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Before the Public Service Commission of the State of Missouri

Surrebuttal Testimony

of

James H. Vander Weide, Ph.D.

April 2010

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DR. JAMES H. VANDER WEIDE
ON BEHALF OF
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION

SURREBUTTAL TESTIMONY
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I. INTRODUCTION AND SUMMARY

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. My name is James H. Vander Weide. I am Research Professor of Finance and Economics at Duke University, the Fuqua School of Business. I am also President of Financial Strategy Associates, a firm that provides strategic and financial consulting services to business clients. My business address is 3606 Stoneybrook Drive, Durham, North Carolina 27705.

Q. ARE YOU THE SAME JAMES H. VANDER WEIDE WHO PROVIDED DIRECT AND REBUTTAL TESTIMONY BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION ("THE COMMISSION") IN THIS PROCEEDING?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. I have been asked by The Empire District Electric Company ("Empire" or "the Company") to review the Staff Rebuttal testimony filed in this proceeding.

Q. WHAT TOPICS DO YOU ADDRESS IN YOUR SURREBUTTAL TESTIMONY?

A. I address Staff's rebuttal comments on my: (1) comparable companies; (2) DCF growth rates; (3) weighting of cost of equity results; and (4) use of forecasted interest rates.

Q. IS THERE ANYTHING IN THE STAFF'S REBUTTAL TESTIMONY THAT WOULD CAUSE YOU TO CHANGE YOUR RECOMMENDED 11.0 PERCENT COST OF EQUITY FOR EMPIRE?

A. No. After reviewing the Staff Rebuttal Testimony, I continue to recommend that Empire be allowed to earn a return on equity of 11.0 percent.

II. COMPARABLE COMPANIES

Q. WHY DO ECONOMISTS ESTIMATE A COMPANY'S COST OF EQUITY FROM COMPARABLE COMPANY DATA RATHER THAN SOLELY FROM MARKET DATA FOR THE COMPANY OF INTEREST?

A. Economists estimate a company's cost of equity from market data for comparable companies because the result of applying cost of equity methods such as the discounted cash flow ("DCF"), risk premium, and Capital Asset Pricing Model ("CAPM") to a single company is highly uncertain. However, as I explain in my rebuttal testimony, the uncertainty in estimating the cost of equity by applying cost of equity methodologies to a single company can be significantly reduced by applying cost of equity models to a relatively large group of comparable risk companies. Intuitively, any over- and under-estimate of the cost of equity that arises from the application of cost of equity methods to a single company is averaged out by applying the methods to a larger group of comparable risk companies.

Q. WHAT PROXY GROUP OF ELECTRIC UTILITIES DO YOU USE FOR THE PURPOSE OF ESTIMATING EMPIRE'S COST OF EQUITY?

A. I use the group of 28 electric utilities shown in Schedule JVW-1 of my direct testimony.

Q. WHAT CRITERIA DO YOU USE TO SELECT PROXY COMPANIES?

A. As described in my direct testimony, I select all the companies in Value Line's groups of electric companies that: (1) paid dividends during every quarter of the last two years; (2) did not decrease dividends during any quarter of the past two years; (3) had at least three analysts included in the I/B/E/S mean growth forecast; (4) have an investment grade bond rating and a Value Line Safety Rank of 1, 2, or 3; and (5) are not the subject of a merger offer that has not been completed.

Q. DOES STAFF AGREE WITH YOUR COMPARABLE COMPANY SELECTION CRITERIA?

A. No. Staff claims that I should have required that my comparable companies have at least 70 percent of revenues from regulated utility operations and be included in the Edison Electric Institute's ("EEI's") regulated utility category (Staff Rebuttal at 11).

Q. WHY DOES STAFF BELIEVE THAT THE CRITERION THAT COMPARABLE COMPANIES HAVE LESS THAN 70 PERCENT REVENUES FROM REGULATED ELECTRIC OPERATIONS IS IMPORTANT?

A. Staff claims:

> It is important to use this criterion because the objective of selecting a comparable group is to find companies that are as 'pure play' as possible. 'Pure play' means that the comparable company is confined, as much as possible, to the operation that is the subject of the cost-of-capital study. [Staff Rebuttal at 11.]

Q. DO YOU AGREE WITH STAFF'S ASSERTION THAT THE PURPOSE OF COMPARABLE COMPANY SELECTION CRITERIA IS TO FIND COMPANIES THAT ARE AS "PURE PLAY" AS POSSIBLE?

A. No. The purpose of comparable company selection criteria is to select the largest possible group of comparable risk companies that have sufficient data to estimate the cost of equity. The emphasis on comparable risk is important because investors require the same rate of return on investments in the target company as on other investments of comparable risk. The emphasis on having as large a proxy group as possible is important because, as discussed above, the uncertainty of the results from applying cost of equity methods to a small group of companies can be reduced by applying cost of equity methods to a relatively large group of comparable risk companies.

Q. DOES STAFF PROVIDE ANY EVIDENCE THAT ELECTRIC UTILITIES WITH LESS THAN 70 PERCENT REVENUES FROM REGULATED ELECTRIC OPERATIONS ARE MORE RISKY THAN ELECTRIC UTILITIES WITH GREATER THAN 70 PERCENT REVENUES FROM REGULATED ELECTRIC OPERATIONS?

A. No.

Q. DO YOU PROVIDE EVIDENCE IN YOUR REBUTTAL TESTIMONY THAT THE VALUE LINE ELECTRIC UTILITIES WITH LESS THAN 70 PERCENT REVENUES FROM REGULATED ELECTRIC OPERATIONS HAVE APPROXIMATELY THE SAME RISK AS THE VALUE LINE ELECTRIC UTILITIES WITH GREATER THAN 70 PERCENT REVENUES FROM REGULATED ELECTRIC OPERATIONS?

A. Yes. I demonstrate in my rebuttal testimony that the electric utilities that Staff excludes because of their criterion that the proxy company must have greater than 70 percent revenues from regulated electric operations have the same average Value Line Safety Rank and Standard & Poor's bond ratings as those companies Staff includes because they have greater than 70 percent revenues from regulated electric operations (see Vander Weide Rebuttal at 6 and Rebuttal Schedule JVW-2).

Q. STAFF ALSO CLAIMS THAT YOU SHOULD HAVE EXCLUDED ELECTRIC UTILITIES THAT EEI CLASSIFIES AS "MOSTLY REGULATED" RATHER THAN AS "REGULATED."[1] DO YOU PROVIDE EVIDENCE IN YOUR REBUTTAL TESTIMONY REGARDING THE RELATIVE RISKS OF EEI'S "MOSTLY REGULATED" AND "REGULATED" ELECTRIC UTILITY COMPANIES?

A. Yes. I demonstrate in my rebuttal testimony that the electric utilities in EEI's "mostly regulated" category have the same average Value Line Safety Rank

1 As described in my rebuttal testimony, EEI classifies its electric utility members into three groups based on its estimate of the percentage of a company's total assets that are regulated. The three groups include: (1) "regulated" utilities--regulated assets greater than 80 percent of total assets; (2) "mostly regulated"--regulated assets between 50 percent and 80 percent of total assets; and (3) "diversified"--regulated assets less than 50 percent of total assets. Both with regard to Staff's requirement that its proxy group have at least 70 percent revenues from regulated electric operations and be classified as "regulated" by EEI, Staff fails to recognize that it is quite difficult to quantify the percentage of a company's business that is "regulated." Ideally, one would measure percent regulated versus percent non-regulated based on the market values of a company's regulated and non-regulated businesses. However, since a company's individual business segments are not market traded, there is no market value for these business segments. Although an analyst might attempt to quantify "percent regulated" and "percent unregulated" using accounting variables such as assets or revenues as a substitute for market values, these accounting categories are imperfect because the accounting for regulated assets and revenues is likely not comparable from one company to another, and accounting values are imperfect indicators of market values.

and Standard & Poor's bond rating as the electric utilities in EEI's "regulated" category (Vander Weide at 7 and Rebuttal Schedule JVW-1).

Q. HOW DOES THE AVERAGE RISK OF YOUR COMPARABLE GROUP OF 28 ELECTRIC UTILITIES COMPARE TO THE AVERAGE RISK OF STAFF'S PROXY GROUP OF 12 ELECTRIC UTILITIES?

A. As I discuss in my rebuttal testimony, my comparable group of 28 electric utilities has approximately the same investment risk as Staff's proxy group of 12 electric utilities. For example, the average S&P bond rating for both my large proxy electric group and Staff's smaller group of electric companies is BBB+, and the average Value Line Safety Rank for both groups is 2.

Q. WHAT CONCLUSION DO YOU DRAW FROM THE EVIDENCE THAT STAFF'S ADDITIONAL SELECTION CRITERIA RELATING TO PERCENT REGULATED ELECTRIC REVENUES AND EEI CATEGORY DO NOT REDUCE THE RISK OF STAFF'S PROXY GROUP COMPARED TO YOUR COMPARABLE GROUP?

A. I conclude that the Commission should rely on my proxy group to estimate Empire's cost of equity. As I have demonstrated, my proxy group has similar investment risk, but includes a significantly larger sample of companies than Staff's proxy group. Since one can obtain more accurate estimates of the cost of equity by using a larger sample of comparable risk companies, the Commission should rely on my proxy companies to estimate Empire's cost of equity.

III. <u>DCF MODEL GROWTH RATE</u>

Q. THE DCF COST OF EQUITY DEPENDS ON ESTIMATES OF THE DIVIDEND YIELD AND INVESTORS' GROWTH EXPECTATIONS. HOW DO YOU ESTIMATE INVESTORS' GROWTH EXPECATIONS IN YOUR DCF ANALYSES?

A. I use the average analysts' estimates of future earnings per share ("EPS") growth reported by I/B/E/S Thomson Reuters.

Q. WHY DO YOU USE THE AVERAGE ANALYSTS' EPS GROWTH RATE FORECASTS REPORTED BY I/B/E/S THOMSON REUTERS?

A. I use the I/B/E/S growth forecasts because my studies indicate that the analysts' growth forecasts are more highly correlated with stock prices than other indicators of future growth. This result is consistent with the hypothesis that investors use analysts' growth forecasts in making stock buy and sell decisions.

Q. DOES STAFF AGREE WITH YOUR USE OF THE AVERAGE ANALYSTS' EPS GROWTH FORECAST IN THE DCF MODEL AS A PROXY FOR INVESTORS' GROWTH EXPECTATIONS?

A. No. Staff argues that the average analysts' growth forecast is unsustainable in the long run (Staff Rebuttal at 11-12).

Q. WHAT IS STAFF'S ESTIMATE OF THE LONG RUN SUSTAINABLE GROWTH RATE FOR ELECTRIC UTILITIES?

A. Staff claims that the long run sustainable growth rate for electric utilities is currently 3.35 percent. Staff arrives at this estimate by adding a 2.35 percent estimate of the rate of inflation in consumer prices to a one percent estimate of future growth in electricity consumption.

Q. IS STAFF'S 3.35 PERCENT ESTIMATE OF SUSTAINABLE GROWTH A REASONABLE ESTIMATE OF INVESTORS' EXPECTATIONS OF LONG RUN GROWTH IN THE DCF MODEL?

A. No. Staff fails to recognize that growth in electric utility revenues depends on the rate of inflation in electric rates, not the rate of inflation in the general level of consumer prices. Since electric utility expenses are likely to increase much faster than the general level of consumer prices due to factors such as rising capacity additions, rising expenditures on green energy technologies, additional costs to meet renewal energy portfolio standards, and rising fuel prices, electric rates are likely to rise faster than the growth in the general level of consumer prices.

Q. DOES STAFF PROVIDE ANY EVIDENCE THAT INVESTORS SHARE ITS VIEW OF THE LONG RUN SUSTAINABLE GROWTH FOR ELECTRIC UTILITIES?

A. No. Staff simply states its own opinion regarding long run utility growth and ignores the evidence that utility stock prices are highly correlated with analysts' EPS growth rates.

Q. DOES THE DCF MODEL REQUIRE THE GROWTH EXPECTATIONS OF INVESTORS OR STAFF'S ESTIMATE OF LONG RUN SUSTAINABLE GROWTH?

A. The DCF model requires the growth expectations of investors rather than Staff's estimate of long run sustainable growth. Since investors' growth rates determine stock prices, if Staff believes it should use a sustainable growth rate that is less than investors' growth expectations, for consistency, Staff should also reduce the stock price in its DCF model.

Q. DO YOU HAVE EVIDENCE THAT INVESTORS USE THE ANALYSTS' GROWTH FORECASTS IN MAKING STOCK BUY AND SELL DECISIONS?

A. Yes. I report such evidence in my direct testimony at pages 25 - 26.

Q. WHAT CONCLUSIONS DO YOU DRAW FROM THE EVIDENCE THAT INVESTORS USE THE ANALYSTS' GROWTH FORECASTS IN MAKING STOCK BUY AND SELL DECISIONS?

A. I conclude that the analysts' growth forecasts used in my DCF analyses are reasonable estimates of investors' long run growth expectations. In consequence, the Commission should rely on my DCF results rather than Staff's DCF results in estimating Empire's cost of equity.

Q. WHAT DCF RESULT WOULD STAFF HAVE OBTAINED IF IT HAD USED THE ANALYSTS' GROWTH FORECASTS AS REPORTED BY THOMSON REUTERS TO ESTIMATE THE GROWTH COMPIONENT OF ITS DCF MODEL?

A. As I show in my rebuttal testimony, Staff would have obtained a DCF estimate of the cost of equity equal to 11.1 percent (see Vander Weide Rebuttal Schedule JVW-3).

IV. <u>WEIGHTING OF COST OF EQUITY RESULTS</u>

Q. HOW DO YOU ESTIMATE EMPIRE'S COST OF EQUITY IN THIS PROCEEDING?

A. I estimate Empire's cost of equity by applying five cost of equity methods, including the DCF, Ex Ante Risk Premium, Ex Post Risk Premium, historical CAPM, and DCF-based CAPM, to a large group of comparable risk electric utilities.

Q. ARE THESE THE SAME FIVE COST OF EQUITY METHODS YOU GENERALLY USE TO ESTIMATE A UTILITY'S COST OF EQUITY IN STATE REGULATORY PROCEEDINGS?

A. Yes. Although I recognize that one or more of my cost of equity methods may produce seemingly illogical results in certain market environments, I generally present cost of equity results for each of these methods in electric utility cases.

Q. HOW DO YOU TREAT ILLOGICAL RESULTS THAT SOMETIMES ARISE WHEN APPLYING THESE COST OF EQUITY METHODS TO A GROUP OF COMPARABLE RISK COMPANIES?

A. I generally treat illogical results by either: (1) giving the illogical results a lower weight; or (2) giving illogical results an equal weight but stating why a recommendation based on equal weighting would be either conservative or not conservative, as the case may be.

Q. WHAT WEIGHT DO YOU GIVE TO THE RESULTS OF YOUR COST OF EQUITY METHODS IN THIS PROCEEDING?

A. I give my DCF result a one-third weight, the average of my two risk premium results a one-third weight, and the average of my two CAPM results a one-third weight (see Vander Weide Direct at page 4, Table 1 and Vander Weide Direct at 45, Table 5).

Q. WHY DO YOU NOT GIVE EQUAL WEIGHT TO EACH OF YOUR FIVE COST OF EQUITY METHODS?

A. I do not give equal weight to each of my five cost of equity methods because: (1) the average beta for my proxy group of electric utilities is currently 0.70; and (2) as discussed in my direct testimony, there is substantial evidence that the CAPM underestimates the cost of equity for companies such as my comparable companies with betas that are significantly less than 1.0. Thus, I believe that the Commission should give less weight to my CAPM results than to my other cost of equity results at this time.

Q. HOW DOES THE ONE-THIRD EQUAL WEIGHTING APPROACH IN THIS PROCEEDING GIVE LESS OVERALL WEIGHT TO YOUR CAPM RESULTS THAN WOULD A ONE-FIFTH EQUAL WEIGHTING OF EACH COST OF EQUITY RESULT?

A. An equal weighting of each cost of equity result would give a one-fifth weighting to my historical CAPM result and a one-fifth weighting to my DCF-based CAPM result, for a total CAPM result weighting equal to two-fifths. Since one-third is less than two-fifths, a one-third equal weighting approach assigns a lower overall weight to my CAPM results than would a one-fifth equal weighting of all five cost of equity results.

Q. WHAT WEIGHT DID YOU GIVE TO THE RESULTS OF YOUR COST OF EQUITY METHODS IN EMPIRE'S LAST CASE, ER-2008-0093?

A. I gave the same one-third weighting to the results of my cost of equity methods in Case No. ER-2008-0093 as I give to the results of my cost of equity methods in this case, namely, one-third weight to my DCF result, one-third weight to the average of my two risk premium results, and one-third weight to the average of my two CAPM results.

Q. WHY DID YOU NOT GIVE ONE-FIFTH EQUAL WEIGHT TO EACH OF YOUR FIVE COST OF EQUITY METHODS IN CASE NO. ER-2008-0093?

A. I did not assign one-fifth equal weight to the results of each of my five cost of equity methods in Case No. 2008-0093 because, in that case, my CAPM results were significantly higher than my DCF and risk premium results, and I believed that my CAPM results likely over-stated Empire's cost of equity at that time. Thus, my recommendation in that case would have been higher if I had given one-fifth equal weighting to each of my five cost of equity methods in that proceeding. (As noted above, a one-third weighting approach gives less overall weight to the CAPM than an equal weighting of all five cost of equity results.)

Q. STAFF CITES SOME CASES IN WHICH YOU GAVE ONE-FIFTH EQUAL WEIGHT TO THE RESULTS OF EACH OF YOUR FIVE COST OF EQUITY METHODS, EVEN THOUGH CAPITAL MARKET CONDITIONS ALLEDGEDLY WERE SIMILAR TO CONDITIONS AT THE TIME YOU PREPARED YOUR TESTIMONY IN THIS PROCEEDING. CAN YOU EXPLAIN WHY YOU GAVE ONE-FIFTH EQUAL WEIGHTING TO THE RESULTS OF EACH OF YOUR FIVE COST OF EQUITY METHODS IN THE CASES CITED BY STAFF?

A. Yes. For the reasons cited in my direct testimony, the current market environment tends to cause the CAPM to underestimate a company's cost of equity. In some cases, I explicitly account for this phenomenon by giving slightly less weight to CAPM results (one-third weighting rather than two-fifths); and, in other cases, I implicitly account for this phenomenon by emphasizing that my recommendation is conservative.

Q. DOES STAFF AGREE WITH YOUR ASSESSMENT THAT LESS WEIGHT SHOULD BE GIVEN TO CAPM RESULTS AT THIS TIME?

A. Yes. Staff asserts in its direct testimony:

> Staff also performed its traditional CAPM cost of common equity analysis on the comparable companies. However, due to recent significant stock market declines through the end of 2008, these CAPM results should not be given much consideration in this case. [Staff Report at 29.]

Q. IN SUMMARY, DO YOU AGREE WITH STAFF'S ASSESSMENT THAT A ONE-THIRD WEIGHTING APPROACH IS INCONSISTENT WITH THE WEIGHTING YOU APPLY IN PREVIOUS CASES?

A. No. In every case, I recognize that the results of applying the CAPM has been volatile in recent years. My two weighting approaches, along with my testimony regarding the CAPM, provide the regulator sufficient information to make a reasonable recommendation in the proceedings in which I have participated.

V. <u>FORECASTED INTEREST RATES</u>

Q. YOUR RISK PREMIUM APPROACHES REQUIRE AN ESTIMATE OF THE YIELD TO MATURITY ON A-RATED UTILITY BONDS, AND YOUR CAPM APPROACHES REQUIRE AN ESTIMATE OF THE YIELD TO MATURITY ON LONG-TERM TREASURY BONDS. HOW DO YOU ESTIMATE THESE YIELDS TO MATURITY IN THIS PROCEEDING?

A. I estimate these yields to maturity using forecasted interest rates on A-rated utility bonds and long-term Treasury bonds.

Q. DOES STAFF AGREE WITH YOUR USE OF FORECASTED INTEREST RATES TO ESTIMATE THE INTEREST RATE COMPONENT OF YOUR RISK PREMIUM AND CAPM METHODS?

A. No. Staff claims that my use of forecasted interest rates in this proceeding: (1) is inconsistent with my use of current interest rates in some other proceedings; (2) is inconsistent with my use of current stock prices in my DCF approach; and (3) is unnecessary because current bond yields already reflect investors' expectations of future interest rates.

Q. IS YOUR USE OF FORECASTED INTEREST RATES IN THIS PROCEEDING INCONSISTENT WITH YOUR USE OF CURRENT INTEREST RATES IN SOME OTHER PROCEEDINGS?

A. No. While it always appropriate in theory to add the risk premium to a forecasted interest rate, I sometimes use current interest rates because the current interest rate at the time of my studies is approximately equal to the forecasted interest rate, and current interest rates are more readily available than forecasted interest rates. In this proceeding, it is appropriate to use forecasted interest rates because forecasted interested rates are significantly different from current interest rates, and I had access to forecasted rates at the time of my studies.

Q. IS THE USE OF FORECASTED INTEREST RATES IN YOUR RISK PREMIUM STUDIES INCONSISTENT WITH YOUR USE OF CURRENT STOCK PRICES IN YOUR DCF APPROACH?

A. No. Although one could, in principle, forecast the DCF cost of equity, such a forecast would require not only a forecast of future stock prices, but also a forecast of future dividends and future growth rates as of a future point in time. I do not know of any source for obtaining such data. In contrast, sources such as Blue Chip, Bloomberg, and Value Line are available to obtain forecasted interest rate data.

Q. DO CURRENT BOND YIELDS ALREADY "REFLECT INVESTORS' EXPECTATIONS CONCERNING FUTURE INTEREST RATES"?

A. I am uncertain what Staff means by the word "reflect" in the context of its statement (see Staff Rebuttal at 8). However, it is clear that current bond yields are not equal to forecasted interest rates at this time.

Q. STAFF ALSO CRITICIZES YOUR USE OF FORECASTED INTEREST RATES, ALLEGING THAT YOU DO NOT "IDENTIFY THE MAGNITUDE OF THE DIFFERENCE BETWEEN FORECASTED YIELDS AND AVERAGE CURRENT YIELDS THAT WOULD CAUSE HIM TO CHOOSE ONE METHOD COMPARED TO THE OTHER." [STAFF REBUTTAL AT 7.] DOES YOUR TESTIMONY IDENTIFY CURRENT BOND YIELDS AS WELL AS FORECASTED BOND YIELDS?

A. Yes. My direct testimony describes my ex ante risk premium methodology, which studies the DCF expected return on a proxy group of electric companies compared to the interest rate on Moody's A-rated utility bonds for each month in my study period, which, in this proceeding consists of 119 months over the period September 1999 through July 2009. Thus, my testimony clearly identifies the average yield on Moody's A-rated utility bonds. (*See* Vander Weide Direct at 31 - 32, Schedule 2, and Appendix 3.)

Q. YOU HAVE EXPLAINED IN YOUR FOREGOING TESTIMONY THAT STAFF'S CRITICISMS REGARDING ALLEGED INCONSISTENTICES IN YOUR CURRENT AND PREVIOUS TESTIMONIES ARE UNJUSTIFIED. DO STAFF'S COST OF EQUITY METHODS IN THIS PROCEEDING DIFFER FROM ITS COST OF EQUITY METHODS IN OTHER PROCEEDINGS?

A. Yes. Staff has used different data, different methodologies, and different proxy group selection criteria in every Empire case in which I have testified in Missouri. For example, in Case No. ER-2004-0570, Staff recommends a cost of equity based on the result of a company-specific annual DCF model (using six-month stock prices) applied to Empire alone. Staff checks the reasonableness of this single-company analysis by applying the DCF model to a four-company proxy group based on seven proxy selection criteria.

In Case No. ER-2006-0315, Staff recommends a cost of equity based on the application of an annual DCF model (using four-month stock prices) and other cost of equity methods to Empire and a five-company proxy group chosen on the basis of the company's being listed in an August 11, 2005, issue of Standard & Poor's *CreditStats* and on other selection criteria that are significantly different from those used in Case No. ER-2004-0570.

In Case No. ER-2008-0093, Staff changes its proxy selection criteria, data, and methods, recommending a cost of equity based on an annual DCF model applied to a 16-company proxy group.

In the current proceeding, Staff once again uses different proxy selection criteria, data, and different cost of equity methodologies, now recommending a multi-stage DCF model using three-month stock prices and its own estimate of a "long-run sustainable growth rate" applied to a 12-company proxy group. Staff appears to believe that it is reasonable to criticize my testimony for minor differences in cost of equity data and weighting, while Staff is free to make significant changes in its cost of equity data, methodologies, and proxy selection criteria from one case to another. Given the many changes in Staff's testimony over time, Staff's criticisms of my testimony on the basis that there are minor differences in my testimonies in different proceedings seems unwarranted.

Q. STAFF CHARGES THAT YOUR COST OF EQUITY METHODS ARE "PLAIN RANDOM." [STAFF REBUTTAL AT 5.] IS THIS CRITICISM JUSTIFIED?

A. No. As discussed above, the minor changes that Staff notes in my testimonies are reasonable responses to changes in capital market conditions, availability of data, and conditions specific to a company or regulatory jurisdiction. Given the rapid changes in economic conditions in recent years, my testimony has remained remarkably consistent.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.

AFFIDAVIT OF JAMES H. VANDER WEIDE

STATE OF NORTH CAROLINA)
) ss
COUNTY OF DURHAM)

On the 20 day of April, 2010, before me appeared James H. Vander Weide, to me personally known, who, being by me first duly sworn, states that he is Research Professor of Finance and Economics at the Fuqua School of Business of Duke University and also President of Financial Strategy Associates and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.

James H. Vander Weide
James H. Vander Weide

Subscribed and sworn to before me this 20 day of April, 2010

Amy C. Knud
Notary Public

My commission expires 2/29/2012

AMY C. KNUDSEN
NOTARY PUBLIC
Person County
N.C.