

Exhibit No.: **118**
Issue(s): Fuel Adjustment Clause
Witness: Julie M. Cannell
Sponsoring Party: Union Electric Company
Type of Exhibit: FAC Rebuttal Testimony
Case No.: ER-2010-0036
Date Testimony Prepared: February 26, 2010

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April 21, 2010
Missouri Public
Service Commission

MISSOURI PUBLIC SERVICE COMMISSION

Case No. ER-2010-0036

FUEL ADJUSTMENT CLAUSE REBUTTAL TESTIMONY

OF

JULIE M. CANNELL

ON

BEHALF OF

**UNION ELECTRIC COMPANY
d/b/a AmerenUE**

**St. Louis, Missouri
February, 2010**

Company
Exhibit No. 118
Date 3/19/10 Reporter AF
File No. ER-2010-0036

FUEL ADJUSTMENT CLAUSE REBUTTAL TESTIMONY

OF

JULIE M. CANNELL

CASE NO. ER-2010-0036

1 **Q. Please state your name, employer, and business address.**

2 A. My name is Julie M. Cannell. I am the president of my own advisory firm, J.M.
3 Cannell, Inc. My business address is P.O. Box 199, Purchase, NY 10577.

4 **Q. Are you the same Julie M. Cannell who filed rebuttal testimony in this case?**

5 A. Yes, I am.

6 **Q. What is the purpose of your rebuttal testimony?**

7 A. The purpose of my rebuttal testimony is to respond to the recommendations of
8 certain intervenors to alter the existing Fuel Adjustment Clause ("FAC") under which Union
9 Electric Company ("AmerenUE" or "Company") currently operates.

10 **Q. From what perspective will your comments be made?**

11 A. From the perspective of equity investors.

12 **Q. Would equity investors view the proposals to change the Company's existing
13 FAC as constructive?**

14 A. No, they would not.

15 **Q. Please elaborate.**

16 A. The investment community applauded the Missouri Public Service Commission's
17 ("Commission" or "PSC") initiation of a FAC in its January 2009 rate order for the Company.
18 Missouri was one of the last states to institute a formal process for fuel recovery. For example,
19 J.P. Morgan, in commenting on the instant proceeding, observed: "The company operates under

1 a fuel recovery clause (which is a sharp improvement over recent years when it was not allowed
2 to recover fuel)....”¹ Jessup & Lamont also favorably noted the implementation of the FAC:

3 We consider this order to be constructive given that they received roughly 65% of the
4 requested revenue increase, a fuel clause was implemented, and the 10.76% allowed ROE
5 is moderately higher than recent national averages.²

6 **Q. Why is a fuel recovery mechanism of importance to equity investors?**

7 A. Because fuel is one of the largest expense categories for any electric utility,
8 uncertainty around recovery of this significant expenditure translates into earnings
9 unpredictability and subsequently into difficulty in accurately valuing a common stock. Thus,
10 when legislation was passed in Missouri empowering the PSC with the ability to construct a
11 means by which utilities operating in the state could reliably recoup their fuel costs, investors
12 welcomed the prospect of companies’ earnings becoming both more predictable and reflective of
13 the actual recovery of the companies’ largest operating expense.

14 **Q. Why would the alteration of the Company’s FAC be of concern to investors?**

15 A. There are several reasons. First, as noted previously, both in this testimony and in
16 my previously submitted rebuttal, the PSC’s January 2009 rate order for AmerenUE was widely
17 viewed as supportive by the investment community. A very important component of this
18 opinion involved the PSC’s instituting a FAC for AmerenUE that assured recovery of nearly all
19 of the Company’s prudently incurred net fuel costs. Changing the FAC only a little more than a
20 year after it was initiated, as well as degrading the quality of the mechanism, would in my
21 opinion signal to investors that the constructive regulatory tone evident in Missouri in early 2009
22 could be evaporating. It would also signal a lack of regulatory consistency and predictability.
23 As my earlier rebuttal testimony detailed, a lack of consistency on the part of the PSC could then

¹ J.P. Morgan. “Ameren Corp.: Positive Catalysts Unlikely.” October 22, 2009.

² Jessup & Lamont. “Ameren: Union Electric Receives Important and Constructive Rate Order.” January 28, 2009.

1 translate into a higher cost of capital for the state's utilities in general and for AmerenUE
2 specifically. At a time that competition for capital is increasing, the Company could be
3 challenged prospectively in that regard.

4 **Q. What other difficulties might investors have with a material change in the**
5 **Company's FAC?**

6 A. The proposed change in the sharing mix would be detrimental to AmerenUE.
7 Currently, the Company is permitted to recover 95% of its net fuel expenditures, with the
8 remaining 5% being borne by the Company. The recommendation to shift the sharing to 80%
9 recovery for the Company would mean that, all other things being equal, AmerenUE's earnings
10 would become more anemic prospectively.

11 A related factor here is that the Company's FAC permits fuel cost recovery only on a net
12 basis, i.e., after netting off-system sales against fuel and purchased power costs, and then that
13 sum must be shared. In other words, AmerenUE at the outset recovers less of its fuel and
14 purchased power costs through its FAC than the majority of utilities that are permitted full
15 recovery of fuel and purchased power. To then further lower the allowed recovery by reducing
16 the percentage of expenses recouped to 80% from 95% means the Company will fail to recover
17 20%, not 5% of fuel and purchased power cost increases. So, on a comparative or relative basis,
18 the Company would end up further behind.

19 **Q. Wouldn't investors see this proposed shift in sharing as an opportunity for**
20 **management to be more incented to cut operating costs?**

21 A. No, I don't think so. Investors view fuel and purchased power expense as a
22 legitimate operating cost for a utility, and denying recovery of a sizeable portion of that expense
23 would more likely be perceived as punitive rather than as a carrot to encourage better

1 management. This is particularly true when one considers that most FACs permit full recovery
2 of fuel and purchased power costs, a fact that the PSC has recognized. Investors would question
3 why this Commission is imposing an under-recovery of fuel and purchased power costs on
4 AmerenUE when there is no sharing at all in most other jurisdictions. Moreover, investors
5 would question why this change is being made so quickly after the FAC was established, at a
6 time when the first prudence review of AmerenUE's net fuel cost management activities has not
7 yet occurred.

8 **Q. What additional concerns are investors likely to have with the proposed**
9 **change in AmerenUE's FAC?**

10 A. In my earlier rebuttal testimony, I discussed in some detail the problems
11 surrounding regulatory lag, and the investment community's acute awareness of this difficulty as
12 it pertains to the Company. A change in the FAC would put additional pressure on AmerenUE's
13 earnings and thus result in an even greater gap between allowed and earned returns. The
14 Company, already at a disadvantage in the eyes of investors because of the existence of
15 significant regulatory lag, would fall even farther behind.

16 **Q. Please summarize your opinion regarding how investors would view a change**
17 **in the Company's current FAC.**

18 A. I believe the investment community would perceive the proposed alterations to
19 the FAC negatively. Investors considered the implementation of the mechanism in the PSC's
20 January 2009 rate decision a very positive move by the Commission, and one that signaled a
21 constructive regulatory trend developing in Missouri. Altering the FAC so close to the time that
22 it was initiated would likely be viewed as a sign of regulatory inconsistency, which in turn would
23 prompt concerns about the quality of Missouri regulation. Investors would understand that the

1 Company's earnings would be impaired by the proposed change in sharing and that regulatory
2 lag would be aggravated. As a result, the cost of capital could be expected to rise, and access to
3 capital could be impaired, particularly during challenging periods in the financial markets.

4 **Q. Does this conclude your rebuttal testimony?**

5 **A. Yes, it does.**

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

In the Matter of Union Electric Company d/b/a) Case No. ER-2010-0036 :
AmerenUE's Tariffs to Increase its Annual) Tracking No. YE-2010-0054
Revenues for Electric Service.) Tracking No. YE-2010-0055

AFFIDAVIT OF JULIE CANNELL

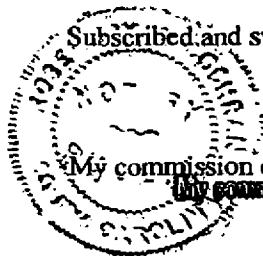
STATE OF NEW YORK)
) ss
CITY OF PURCHASE)

Julie M. Cannell, being first duly sworn on his oath, states:

1. My name is Julie M. Cannell. I work in Purchase, New York, and I am the President of my own advisory firm, J.M. Cannell, Inc.
2. Attached hereto and made a part hereof for all purposes is my Additional Rebuttal Testimony regarding AmerenUE's Fuel Adjustment Clause on behalf of Union Electric Company, d/b/a AmerenUE, consisting of 5 pages and Schedules ~~JMC-FRXX~~ through ~~JMC-FRXX~~, all of which have been prepared in written form for introduction into evidence in the above-referenced docket.
3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.



Julie M. Cannell



Subscribed and sworn to before me this 2nd day of February, 2010.



Notary Public

My commission expires:
~~My commission expires on November 17, 2016~~

Exhibit No.:
Issue(s): Return on Equity
Witness: Julie M. Cannell
Sponsoring Party: Union Electric Company
Type of Exhibit: Surrebuttal Testimony
Case No.: ER-2010-0036
Date Testimony Prepared: March 5, 2010

MISSOURI PUBLIC SERVICE COMMISSION

Case No. ER-2010-0036

SURREBUTTAL TESTIMONY

OF

JULIE M. CANNELL

ON

BEHALF OF

**UNION ELECTRIC COMPANY
d/b/a AmerenUE**

**St. Louis, Missouri
March 5, 2010**

SURREBUTTAL TESTIMONY

OF

JULIE M. CANNELL

CASE NO. ER-2010-0036

1 **Q. Please state your name, employer, and business address.**

2 A. My name is Julie M. Cannell. I am the president of my own advisory firm,
3 J.M. Cannell, Inc. My business address is P.O. Box 199, Purchase, NY 10577.

4 **Q. Are you the same Julie M. Cannell who filed rebuttal testimony and**
5 **additional rebuttal testimony regarding the fuel adjustment clause in this case?**

6 A. Yes, I am.

7 **Q. What is the purpose of your surrebuttal testimony?**

8 A. The purpose of my surrebuttal testimony is to respond to portions of the rebuttal
9 testimony of Missouri Public Service Commission ("PSC" or "Commission") Staff witness
10 David Murray.

11 **Q. Does Mr. Murray rely on reports authored by financial analysts in his**
12 **rebuttal testimony?**

13 A. Yes, he does.

14 **Q. In your opinion, does Mr. Murray properly utilize the analyses contained in**
15 **those reports in reaching his recommendation for Union Electric Company's**
16 **("AmerenUE" or "Company") return on common equity ("ROE")?**

17 A. No, I don't believe he does. As he did in his direct testimony, Mr. Murray
18 references the analytical methodology contained in investor reports, incorrectly pointing to some

1 of the elements and assumptions in the analysts' models as representing their required return on
2 equity.

3 **Q. Please elaborate.**

4 A. In his rebuttal testimony, Mr. Murray points to a recent Goldman Sachs report and
5 the authors' baseline price/earnings ("P/E") assumption for valuing regulated utilities. He
6 averred that because this P/E figure was higher than the P/E assumption incorporated by the
7 analysts in early summer 2009 but the same as had been used by them in March 2008, that this
8 implied "a cost of equity that is similar or possibly even lower than that which was estimated in
9 March 2008."¹

10 **Q. What is incorrect about Mr. Murray's conclusion?**

11 A. My rebuttal testimony addressed Mr. Murray's referencing the cost of equity
12 discount rates incorporated in investor reports as support for his lower ROE proposal. I noted
13 that this was an incorrect comparison on his part, as the discount rate in a dividend discount
14 model is a valuation tool, used for stock selection. The argument made in his rebuttal testimony,
15 which is based on P/E assumptions by the analysts, is similarly off the mark. As is the case of a
16 discount rate in a dividend discount model, investors use P/E ratios to value common stocks.
17 These ratios do not reflect their required return on equity for a utility investment.

18 **Q. Please explain why a P/E ratio does not represent the cost of equity.**

19 A. The P/E ratio is the multiple of earnings at which a stock is expected to sell. The
20 earnings figure used in this ratio is the company's financial earnings: either the actual historic
21 financial earnings of the company or the investor's projection of future financial earnings at a
22 specific point in time (e.g., the current year or the next year). These are the earnings either the

¹ Rebuttal testimony of David Murray at 26.

1 company has earned or what the analyst expects the company to earn, and are the earnings that
2 are publicly reported. These actual, financial earnings over a particular period of time do not
3 reflect normalizations or annualizations that are a standard part of the ratemaking process, and
4 they certainly do not reflect the investor's required return for an investment. To take an extreme
5 example, let's assume that, for a variety of reasons, a company's earnings are expected to be zero
6 or negative one year. That does not mean that the investor's required return on his equity
7 investment is similarly zero or a negative number. In other words, the expected return as related
8 to financial earnings is not equal to what the authorized return on common equity as established
9 in a regulatory proceeding should be. A related point is that the P/E ratio is connected with the
10 common stock of a company, not with that company's subsidiaries. In the case of Ameren
11 Corporation, the P/E applies to the corporation's publicly traded common stock, not to
12 AmerenUE.

13 **Q. As a practicing investor, did you use P/E ratios in your work? If so, how?**

14 A. I used P/E ratios frequently in relation to my responsibilities as a utility securities
15 analyst and portfolio manager. These ratios were one means I had of assessing whether an
16 existing or potential stock investment was undervalued, fairly valued, or overvalued in relation to
17 other available investment choice.

18 **Q. Specific to your previous utility investment responsibilities, in any analysis**
19 **you performed involving P/E ratios, were those ratios ever synonymous with your required**
20 **return for a utility operating company?**

21 A. No. My use of P/E ratios consistently related to stock valuation and the expected
22 performance of a stock. In no way did such ratios relate to fair, required equity returns.

1 **Q. Please summarize why a P/E ratio, as pointed to by Mr. Murray, does not**
2 **reflect an investor's required return on equity.**

3 A. Investors have a wide range of investment choices available to them. They must
4 determine how attractive one investment is relative to another. This determination can be made
5 through a variety of means, including utilization of P/E ratios. A P/E ratio represents the
6 magnitude by which the common stock price is expected to sell compared to the company's
7 historic or expected financial earnings. In short, this ratio is a valuation tool used by investors.
8 It is not an indicator of the required, fair return on a utility's common equity, which is
9 established through consideration of various methodologies and attendant factors in rate cases.

10 **Q. Does this conclude your surrebuttal testimony?**

11 A. Yes, it does.

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

In the Matter of Union Electric Company d/b/a) Case No. ER-2010-0036
AmerenUE's Tariffs to Increase its Annual) Tracking No. YE-2010-0054
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AFFIDAVIT OF JULIE CANNELL

STATE OF NEW YORK)
) ss
CITY OF PURCHASE)

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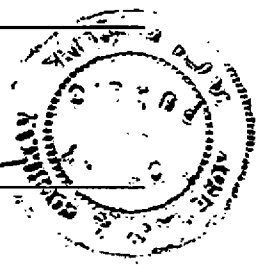
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3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.

Julie M. Cannell
Julie M. Cannell

Subscribed and sworn to before me this 4th day of March, 2010.

Rosmary K. Cook
Notary Public



My commission expires: ~~My commission expires~~ on November 17, 2013