, instead,  
4 relied on a previously awarded return on equity or was based on a settlement. Based  
5 on this adjustment to Mr. Hevert's Chart 1 information, industry authorized returns on  
6 equity averaged 9.85%.

7 Based on this expanded evaluation of the information available to investors, I  
8 believe it reasonable and rational for an investor to believe that if the Commission is  
9 attempting to measure the current market cost of equity for a utility in this rate case,  
10 as I believe the Missouri Commission is attempting to do here for Ameren Missouri,  
11 investors would expect an authorized return on equity of approximately 9.63%, which  
12 is generally consistent with my estimated return on equity range of 9.00% to 9.60%,  
13 Further, this data demonstrates that Mr. Hevert's proposed 10.4% return on equity for  
14 Ameren Missouri is far out of line with reasonable estimates of the current cost of  
15 capital for low risk electric utilities.

16 **Q HOW DO YOU RECOMMEND THE COMMISSION USE THIS DATA CONCERNING**  
17 **COMMISSION AUTHORIZED RETURNS ON EQUITY FOR ELECTRIC UTILITY**  
18 **COMPANIES?**

19 **A** Reviewing the Commission authorized returns on equity for electric utility companies  
20 around the country, if they measure the current market cost of equity, they are  
21 another data point the Commission can use to help determine a fair and reasonable  
22 return on equity for Ameren Missouri. However, this data should not be used in lieu  
23 of reasonable estimates of the current market cost of equity, nor should settlements

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1 or non-findings of current market cost of equity be used to influence the Commission  
2 on what reasonable estimates are for Ameren Missouri's current cost of equity.

3 This market evidence shows that my estimated return on equity range is  
4 reasonable in relationship to authorized returns on equity found by other regulatory  
5 commissions around the country. While I recognize that the average is approximately  
6 at the high end of my recommended range, I encourage the Commission to carefully  
7 consider market-based estimates of the return on equity in support of a reasonable  
8 finding in this case. Ameren Missouri's and other electric utilities' capital costs are at  
9 historically low levels. These low capital market costs help offset increases in electric  
10 utility rates caused by commodity prices, and increased rate base investment. In my  
11 judgment, a balanced regulatory decision reflects the increase in utilities' cost of  
12 capital, and decreases in their cost of capital. The current market environment has  
13 offered a significant decline in utilities' cost of capital, that should be considered in  
14 setting Ameren Missouri's revenue requirement, and determining a fair and  
15 reasonable return on equity.

16 Authorized returns on equity have recognized declining capital market costs  
17 for utilities over many years recently, and continue to decline in response to these  
18 very low capital market costs. Importantly, I believe authorized returns on equity are  
19 useful information in gauging what other commissions have found to be reasonable  
20 for rate-setting purposes, but a finding on a commission authorized return on equity  
21 should be heavily weighted toward what the estimate of the current market cost of  
22 equity is for the utility in the specific case. Commissions may have had external  
23 factors in awarding returns on equity which are not relevant or useful for the Missouri  
24 Commission to determine a fair return on equity in this case.

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1 For all these reasons, I believe that the recent awards for industry authorized  
2 returns on equity support my recommended return on equity range, and the specific  
3 circumstances of this case support my point estimate of 9.3% for Ameren Missouri in  
4 this case.

5 Q AT PAGE 6 OF MR. HEVERT'S REBUTTAL TESTIMONY, HE STATES THAT THE  
6 CURRENT INTEREST RATE ENVIRONMENT DOES NOT SUPPORT A  
7 REDUCTION TO AMEREN MISSOURI'S CURRENT AUTHORIZED RETURN ON  
8 EQUITY OF 9.8%. DO YOU BELIEVE THAT THE CURRENT CAPITAL MARKET  
9 ENVIRONMENT SUPPORTS A REDUCTION TO AMEREN MISSOURI'S  
10 CURRENT AUTHORIZED RETURN ON EQUITY?

11 A Yes. I state this for several reasons. First, interest rates used in my most recent  
12 Ameren Missouri rate of return are lower than the interest rates reflected in my  
13 testimony in Ameren Missouri's last rate case filing. This is shown below in Table 1.

<b><u>Description</u></b>	<b><u>Current Case<sup>1</sup></u></b>	<b><u>Direct Testimony<sup>3</sup></u></b>	<b><u>Case No. ER-2012-0166<sup>3</sup></u></b>
"A" Rated	3.90%	4.13%	4.27%
"Baa" Rated	4.63%	4.71%	5.01%
13 Week Period Ending	1/23/2015	11/7/2014	6/15/2012

Sources:  
<sup>1</sup>Schedule MPG-SR-2.  
<sup>2</sup>Schedule MPG-14, page 1 filed with my direct testimony.  
<sup>3</sup>Case ER-2012-0166, Schedule MPG-14, page 1.

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1           As shown in the table above, interest rates have declined by approximately  
2           37 basis points since Ameren Missouri's last rate case. On this basis alone, Ameren  
3           Missouri's authorized return on equity of 9.8% should be reduced closer to about  
4           9.4%. Moreover, as this table also shows, interest rates have declined even further  
5           since the filing of my direct testimony in this case which further supports the  
6           reasonableness of my recommended return on equity for Ameren Missouri.

7           Further, utility stock prices have increased and their dividend yields have gone  
8           down. This is an indication that utilities' cost of capital has declined because the  
9           utilities need to sell fewer shares in order to generate enough capital to support their  
10          capital investment program. In the last case, the 13-week average proxy group stock  
11          price was \$36.25 based on an annualized dividend of \$1.54. This produced an  
12          unadjusted dividend yield of 4.2%.<sup>2</sup> In the current case, my Discounted Cash Flow  
13          ("DCF") studies show an annualized dividend of \$1.58 based on a 13-week average  
14          stock price of \$42.80 for an unadjusted dividend yield of 3.7%.

15          This 50 basis point decline in electric utility dividend yield is an indication that  
16          utilities' cost of capital has declined since Ameren Missouri's last rate case. When  
17          stock prices increase, all else equal, utilities' cost of capital declines.

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<sup>2</sup>Schedule No. MPG-4; Case No. ER-2012-0166, Tariff No. YE-2012-0370; Schedule MPG-4,  
July 6, 2012.

1 Q AT PAGE 5 OF HIS REBUTTAL TESTIMONY, MR. HEVERT ASSERTS THAT  
2 UTILITIES' PRICE TO EARNINGS ("P/E") RATIOS ARE AT ELEVATED LEVELS,  
3 AND THERE IS NO REASON TO BELIEVE THAT THESE ELEVATED P/E RATIOS  
4 WILL BE SUSTAINABLE. HE CONCLUDES THAT THESE ELEVATED P/E  
5 RATIOS DOWNWARDLY BIAS THE RESULTS OF THE DCF STUDIES. PLEASE  
6 RESPOND.

7 A Mr. Hevert's analyses are simply incomplete and not based on relevant data. He  
8 measures P/E ratios by comparing current prices relative to historical earnings per  
9 share. Based on this relationship, he is measuring elevated P/E ratios. However,  
10 many electric utility companies, including Ameren Missouri, have stronger near-term  
11 earnings outlooks, relative to what they have had in the past.

12 For example, as shown on my Schedule MPG-5 filed with my direct testimony,  
13 my proxy group's earned return on equity from 2013 to the three- to five-year  
14 projections, increased from \$2.46 to \$3.18, or an approximate 29.3% increase in  
15 earning over a three- to five-year period. This strong improvement in expected  
16 earnings is causing stock prices to adjust to stronger future earnings outlooks.  
17 Mr. Hevert's P/E ratio is tied to historical earnings and ignores the expected earnings.  
18 Reflecting the proxy group's forward-looking earnings, the P/E ratio of the proxy  
19 group's prevailing stock price is actually below the historical normal.

20 The 13-week average current observable proxy group stock price of \$42.80,  
21 and a projected earnings per share three to five years out for the proxy group of  
22 \$3.18, produce a P/E ratio of 13.5x.<sup>3</sup> A P/E ratio of 13.5x is below the historical P/E  
23 ratios for the electric utility industry and my proxy group (approximately 16.0x), as  
24 shown in Mr. Hevert's Chart 9 at page 92 of his rebuttal. Therefore, Mr. Hevert's

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<sup>3</sup>See Schedule MPG-6 filed with my direct testimony.

1 claim that current P/E ratios are elevated and throw into question the reliability of the  
2 DCF results, is based on a faulty analysis and inappropriate data inputs.

3 **Q DO YOU HAVE ANY OTHER COMMENTS CONCERNING MR. HEVERT'S**  
4 **OBSERVATION ON P/E RATIOS AND THE IMPLICATIONS THAT HIGH P/E**  
5 **RATIOS SUGGEST THAT DCF RETURN ESTIMATES ARE NOT RELIABLE**  
6 **CURRENTLY?**

7 **A** Yes. High P/E ratios also correspond to very low dividend yields, which are an  
8 indication of reductions to utilities' cost of capital. As noted above, dividend yields for  
9 utility companies have decreased to well below 4% more recently, where in the last  
10 case they were above 4%, which at that time was relatively low. All of this is an  
11 indication that current utility capital costs are very low relative to the past. While  
12 Mr. Hevert and others may have opinions that capital market costs will increase  
13 sometime in the future, increasing capital costs and the timing of when the increase  
14 will occur are highly uncertain and not easily reconciled for measuring the current  
15 market cost of capital for utility companies. Because customers are burdened by  
16 increasing fuel costs, and increasing costs associated with capital investments, they  
17 should not be denied the benefits of declines in cost of service related to reductions in  
18 utilities' cost of capital. For all these reasons, Mr. Hevert's incomplete and erroneous  
19 data suggesting the current DCF return estimates are unreliable should be denied,  
20 and the Commission should consider all viable and accurate measures of the current  
21 market cost of equity in setting a fair return on equity in this proceeding.

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1 Q DOES MR. HEVERT MAKE CERTAIN CRITICISMS OF YOUR APPLICATION OF A  
2 CONSTANT GROWTH DCF ANALYSIS?

3 A Yes. His comments include the following:

- 4 1. A concern about the reliability of the constant growth DCF model based on  
5 current P/E ratios. As I responded to this argument above, Mr. Hevert's concerns  
6 are based on faulty analyses, incomplete data, and a flawed assessment of  
7 market prices and relative valuation.
- 8 2. An assertion that certain estimates should be excluded in measuring a constant  
9 growth DCF return. He argues that certain returns should be excluded if they are  
10 outside authorized returns on equity for the electric utility industry. This practice  
11 biases an estimate of Ameren Missouri's current market cost of equity using a  
12 DCF study.

13 Q PLEASE EXPLAIN WHY MR. HEVERT'S PROPOSAL TO EXCLUDE DCF  
14 ESTIMATES BASED ON COMMISSION AUTHORIZED RETURNS ON EQUITY  
15 DOES NOT PRODUCE AN UNBIASED LEGITIMATE ESTIMATE OF THE  
16 CURRENT MARKET COST OF EQUITY BASED ON A DCF MODEL.

17 A Mr. Hevert simply excludes certain DCF estimates based on external factors rather  
18 than a legitimate estimate based on a reliable and accurate DCF model development.  
19 Mr. Hevert cannot accurately measure a DCF estimate of the current market cost of  
20 equity for a utility if he excludes a DCF return based on factors that have nothing to  
21 do with the development of a legitimate and reliable DCF return estimate. If the  
22 Commission follows Mr. Hevert's advice, the constant growth DCF estimate will be  
23 manipulated and will not be a useful and accurate data point available to measure  
24 Ameren Missouri's current market cost of equity.

25 I agree that after all cost studies are performed in an independent unbiased  
26 and reliable manner, external factors can be used by the Commission to interpret  
27 model results and support its finding of a fair and balanced return on equity.  
28 However, Mr. Hevert proposes to bias the DCF model results before they are

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1 presented to the Commission and thereby manipulates the data point available to the  
2 Commission to determine a fair return on equity.

3 **Q DID MR. HEVERT ALSO MAKE COMMENTS CONCERNING YOUR**  
4 **SUSTAINABLE GROWTH DCF ANALYSIS?**

5 A Yes. These are the same arguments I have had with Mr. Hevert in previous rate  
6 cases concerning the sustainable growth DCF model. However, one of the major  
7 difficulties I have with Mr. Hevert's arguments is that his criticisms of this model are  
8 simply disingenuous. Mr. Hevert's multi-stage growth DCF model is constructed  
9 based on the principles of sustainable growth. Therefore, his criticism of this model,  
10 can be used as criticism of his own multi-stage growth DCF model.

11 Specifically, my sustainable growth rate model assumes that there is a  
12 relationship between earnings growth, dividend growth, and dividend payout ratios.  
13 Similarly, Mr. Hevert's multi-stage growth DCF model shows a relationship between  
14 earnings growth, dividend growth, and dividend payout ratios.

15 My sustainable growth DCF model and Mr. Hevert's multi-stage growth model  
16 are based on the same sustainable growth mathematical construct. Again,  
17 Mr. Hevert's criticism of my sustainable DCF model is simply without merit because  
18 he uses a version of the same sustainable growth model himself.

19 **Q PLEASE OUTLINE MR. HEVERT'S CRITICISMS OF YOUR MULTI-STAGE**  
20 **GROWTH DCF MODEL.**

21 A Mr. Hevert primarily makes two complaints concerning my multi-stage growth DCF  
22 model. Those include the following:

23 1. He believes that I did not reflect the quarterly payment of dividends in my model  
24 and therefore understate the DCF return estimate.

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1 2. He believes my Gross Domestic Product ("GDP") growth rate understates a  
2 long-term sustainable GDP growth.

3 **Q PLEASE COMMENT ON MR. HEVERT'S PROPOSAL TO ADJUST YOUR DCF**  
4 **MODEL TO REFLECT QUARTERLY DIVIDEND PAYMENTS.**

5 A Mr. Hevert's proposal to modify the timing of the cash flows in the DCF model simply  
6 does not reflect reality. In my DCF model, I assume the utility investor will receive  
7 four quarterly dividend payments after it owns the stock for one year. In contrast,  
8 Mr. Hevert assumes a utility investor will receive four quarterly dividend payments  
9 after owning the stock for only two quarters. Mr. Hevert's modification to the cash  
10 flow of the model simply distorts reality and inflates the DCF return.

11 By accelerating the timing of cash flow as Mr. Hevert does in his multi-stage  
12 growth DCF model, he increases the DCF return estimate because he falsely  
13 assumes that investors will receive cash flows significantly sooner than they actually  
14 receive the cash after buying a stock. This does not accurately reflect the dividend  
15 timing, and biases his multi-stage growth DCF estimate.

16 **Q PLEASE RESPOND TO MR. HEVERT'S CONCERN OF YOUR GDP GROWTH**  
17 **OUTLOOK USING YOUR MULTI-STAGE GROWTH DCF MODEL.**

18 A I have already responded to the inappropriateness of Mr. Hevert's GDP growth  
19 forecast in my rebuttal testimony at 6-8. There, I describe how he relies on historical  
20 real GDP growth, with a projection of future inflation to arrive at his nominal GDP  
21 growth estimate. A significant flaw in Mr. Hevert's GDP growth forecast is that he is  
22 not reflecting consensus market participants' outlook for future real GDP growth.  
23 Historical real GDP growth is much higher than GDP growth is expected to be going  
24 forward. There can be many factors that describe this slowdown in real U.S. GDP

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1 growth, likely attributable to globalization of the world economy, and increasing the  
2 competition the U.S. economy has for selling goods and services. Whatever the  
3 exact reason, independent consensus economists that provide relevant information to  
4 investors to make real world investment decisions, are projecting real GDP growth  
5 significantly lower than Mr. Hevert is projecting in his rate of return testimony in this  
6 proceeding. Hence, his outlook for real GDP growth is not reflective of consensus  
7 market participants and therefore overstates a reasonable estimate of what investors  
8 assume in making investment decisions. For these reasons, his GDP growth outlook  
9 should be rejected because it has not been shown to be reflective of rational  
10 investment outlooks.

11 **Q DID MR. HEVERT COMMENT ON YOUR CAPITAL ASSET PRICING MODEL**  
12 **("CAPM")?**

13 **A** Yes. Mr. Hevert took issue with my development of the market risk premium  
14 component of my CAPM. He states that the market risk premium estimate was too  
15 low based on several measures including frequency distributions of market returns,  
16 and earnings retention ratios.

17 **Q ARE MR. HEVERT'S COMMENTS CONCERNING AN APPROPRIATE MARKET**  
18 **RISK PREMIUM WITHIN A CAPM REASONABLE?**

19 **A** No. All of Mr. Hevert's arguments on measuring an appropriate market risk premium  
20 are based on the premise that the market going forward will only have above average  
21 returns, while the normal historical realized returns on the market include below  
22 average and above average returns.

1           His Chart 10 shows a frequency distribution of observed market returns from  
2           1926 to 2013. There, he states that a 13% return and higher actually occur quite  
3           often in the marketplace. Based on this, he believes his estimated market returns of  
4           12.75% and 13.49% represent approximately the 50th percentile of actual historical  
5           returns.

6           What Mr. Hevert's return outlooks do not include is the expectation that the  
7           market will continue to experience above average returns (above the upper 50th  
8           percentile) and below average returns (below the 50th percentile). Mr. Hevert's  
9           market return is inflated and not based on a rational outlook for further returns.

10          Mr. Hevert's second argument deals with whether earnings growth will  
11          increase in the Standard & Poor's ("S&P") 500 because the earnings paid out as  
12          dividends will change relative to historical periods. Mr. Hevert's Chart 11 shows that  
13          the earnings retention ratio (or 1 minus the payout ratio) has increased from 1926 to  
14          2006. He states that this earnings retention ratio will fuel more earnings growth, and  
15          allow for greater earnings growth going forward than which has been achieved in the  
16          past.

17          What Mr. Hevert's analysis simply does not show is how stocks will fuel  
18          earnings growth, if the growth rate of the earnings exceeds the growth rate of the  
19          markets in which they sell their goods and services. It is simply again not rational for  
20          Mr. Hevert to believe that earnings can grow measurably higher than the growth rate  
21          of the market in which they sell their services and goods.

22          Further, earnings retention ratios as he shows on his Chart 11 have been  
23          quite volatile in reality over time, and largely can be impacted by taxes on dividends,  
24          and capital gains. All of this can change over time, and the relationship of earnings



1 retention ratios and dividend payout ratios will be impacted by many factors over time  
2 and may not necessarily continue on the trend that Mr. Hevert has shown.

3 Further, Mr. Hevert's Chart 12 and Chart 13 attempt to give a false implication  
4 concerning the probability of future market risk premiums. His frequency distribution  
5 of risk premiums is used to produce an expected risk premium going forward.  
6 Indeed, all observations whether positive or negative are equally likely to reoccur in  
7 the future. Hence, giving equal weight to all historical annual market risk premiums  
8 and market returns is the most balanced and unbiased method of estimating future  
9 expected market returns and market risk premiums.

10 **Q DID MR. HEVERT COMMENT ON YOUR RISK PREMIUM STUDY?**

11 **A** Yes. He makes three comments:

- 12 1. He states that my method of excluding the fourth highest and fourth lowest risk  
13 premiums is arbitrary and establishes a return on equity range that is not  
14 predicated on economic and financial conditions.
- 15 2. He says that the methodology ignores an inverse relationship between equity risk  
16 premiums and interest rates.
- 17 3. He states that the low end of my estimated range is far lower than the return on  
18 equity authorized since at least 1986 and as such has no relevance in estimating  
19 the Company's cost of equity.

20 **Q PLEASE RESPOND TO MR. HEVERT'S COMMENTS CONCERNING YOUR RISK  
21 PREMIUM STUDY.**

22 **A** Mr. Hevert's criticisms are without merit for the following reasons:

- 23 1. His first comment that the exclusion of the four highest and four lowest risk  
24 premiums is arbitrary is simply without merit. By excluding the highest and  
25 lowest, I am narrowing the range of historical observed returns, and giving equal  
26 consideration to all the returns examined over this time period. Further, my  
27 rebuttal testimony offered a similar analysis but used five-year and 10-year rolling  
28 averages of equity risk premiums to develop a range. That analysis produced a  
29 similar result to the risk premium study included in my direct testimony. His claim

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1 of arbitrary exclusion of numbers was not relevant in that risk premium study  
2 offered in rebuttal.

3 2. Mr. Hevert's belief that there is an inverse relationship between interest rates and  
4 equity risk premiums is simplistic and without merit. While interest rates and  
5 equity risk premiums are interrelated, changes in interest rates are not the sole  
6 factor which explains changes in equity risk premiums. Rather, academic  
7 literature states that equity risk premiums change based on perceived changes in  
8 investment risk between equity investments and debt investments. It is simply not  
9 accurate nor consistent with academic literature to assume an inverse relationship  
10 between equity risk premiums and interest rates over all market periods.  
11 Academic literature is clear. This relationship changes over time, and is largely  
12 driven by changes in relative investment risk between equity and debt securities.

13 3. Mr. Hevert's observation concerning my lowest derived risk premium is again  
14 based on his arbitrary adjustment to market models to produce an imbalanced  
15 estimate of the current market cost of equity. Mr. Hevert's practice is to exclude  
16 numbers which he does not like in an effort to try to increase the authorized return  
17 on equity finding of the specific model. Instead, the model should be performed in  
18 an unbiased manner in order to produce a valid and reliable estimate from the  
19 market-based model, in this case the risk premium model. If there are reasons to  
20 dismiss or give minimal weight, or give significant weight to the model result, then  
21 such considerations should be taken into account when interpreting the results of  
22 the models. Mr. Hevert's practice is to bias the results of the model, which  
23 diminishes the validity and value of the returns produced from the model and  
24 limits the amount of useful information to make an informed decision of the  
25 current market cost of equity.

26 **Q DID MR. HEVERT OFFER CERTAIN COMMENTS CONCERNING YOUR PROXY**  
27 **GROUP'S COMPARISON TO AMEREN MISSOURI'S INVESTMENT RISK?**

28 **A** Yes. He suggests that the business risk profile of Ameren Missouri of "Excellent" is  
29 not a distinguishing factor for electric utility companies. He finds that the credit rating  
30 may not be a good indicator of investment risk, because he believes that equity and  
31 debt investors face different risks, require different returns and invest in different  
32 securities.

1 Q DO YOU BELIEVE THAT MR. HEVERT'S CONCLUSIONS SUGGEST THAT THE  
2 PROXY GROUP YOU USED TO ESTIMATE AMEREN MISSOURI IS NOT A  
3 REASONABLE RISK PROXY FOR AMEREN MISSOURI?

4 A No. Mr. Hevert's comments do not seem to focus on investment risk. The proxy  
5 group I used is largely the same as the proxy group he used. To the extent he  
6 believes the proxy group is not risk comparable to Ameren Missouri then my results  
7 are not less reliable than his. Contrary to Mr. Hevert's assertions, a bond rating is  
8 useful in measuring equity investment risk. A utility company relies on internal cash  
9 flows to meet its debt service obligations, and to also satisfy the expected return of  
10 equity investors. Hence, while debt and equity security investors assume different  
11 risk and invest in different securities, the utility's ability to produce adequate and  
12 predictable cash flows allows the utility to meet its debt security obligations, and to  
13 meet the return expected by equity investors.

14 Equity investors have greater risk than bondholders, because they are paid  
15 after debt holders, but nevertheless they are paid out of the same utility operating  
16 cash flow generation. As such, there is a strong correlation between investment risk  
17 for an equity investor and bond investor.

18 Indeed, bond rating measures as a form of estimating a comparable risk proxy  
19 group is in my experience a widely recognized and highly utilized method of selecting  
20 proxy risk companies. For example, before the Federal Energy Regulatory  
21 Commission ("FERC"), the bond rating is a primary benchmark used to select  
22 comparable risk companies.<sup>4</sup>

23 I would note, that Mr. Hevert's suggestion that my proxy group is not risk  
24 comparable to Ameren Missouri is simply not based on credible evidence, and again,

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<sup>4</sup>147 FERC ¶ 61,234, Opinion 531, Order on Initial Decision at paragraphs 106-108.

1 largely refutes the reliability of his own proxy group and capital market analyses. His  
2 arguments are simply without merit.

3 **Q DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

4 **A** Yes, it does.

9913/273066

# Ameren Missouri

## 2014 Electric Utility Rate Case Authorized Return on Equity

2014 Authorized Return on Equity <sup>1</sup>							Fully Litigated Rate Cases <sup>2</sup>						
State (1)	Company (2)	Case Type (3)	Decision Type (4)	Return on Equity		S&P Credit Rating (7)	State (8)	Company (9)	Case Type (10)	Decision Type (11)	Return on Equity		S&P Credit Rating (14)
				%L (5)	Date (6)						%L (12)	Date (13)	
New York	Consolidated Edison Co. of NY	Distribution	Settled	9.20	2/20/2014	A-	District of Columbia	Potomac Electric Power Co.	Distribution	Fully Litigated	9.40	3/26/2014	BBB+
North Dakota	Northern States Power Co. - MN	Vertically Integrated	Settled	9.75	2/26/2014	A-	New Mexico	Southwestern Public Service Co	Vertically Integrated	Fully Litigated	9.96	3/26/2014	A-
New Hampshire	Liberty Utilities Granite St	Distribution	Settled	9.55	3/17/2014	BBB	Delaware	Delmarva Power & Light Co.	Distribution	Fully Litigated	9.70	4/2/2014	BBB+
District of Columbia	Potomac Electric Power Co.	Distribution	Fully Litigated	9.40	3/26/2014	BBB+	Massachusetts	Fitchburg Gas & Electric Light	Distribution	Fully Litigated	9.70	5/30/2014	BBB+
New Mexico	Southwestern Public Service Co	Vertically Integrated	Fully Litigated	9.96	3/26/2014	A-	Maryland	Potomac Electric Power Co.	Distribution	Fully Litigated	9.62	7/2/2014	BBB+
Delaware	Delmarva Power & Light Co.	Distribution	Fully Litigated	9.70	4/2/2014	BBB+	Montana	NorthWestern Corp.	Limited-Issue Rider	Fully Litigated	9.80	9/25/2014	BBB
Texas	Entergy Texas Inc.	Vertically Integrated	Settled	9.80	5/16/2014	BBB	Illinois	MidAmerican Energy Co.	Vertically Integrated	Fully Litigated	9.56	11/6/2014	A-
Massachusetts	Fitchburg Gas & Electric Light	Distribution	Fully Litigated	9.70	5/30/2014	BBB+	Wisconsin	Wisconsin Public Service Corp.	Vertically Integrated	Fully Litigated	10.20	11/6/2014	A-
Wisconsin	Wisconsin Power and Light Co.	Vertically Integrated	Fully Litigated	10.40	6/6/2014	A	Virginia	Appalachian Power Co.	Vertically Integrated	Fully Litigated	9.70	11/26/2014	BBB
Maine	Emera Maine	Distribution	Settled	9.55	6/30/2014	BBB+	Illinois	Ameren Illinois	Distribution	Fully Litigated	9.25	12/10/2014	BBB+
Maryland	Potomac Electric Power Co.	Distribution	Fully Litigated	9.62	7/2/2014	BBB+	Illinois	Commonwealth Edison Co.	Distribution	Fully Litigated	9.25	12/10/2014	BBB
Louisiana	Entergy Louisiana LLC	Vertically Integrated	Settled	9.95	7/10/2014	BBB	Connecticut	Connecticut Light & Power Co.	Distribution	Fully Litigated	9.17	12/17/2014	A-
New Jersey	Rockland Electric Company	Distribution	Settled	9.75	7/23/2014	A-	Colorado	Black Hills Colorado Electric	Vertically Integrated	Fully Litigated	9.83	12/18/2014	BBB
Maine	Central Maine Power Co.	Distribution	Settled	9.45	7/29/2014	BBB+							
Wyoming	Cheyenne Light Fuel Power Co.	Vertically Integrated	Settled	9.90	7/31/2014	BBB							
New Jersey	Atlantic City Electric Co.	Distribution	Settled	9.75	8/20/2014	BBB+							
Vermont	Green Mountain Power Corp	Vertically Integrated	Settled	9.60	8/25/2014	BBB+							
Utah	PacificCorp	Vertically Integrated	Settled	9.80	8/29/2014	A-							
Florida	Florida Public Utilities Co.	Vertically Integrated	Settled	10.25	9/15/2014	N/A							
Montana	NorthWestern Corp.	Limited-Issue Rider	Fully Litigated	9.80	9/25/2014	BBB							
Nevada	Nevada Power Co.	Vertically Integrated	Settled	9.80	10/9/2014	BBB+							
Illinois	MidAmerican Energy Co.	Vertically Integrated	Fully Litigated	9.56	11/6/2014	A-							
Wisconsin	Wisconsin Public Service Corp.	Vertically Integrated	Fully Litigated	10.20	11/6/2014	A-							
Wisconsin	Wisconsin Electric Power Co.	Vertically Integrated	Fully Litigated	10.20	11/14/2014	A-							
Virginia	Appalachian Power Co.	Vertically Integrated	Fully Litigated	9.70	11/26/2014	BBB							
Wisconsin	Madison Gas and Electric Co.	Vertically Integrated	Fully Litigated	10.20	11/26/2014	AA-							
Oregon	Portland General Electric Co.	Vertically Integrated	Settled	9.68	12/4/2014	BBB							
Illinois	Ameren Illinois	Distribution	Fully Litigated	9.25	12/10/2014	BBB+							
Illinois	Commonwealth Edison Co.	Distribution	Fully Litigated	9.25	12/10/2014	BBB							
Mississippi	Entergy Mississippi Inc.	Vertically Integrated	Settled	10.07	12/11/2014	BBB							
Wisconsin	Northern States Power Co - WI	Vertically Integrated	Fully Litigated	10.20	12/12/2014	A-							
Connecticut	Connecticut Light & Power Co.	Distribution	Fully Litigated	9.17	12/17/2014	A-							
Colorado	Black Hills Colorado Electric	Vertically Integrated	Fully Litigated	9.83	12/18/2014	BBB							
			Average:	9.76		BBB+				Average:	9.63		BBB+
			Median:	9.75		BBB+				Median:	9.70		BBB+
			Minimum:	9.17		BBB				Minimum:	9.17		BBB
			Maximum:	10.40		AA-				Maximum:	10.20		A-

1) Rate Cases with out ROE authorization and Virginia limited issue cases for Riders are excluded.  
 2) Rate Cases decided by settlement have been eliminated, along with the following Wisconsin cases.  
 Wisconsin Power and Light Co., docket D-6680-UR-119 (Elec)  
 No rate change requested, parties filed comments in support, no hearing, ROE from prior case.  
 Wisconsin Electric Power Co., docket D-05-UR-107 (WEP-Elec)  
 Madison Gas and Electric Co., docket D-3270-UR-120 (Elec)  
 Northern States Power Co - WI, docket D-4220-UR-120 (Elec)  
 ROE was not contested and agreed to in settlement by the parties.

Source: SNL Financial

# Ameren Missouri

## 2014 Vertically Integrated Electric Utility Rate Case Authorized Return on Equity

2014 Authorized Return on Equity <sup>1</sup>							Fully Litigated Rate Cases <sup>2</sup>						
State	Company	Case Type	Decision Type	Return on Equity (%)	Date	S&P Credit Rating	State	Company	Case Type	Decision Type	Return on Equity (%)	Date	S&P Credit Rating
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
North Dakota	Northern States Power Co. - MN	Vertically Integrated	Settled	9.75	2/26/2014	A-	New Mexico	Southwestern Public Service Co	Vertically Integrated	Fully Litigated	9.96	3/26/2014	A-
New Mexico	Southwestern Public Service Co	Vertically Integrated	Fully Litigated	9.96	3/26/2014	A-	Illinois	MidAmerican Energy Co.	Vertically Integrated	Fully Litigated	9.56	11/6/2014	A-
Texas	Entergy Texas Inc.	Vertically Integrated	Settled	9.80	5/16/2014	BBB	Wisconsin	Wisconsin Public Service Corp.	Vertically Integrated	Fully Litigated	10.20	11/6/2014	A-
Wisconsin	Wisconsin Power and Light Co	Vertically Integrated	Fully Litigated	10.40	6/6/2014	A	Virginia	Appalachian Power Co.	Vertically Integrated	Fully Litigated	9.70	11/26/2014	BBB
Louisiana	Entergy Louisiana LLC	Vertically Integrated	Settled	9.95	7/10/2014	BBB	Colorado	Black Hills Colorado Electric	Vertically Integrated	Fully Litigated	9.83	12/18/2014	BBB
Wyoming	Cheyenne Light Fuel Power Co.	Vertically Integrated	Settled	9.90	7/31/2014	BBB							
Vermont	Green Mountain Power Corp	Vertically Integrated	Settled	9.60	8/25/2014	BBB+							
Utah	PacificCorp	Vertically Integrated	Settled	9.80	8/29/2014	A-							
Florida	Florida Public Utilities Co.	Vertically Integrated	Settled	10.25	9/15/2014	N/A							
Nevada	Nevada Power Co.	Vertically Integrated	Settled	9.80	10/9/2014	BBB+							
Illinois	MidAmerican Energy Co.	Vertically Integrated	Fully Litigated	9.56	11/6/2014	A-							
Wisconsin	Wisconsin Public Service Corp.	Vertically Integrated	Fully Litigated	10.20	11/6/2014	A-							
Wisconsin	Wisconsin Electric Power Co.	Vertically Integrated	Fully Litigated	10.20	11/14/2014	A-							
Virginia	Appalachian Power Co.	Vertically Integrated	Fully Litigated	9.70	11/26/2014	BBB							
Wisconsin	Madison Gas and Electric Co.	Vertically Integrated	Fully Litigated	10.20	11/26/2014	AA-							
Oregon	Portland General Electric Co.	Vertically Integrated	Settled	9.68	12/4/2014	BBB							
Mississippi	Entergy Mississippi Inc.	Vertically Integrated	Settled	10.07	12/11/2014	BBB							
Wisconsin	Northern States Power Co - WI	Vertically Integrated	Fully Litigated	10.20	12/12/2014	A-							
Colorado	Black Hills Colorado Electric	Vertically Integrated	Fully Litigated	9.83	12/18/2014	BBB							
				Average:	9.94	BBB+					Average:	9.85	BBB+
				Median:	9.90	A-					Median:	9.83	A-
				Minimum:	9.56	BBB					Minimum:	9.56	BBB
				Maximum:	10.40	AA-					Maximum:	10.20	A-

1) Rate Cases with out ROE authorization and Virginia limited issue cases for Riders are excluded.  
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 Wisconsin Electric Power Co., docket D-05-UR-107 (WEP-Elec)  
 Madison Gas and Electric Co., docket D-3270-UR-120 (Elec)  
 Northern States Power Co - WI, docket D-4220-UR-120 (Elec)  
 ROE was not contested and agreed to in settlement by the parties.

Source: SNL Financial

# Ameren Missouri

## Utility Bond Yields

<u>Line</u>	<u>Date</u>	<u>"A" Rated Utility Bond Yields</u>	<u>"Baa" Rated Utility Bond Yields</u>
1	1/23/2015	3.51%	4.33%
2	1/16/2015	3.55%	4.38%
3	1/9/2015	3.68%	4.49%
4	1/2/2015	3.82%	4.60%
5	12/26/2014	3.94%	4.72%
6	12/19/2014	3.90%	4.71%
7	12/12/2014	3.87%	4.63%
8	12/5/2014	4.06%	4.73%
9	11/28/2014	3.99%	4.66%
10	11/21/2014	4.08%	4.77%
11	11/14/2014	4.09%	4.76%
12	11/7/2014	4.08%	4.71%
13	10/31/2014	4.10%	4.71%
14	Average	3.90%	4.63%

Source:  
<http://credittrends.moodys.com>