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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2010-0036

REBUTTAL TESTIMONY

OF

JULIE M. CANNELL

ON

BEHALF OF

UNION ELECTRIC COMPANY
d/b/a AmerenUE

St. Louis, Missouri

February 11, 2010

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INTRODUCTION

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

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

Q. Please describe your professional and educational background.

A. My firm, J.M. Cannell, Inc., provides investor-related advisory services to electric utility companies and other firms and organizations with an interest in the industry. Prior to establishing my firm in February 1997, I was employed by the New York-based investment manager, Lord Abbett & Company, from June 1978 to January 31, 1997. During my tenure with Lord Abbett, I was a securities analyst specializing in the electric utility and telecommunications services industries; portfolio manager of America's Utility Fund, an equity utility mutual fund, for which Lord Abbett was a sub-advisor; portfolio manager of numerous institutional equity portfolios; and co-director of Lord Abbett's Equity Research Department.

My educational credentials include a B.A. from Mary Baldwin College, M.Ln. from Emory University, and M.B.A. from Columbia University. I am also a Chartered Financial Analyst (C.F.A.).

I have been a member of the Wall Street Utility Group, an organization of security and credit rating analysts having an expertise in the utility industry, for over thirty years.

Q. On whose behalf are you providing rebuttal testimony in this proceeding?

A. I am providing rebuttal testimony on behalf of Union Electric Company d/b/a AmerenUE ("AmerenUE" or the "Company").

Q. Have you submitted testimony previously before any state regulatory agencies?

A. Yes, I have. I have submitted pre-filed testimony on behalf of investor-owned utilities before Public Service or Public Utility Commissions in the states of Arizona, Colorado, Connecticut, Kansas, Massachusetts, Nevada, New York, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Texas, Virginia, Washington, and Wisconsin.

Q. Have you also submitted testimony in Missouri?

A. Yes. In 1997, I sponsored direct testimony for Western Resources in its merger proceeding and in 1999, direct testimony for St. Joseph Light & Power. Both cases settled prior to the onset of hearings.

Q. Have you had additional regulatory experience?

A. Yes. As a consultant to the Edison Electric Institute, I have been extensively involved since 2004 in an ongoing initiative geared toward fostering and improving communications between state regulators and the investment community. This effort has centered on a series of forums held throughout the United States bringing together these two constituencies, sponsored by the Edison Electric Institute and facilitated by Gee Strategies president Robert Gee, former chairman of the Texas Public Utilities Commission and former assistant secretary for the United States Department of Energy.

In addition to helping structure these dialogues, my role has been to moderate panel discussions of equity and debt security analysts.

I have also conducted several studies of investor perceptions of regulatory issues. Further, I have written articles addressing the implications for utilities and state regulators of various topical issues, including the current electric industry capital expenditure cycle, and, most recently, the financial crisis.

Q. What is the scope of your rebuttal testimony in this proceeding?

A. I will respond to the Revenue Requirement Cost of Service Report of the Missouri Public Service Commission Staff, the direct testimony of Mr. Daniel J. Lawton on behalf of the Missouri Office of the Public Counsel, and Mr. Michael Gorman on behalf of the Missouri Industrial Energy Consumers. I will provide comments on several areas: (1) investors' perspective of risk due to the massive investment currently being undertaken by electric utilities in general and the Company in particular; (2) investors' perception of risk as impacted by current macroeconomic conditions and reflected in an increase in the trend in allowed returns on equity ("ROE"); and (3) investors' expectations for a continuation of the improving trend of the Missouri regulatory climate to ensure the Company's continued access to the capital markets at a reasonable cost.

Q. What in your experience allows you to provide testimony about investors' perspectives and expectations?

A. As a securities analyst, I specialized in the electric utility industry and the individual companies comprising it. And as a portfolio manager, I applied that knowledge, along with investment fundamentals, toward investment decisions on behalf of institutions and individual investors. My experience has given me familiarity with the information and tools that investors use in making decisions with respect to the expected ROEs necessary for them to invest in electric utilities in general, or in a particular electric utility. Moreover, I have reviewed the various reports of security analysts, which have addressed the Company and its regulatory situation. Further, I have familiarized myself with the Company's fundamentals and its planned investment levels.

Q. As an analyst or portfolio manager, did you follow the Company?

A. Yes, I did. Both Lord Abbett and America's Utility Fund periodically maintained a holding in the common stock of Union Electric Company.

Q. Please summarize the key points of your testimony.

A. As my testimony will explain, investors now require a higher return when investing in the electric utility industry due to the changing nature of the industry through a hybrid deregulated structure and attendant increased risk. That risk level has also been raised due to the major capital expenditure cycle for infrastructure expansion and refurbishment, coupled with environmental compliance, on which the industry has embarked, and exacerbated most recently by the global recession and financial crisis. Even prior to the onset of the crisis in fall 2008, the investment industry itself had experienced major changes in recent years, including a dramatic growth in the amount of capital controlled by sophisticated institutional investors and hedge funds. Performance pressures have shortened significantly the timeframe during which an investment must realize its expected return.

In making their assessments of utility companies, investors consider various factors, key among them the regulatory environment. Regulators influence a utility's capital structure and returns that may be earned on that capital. Those factors in turn determine a company's creditworthiness, as well as its ability to provide stable earnings and dividends.

In my judgment, the investment community would not find Staff's recommendation of a 9.35% ROE, nor Intervenor witnesses Gorman's 10.0% and Lawton's 10.2% proposals reasonable. Such return levels would reduce the necessary cash flows needed by AmerenUE to help fund their considerable capital expenditure program and also meet the expectations of equity investors so as to ensure access to the capital markets at a reasonable cost during a challenging period. Investors, encouraged that a constructive regulatory trend is in the making in Missouri, will be watching the outcome of this proceeding closely. A significant degradation in the Company's currently allowed 10.76% ROE would neither be consistent with recent ROE awards nationwide nor a sign of regulatory support. Indeed, as I discuss later in my testimony, the fact that even a continuation of the 10.76% ROE would likely not allow the Company to actually earn 10.76%, coupled with other Company-specific risks, suggest that an ROE at or near the 10.8% recommended by Company witness Dr. Roger Morin is appropriate.

Q. Please describe how your testimony is organized.

A. There are four parts to my testimony.

I. **Investors' Requirements for Increased Returns on Utility Investments**. This section discusses the investment risk of electric utilities; specifically, why the current capital expenditure cycle has increased the risk of investing in the industry. It also addresses how regulatory risk has risen due to this higher capital spending.

II. **The Macroeconomic Environment**. This section discusses the elevated risk created by the global economic crisis.

III. **<u>Investors' Expectations for Returns and Perceptions of the Current Proceeding</u>**. This section focuses on how investors actually make their decisions, reviewing the investment community's perceptions of the Company and Missouri regulation. This review is based on a number of recent publications by investment analysts discussing their perceptions of the Company and its regulatory environment.

IV. **<u>Investor Expectations for Return on Equity for AmerenUE</u>**. This section responds in part to the testimony of Staff and Intervenor witnesses that a return on equity of 9.35%, 10.2%, or 10.0 % is reasonable. My conclusion is that investors would not view any of these recommendations to be reflective of a fair ROE for AmerenUE; rather, retaining an existing allowed ROE at or near the existing 10.76% level is important to the perception that a constructive regulatory climate now exists in Missouri. Such an environment will be critical to AmerenUE having access to the capital markets at a reasonable cost, particularly during a time when increased financial stability is very important to the Company.

I. INVESTORS' REQUIREMENTS FOR INCREASED RETURNS IN UTILITY INVESTMENTS

Q. Why is it important to consider the opinions of the investment community?

A. Electric utilities are in the business of providing the infrastructure needed to give their customers safe, reliable, and efficient service. Electric delivery is a very capital-intensive business. Investors provide the capital necessary to maintain and expand a utility's infrastructure, which in turn enables utilities like the Company to provide reliable service to customers. The terms on which the Company is able to obtain that capital have a direct and measurable impact on customers and the amounts they pay for electric service.

For example, if credit rating agencies such as Moody's Investors Service or Standard & Poor's believe that the utility's revenues will be diminished by adverse business or regulatory decisions, the utility's credit quality will deteriorate, and ultimately those rating agencies could lower their credit ratings for the utility, which would raise the cost of debt. And, because the cost of debt is a component of the weighted average cost of capital, the increased costs of capital would ultimately be passed on to customers in the form of higher rates to cover those higher debt costs.

The same is true for equity investors. If individual or institutional investors believe that the return they are offered is too low in light of the risk involved, they will either sell their stock or elect not to purchase the stock, which generally drives the stock price down. Although lower stock prices would appear at first blush to be a concern only to investors, they also affect customers. When a utility has to go to the equity markets to obtain capital, a low stock price requires it to issue more shares of stock to obtain the same amount of money that it would have received for fewer shares if the per share price had been higher. Because of the resulting increase in the number of shares outstanding, more dollars would have to be expended toward dividends, resulting in less retained earnings for reinvestment in the company.

The corollary is that when investors believe that they are investing in a company that enjoys fair, consistent regulation and a reasonable rate of return, those investors charge less for their capital. And when debt and equity investors demand less for their capital, utility rates remain lower and utilities have more ready access to the capital markets. Thus, a utility and its ratepayers have a shared interest in meeting the expectations of investors and credit rating agencies. Regulators share this interest as well, because fair treatment of one utility decreases the costs of capital for all utilities in that regulatory jurisdiction.

Q. Are you suggesting that the decisions of the Missouri Public Service Commission ("PSC" or "Commission") should be dictated by the desires of investors?

A. No. I realize that the Commission has to balance the interests of both investors, who want consistent and constructive regulatory treatment, and customers, who want lower rates. My point is that the PSC's decision on rate of return is not simply a zero-sum game. If the rate of return strikes an appropriate balance between the utility and customers, both benefit. If the rate of return is set too low, both the utility and customers are adversely impacted because of the effect on the cost of and access to capital. My testimony will later address why the correlation between investor and customer interests exists.

Q. What goals lead investors to invest in electric utilities?

A. Historically, electric utilities have been regarded as investment vehicles that provide stable performance through the ups and downs of market cycles and changing economic conditions. Electric utilities historically have earned a reasonable return even when conditions were not favorable for other companies. Accordingly, electric utility stocks have been particularly valuable holdings when conditions were not conducive to investments in more volatile industry sectors. In other words, investors might see greater returns from investment in other industries when times were good, but they would lose less on electric utility stocks when times were less favorable.

In addition, the reliability of electric utilities' earnings streams historically has permitted most of the companies to continue to pay regular dividends during both good and bad economic cycles. For investors with a need for regular cash income, the prospect of regular dividends has been an important consideration in making a decision to invest in electric utility stocks.

Based on these factors, investors traditionally have viewed electric utility stocks as bond substitutes. In other words, electric utility stocks have provided regular cash returns in the form of dividends and the shares themselves were seen to have a stable underlying value. Electric utilities historically have paid out a large proportion of their earnings as dividends, and their large construction programs have kept them dependent on the capital markets. As a result, electric utility stocks as a group have tended to move closely in line with the direction of interest rates, but in an inverse relationship. That is, utility stock prices rose when interest rates fell, and vice versa. These factors made electric utilities a preferred investment during economic slowdowns or recessions and owning them was a way of balancing the risks in a stock portfolio that included stocks in more volatile industries. That historic relationship between utility stock prices and interest rates has not been consistent of late. This is due to fundamental concerns that investors have about the massive capital expansion program the industry is facing; the amount of capital that will be required to fund it; whether regulators will allow full and timely recovery of the costs associated with these investments; and whether regulators will provide utilities with a reasonable opportunity to earn a fair return on their investment, among other issues.

Q. Have the recent changes in the industry increased the risk of investing in electric utilities?

A. Yes. The predictability of the electric utility industry's earnings, across the sector, was undermined in the last ten to fifteen years by the restructuring of the industry that has taken place in many parts of the country. Presently, the onset of a major new construction cycle is seen as posing a new and significant challenge to the electric utility sector. Related to the significant expansion of capital spending by electric utilities, regulatory exposure has become a key focus for investors as utilities face a series of rate cases in order to recover the costs they are incurring to replace aging infrastructure, meet new environmental requirements and expectations, address the need for smart grid investments, and recover other cost increases such as health care expenses. These risks are in addition to those posed by technological, economic, environmental and other policy changes that affect the industry. These increased risks mean that investors no longer perceive electric utilities as a group as being the "safe havens" they once were.

Q. Have investors' goals for utility investments changed in response to these increased risks?

A. No. Investors' goals for electric utility investments have not fundamentally changed. They still look to electric utilities primarily as defensive investments, and still look for stable performance and regular dividends as the reason to invest in electric utilities. But investors also understand that the investment risk in electric stocks has risen significantly.

In the end, investors have a very large universe of stocks from which to select; with few exceptions, they have no requirement to own electric utility stocks. To the extent that they do invest within the utility sector, investors must be discriminating in their stock selection. As a result, utilities with strong financial metrics operating in constructive regulatory environments with minimal regulatory lag will have stronger investment appeal than utilities with weak metrics and less favorable regulation.

Q. Please expand on how investors view the industry's current construction cycle as a risk.

A. In its annual regulatory study, *Capital Management*, Barclays Capital explores extensively the ramifications of the current construction cycle. Among the key points detailed in the study are the following [***emphasis added***]:

- We are in the third year of the infrastructure build cycle for regulated utilities that began in 2007. Based on our 2009 capex survey, we now anticipate that the industry will proceed with a pre-dividend free cash flow deficit through at least 2013, but likely significantly longer. We estimate over the next five years, the industry will spend on average 2.0x its annual depreciation and amortization expense growing industry rate base at an average annual pace of 6.3%.

- We expect that the risks of this build cycle will offset much of the growth opportunity in share performance through the construction period. This is consistent with the investor experience in the last major infrastructure cycle which extended from 1973-1984. ***The headwinds we forecast will likely come from the dilutive effect of heightened external capital funding requirements, regulatory risk in a rising rate environment and execution risk associated with a significant construction program. The best performing stocks over the cycle will likely be those spending on infrastructure with the highest public policy support, with the highest quality balance sheets, doing business in the best regulatory jurisdictions.***

- ***In the long term, structural headwinds should persist for regulated utilities, owing to risks associated with capital acquisition, construction execution, and regulatory recovery in a rising rate-base environment.*** The bulk of this report is focused on these long run trends. ***As a result of these trends, we would be owners of the most constructive regulatory jurisdictions, the strongest balance sheets, and most capable managements.***

- ***In the intermediate term, we are looking for potential catalysts around rate case filings and equity issuance schedules.***[1]

[1] Barclays Capital. Capital Management. July 16, 2009.

Q. Did Barclays also address the rate case process?

A. Yes. Barclays noted the added problem of regulatory lag caused by the use of historic test years during a time of substantial investments:

> During periods of rising capital expenditures and rate base as well as rising costs, utilities with historic test years cannot fully recover those rising costs over time. That is, during periods of free cash flow deficits, revenues meant to offset depreciation, capital, and operating costs, for utilities with historic test years are often delayed versus the actual incurrence of these costs due to the review process.
>
> As FCF [free cash flow] deficits have increased, this has in turn increased balance sheet strain, regulatory scrutiny, and execution risk. Investors may, as a result, demand a higher risk premium. …we would expect to see risk premiums spike to the area of 13.5% by 2010 versus the 3.17% seen in 2008, before moderating in the 11%-12% area from 2011 to 2013. [Earned] returns should move lower with the increase in equity risk premiums.[2]

Q. Are investors concerned about state regulation in the context of mounting risk?

A. Yes. Nationally, rate case filings have become much more frequent. From an investor's perspective, each regulatory proceeding introduces a period of uncertainty for a utility. Among the unknowns are the ROE the company will be allowed to earn, the equity base on which that return can be earned, the extent to which costs—both historical and future—can be recovered, and the degree to which the rate case will prompt a negative reaction. In other words, the utility's future earnings power is thrown into question until the case is decided. Because that earnings power is the basis for an investment in the company, the stability, consistency and constructiveness of state regulatory policies are critical concerns to investors.

[2] Ibid.

Q. What implications does Barclays' analysis have for AmerenUE?

A. Missouri regulatory practice utilizes an historical test year with adjustments permitted only for known and measurable changes. This updated information, which is itself based on historical data, is only permitted if the changes occur prior to a cut-off date before the conclusion of the rate case. This means that further changes (often increases) after that cut-off date are not considered as part of the rate case proceedings. While the allowed adjustments provide for more timely recovery than would a purely historical test year by itself, this does not keep the Company as whole in expense recovery as would a future test year, which is used in many jurisdictions. The prohibition on including construction work in progress in rate base in Missouri also exacerbates this problem, particularly as compared to the many jurisdictions that have no such prohibition. It is thus reasonable to expect investors to increase the risk premiums they would require to supply the Company with capital.

Q. How do the concerns set forth by Barclays impact AmerenUE in terms of how investors evaluate a specific company within an industry?

A. Investors arrive at investment judgments by essentially a two-step process. First, they make judgments about investment risks that apply to industry sectors as a whole. This step incorporates a consideration of macroeconomic factors. Step two involves examining company-specific risk factors, which are additive to sector risk. In other words, investors first determine the risk involved in investing in a particular sector. They then add to that sector risk the specific risks applicable to individual companies.

Q. Please address the specific risks the Company is facing.

A. Like many other utilities, AmerenUE has a large construction program. From 2010 through 2014, the utility currently expects to spend a total of $3.7 billion, averaging over $700 million annually. During that period, the Company will need to access the equity and debt markets each year, sometimes requiring funding from both sources annually. The Company (and its parent, which supplies it with equity) will thus be exposed to market vicissitudes and pricing levels. It bears mention that last year Ameren announced a $2 billion reduction in consolidated capital expenditures, including $1 billion in the regulated businesses, between 2010 and 2013 in response to the disruption and uncertainties in the capital and credit markets. Even with reductions in capital expenditure levels from those planned a year or two ago, capital expenditure needs remain high and at such future time that the economy has fully stabilized, it is possible that AmerenUE will ramp back up its capital spending plans, and financing needs along with it. This would bring additional focus to dependence on the financial markets.

Q. Does the Company face further risks?

A. Yes. With its major planned capital spending, it is clear that AmerenUE will face more regular rate cases. This raises questions about the timing and certainty of the utility's cash recovery of costs, particularly because of the built-in lag associated with the Missouri regulatory process. Such proceedings will be driven by the substantial current-dollar costs of maintaining, improving, and expanding a mature utility infrastructure, as well as responding to current and future environmental and carbon requirements.

Q. Does AmerenUE face additional risks in a competitive market for energy?

A. Yes, it does. Major risks are rising environmental requirements such as renewable portfolio or renewable energy standards, possible more stringent SO_2 or mercury rules, as well as other forms of carbon regulation, coupled with a significantly heightened public awareness of climate issues. While utilities have long faced environmental compliance costs, such expenditures are likely to rise to a new level under the Obama Administration. This puts pressure on total costs, and thus makes it more difficult to accept rate increases. AmerenUE will face a particularly high exposure to more stringent SO_2, mercury or carbon regulation, as coal-fired generation constitutes roughly three-quarters of its energy production.

Q. You've discussed the mounting risks you see the Company facing. Do those risks have the potential to reduce its earnings and cash flow streams and increase their volatility?

A. Yes. Given the fact that the foregoing factors are in large part beyond AmerenUE's control, the Company's investors have little guidance and more uncertainty. Uncertainty leads to investor concern and demands for higher investment returns.

Q. Do investors have additional regulatory concerns?

A. Yes. Many states, including Missouri, offer little assurance of cost recovery, especially in the context of a major capital expenditure program, through such mechanisms as construction work in progress in rate base or investment pre-approval. This serves as a deterrent to investors with long memories relative to the last construction cycle, during which billions of investment dollars—especially shareholder equity—were disallowed by state regulators through *ex post facto* cost disallowances.

II. The Macroeconomic Environment

Q. What other challenges are utilities facing at the present time?

A. The United States and, indeed, the world economies are currently in recession and grappling with a very serious financial crisis. While few industries are untouched by these circumstances, utilities are particularly vulnerable because of their capital-intensive nature and the magnitude of the construction expenditures they now face, a large portion of which must be financed.

Q. How has the financial crisis affected the industry?

A. The financial crisis has affected the industry in a number of ways, as detailed in two white papers I prepared for the Edison Electric Institute last year.[3] With the demise of a number of investment and commercial banks, coupled with the significant weakening of surviving institutions, access to capital was initially difficult for most companies and impossible for others. Indeed, for a period of several weeks in September 2008, the debt markets were completely closed to any company. While the capital markets are currently functioning, the unprecedented volatility that has characterized the markets over the last eighteen months negatively impacted the terms and cost of capital.

Utilities are significantly impacted in this environment because of their need to raise equity and debt to fund mounting construction programs. Despite their best efforts to ensure an adequate supply of capital, utilities will continue to face uncertainty in the markets. With fewer lenders now in existence, there is simply less capital available—a circumstance which is expected to continue. Additionally, surviving institutions are

[3] Julie M. Cannell, "The Financial Crisis and Its Impact on the Electric Utility Industry." February 2009. "Beyond the Financial Crisis: Steps Toward a Solution." December 2009.

imposing more stringent lending standards. This has the effect of increasing competition for the capital that is available, both within and beyond the utility sector. This circumstance increases the risk for investors that some regulators will be unwilling to let utilities recover their increased costs.

In this environment, set in the context of large capital expenditure levels for the industry as a whole and the Company specifically, it is important that the Commission recognize that investors require a level of return that reflects the increased level of risk.

Q. What additional implications does the financial crisis hold for utilities?

A. The current environment presents a distinct challenge to the industry. At a time when utilities are engaged in major expansion initiatives, access to the capital markets has become more questionable. As the financial crisis unfolded, utility companies learned that they could not count on being able to finance precisely on demand; rather, market access was limited, volatile, and very expensive. While the markets are now open and the cost of access has dropped from the crisis peak, participants are mindful that instability could return again; memories of those challenging times remain very strong. Importantly, the industry must retain its financial health and strength during this period of market uncertainty in order to provide safe and reliable service to customers. This will require consistent, constructive regulatory support. It will be imperative for electric utilities and regulators to communicate effectively and work together to find the right balance in satisfying the needs of all constituencies in this challenging environment. Maintaining a solid and consistent regulatory compact will be critical.

Q. Does the Company's financial health and investment grade credit rating guarantee it easy access in the credit markets?

A. No. As previously discussed, the turmoil in the financial markets has resulted in no company—no matter how financially strong—having carte blanche access to debt and equity financing. The stronger the company, the better the odds that financing would be available, but there are no guarantees.

Q. Please comment on the public issuance of equity last fall by the Company's parent, Ameren Corporation ("Ameren.")

A. Ameren successfully sold 21.9 million shares of common stock in September 2009 at a price of $25¼. I believe there were a number of reasons Ameren was able to issue stock despite the fact that the stock was selling below book value. First, investors understood that the offering would serve to boost Ameren's common equity ratio, thus improving the company's (and, in related fashion, its subsidiaries') financial metrics. The stronger financial metrics also served to bolster existing credit ratings. Second, even after the dividend reduction announced earlier in the year, Ameren's common stock had an above average yield, the result of its stock price being depressed. In a market where Treasury securities were in the low single digits, this was attractive to income-oriented investors. Third, with the peak of the financial crisis having subsided, investors were willing to assume more risk to obtain a higher yielding security.

Q. Do you agree with Mr. Lawton's suggestion that "the upheaval in financial markets is an event of the past" (Lawton Direct at 16)?

A. Not fully. As I noted, market access has improved in recent months, consistent with Mr. Lawton's testimony. And, as he correctly observes, bond yields are near or approaching pre-crisis levels. That phenomenon, however, is likely due more to investors trying to deploy capital as quickly as possible into assets where a profit seems likely to exist than it is to a change in risk perception, particularly as it pertains to utilities. Indeed, a number of utilities pre-funded some of their 2010 capital requirements last fall, similar to the path they pursued in late 2008 and early 2009. That action suggested that utilities are both seeking to secure financing when it is available and taking advantage of current prices, which they understand could become less attractive.

Q. What other factors suggest that improving times may still be slow to come in the economy, with attendant negative implications for the markets?

A. News sources contain articles on almost a daily basis conveying that the economy is still fragile and the opportunity for additional shocks to the system exists. For example, the Federal Reserve Board has signaled that it would cease its program of Treasury bond purchases in coming months, which will remove an important stabilizing feature from the markets. The Fed has also acknowledged that it will be faced with a delicate balancing act of maintaining a tender rebounding economy while not fueling inflationary pressures in the process. Another major problematic area is commercial real estate, which has billions of dollars of loans coming due and limited prospects of repayment. The U.S. dollar remains very weak and unemployment levels are still high. These factors could exacerbate ongoing problems in the already weak banking sector. And the possibility of frightening exogenous events always exists. For example, had the debt problems that surfaced in November 2009 at Dubai's government-owned investment company, which rattled capital markets globally, not resolved itself quickly, the impact on the financial markets could have been very destructive. In short, given the unstable economic backdrop that still exists globally, there are numerous possibilities for circumstances and/or events that could plunge the financial markets back into a crisis mode at any time and on short notice. In short, substantial risk still exists.

III. INVESTORS' EXPECTATIONS FOR RETURNS AND PERCEPTIONS OF THE CURRENT PROCEEDING

Q. Why is the perception of regulatory climate of such importance to investors?

A. Equity investors today still seek companies that can offer stability in earnings and dividends. Fixed income investors look for stable and adequate cash flows to ensure payment of principal and interest when due. The ability to pay dividends and sustain credit ratings is directly related to the consistency and sufficiency of a utility's earnings, which depend in large part on how the utility is regulated. If there is uncertainty about whether regulation will allow a utility a reasonable opportunity to earn a fair return in future years, then that uncertainty will lead investors to avoid holding investment positions in the utility, all other things being equal.

As a result, I believe that investors selecting electric utility stocks today place a very high value on consistent and constructive regulation, as well as on regulatory environments not characterized by excessive regulatory lag. And, with a new round of base rate case filings underway in the industry, the quality of regulation is receiving renewed investor attention.

Q. In your experience as an analyst and portfolio manager, could a perceived change in a company's regulatory climate affect your investment opinion?

A. Absolutely. During my tenure as an institutional investor, a utility's regulatory environment was a critical factor in my assessment of its investment attractiveness. An adverse regulatory decision could be a key determinant in my recommendation or decision to sell a stock already owned or not to make an investment in one under consideration.

Q. Who are typical investors in utility stocks?

A. There are two kinds of investors: individuals, who generally seek stability and income from their utility holdings, and institutions, which generally seek total return (i.e., price appreciation plus dividend income) from their utility investments.

Q. How has the investment industry itself changed in recent years?

A. In recent years, institutional investors and hedge funds have grown dramatically in the amount of capital they control. This growth has had a significant impact on the speed with which the market reacts to unfavorable developments. It has led the market to be much more reactive and much less forgiving than it may have been in the past. In the context of a regulatory decision, investors will not necessarily wait, as they would have in the past, to see how the ramifications of a decision might play out. Rather, they simply sell their shares if a regulator's decision runs counter to their expectations.

Q. What has led to that change in the market's reaction?

A. The market is now heavily populated by institutional investors, who play a significant role in the marketplace.

Q. Why are institutional investors of such importance generally?

A. Because of the sheer size of their investment positions, institutions can effectively direct the course of individual securities, and sometimes can move the market as a whole. Institutional investors include financial institutions such as: mutual funds, investment companies, insurance companies, commercial and investment banks, and various types of public retirement funds. They approach the investment selection process from the standpoint of a portfolio. An investment portfolio is a collection of stocks selected to achieve the highest possible return within a commensurate level of risk. Therefore, institutional investors keep electric utilities in their portfolios only when such stocks contribute to achieving the desired risk/return relationship.

It should be remembered that, generally, the customers of institutional investors are individuals and it is they who ultimately gain or suffer loss from changes in the value of the institution's investments. Anyone who has a stake in a retirement plan, owns a mutual fund, or has a trust fund, for example, is directly or indirectly a client of an institutional investor. But the individuals who make the decisions concerning these investments are paid money managers, and how they see their responsibilities to the clients they serve, and the way that their performance is judged, have a great deal to do with how they react to developments in the market.

In addition to managing their clients' accounts, institutional investors provide an important service to corporations and their customers. These investors provide significant demand for the common stock of corporations. This results in much greater liquidity for the stock than would be the case without these investors, resulting in corporations having better access to the equity markets at a more reasonable cost. This lower cost in turn benefits the customers of the corporations selling their common stock.

Q. Why are institutional investors important to the Company and its parent?

A. Institutional investors, who currently own approximately 60% of Ameren's common stock, warrant significant attention because they can dramatically change the market for the parent's shares. Because institutional investors own large blocks of shares relative to the volumes typically traded, their activity in moving in or out of a company's shares is often noticeable as a significant change in the price and volume of shares being traded for the company. This change may be picked up by other institutional investors, by the investment community in general, and eventually by individual investors. These other entities will then look to see what is driving this trend in the stock and whether the trend is likely to continue or disappear. If they see support for the trend, they may follow the lead of the firms that initially began to move the market, and by following the leaders, the late movers may further strengthen the trend.

Q. What does this mean for investments in regulated utilities specifically?

A. This shortened time frame means that if there is bad news, institutional investors are more likely to react quickly. In the instance of a rate proceeding, these investors are unlikely to wait to see what the outcome of the next rate decision will be. That would represent an opportunity cost to them. Rather, institutional investors would be more prone to sell their shares on the news of an adverse regulatory outcome. This would not be good for customers either, for the reasons discussed earlier.

Q. How have you gauged investors' perceptions of the issues in this proceeding?

A. To supplement my own knowledge of the industry, I have reviewed various reports related to the Company and its parent written by investment analysts. A clear picture of investors' perceptions emerges from these reports, which is in keeping with my own views.

Q. Have investors offered evaluations of Missouri regulation relative to other state commissions?

A. Yes. Regulatory Research Associates ("RRA") has ranked the Missouri Public Service Commission ("PSC" or "Commission") from an investor perspective. In its most recent quarterly evaluation of state regulatory commissions, RRA accorded Missouri regulation an "Average-2" rating.[4] There are three tiers to RRA's ranking scheme: Above Average, Average, and Below Average, with a numeric designation of 1, 2, or 3 (with 1 being the strongest) within the principal rating category employed to indicate relative strength therein. The regulatory firm notes that its evaluations:

> …are assigned from an investor perspective and indicate the <u>relative</u> regulatory risk associated with the ownership of securities issued by the jurisdiction's electric, gas, and telephone utilities. Each evaluation is based upon our studies of the numerous factors affecting the regulatory process in the state, and is changed as major events occur that cause us to modify our view of the regulatory risk accruing to the ownership of utility securities in that individual jurisdiction.[5]

In its profile of the PSC, RRA stated:

> Missouri regulation is relatively balanced from an investor perspective. Recently authorized equity returns have approximated or, in certain cases, have been above prevailing industry averages at the time established." Separately, the PSC has authorized innovative regulatory techniques designed to support certain utilities' cash flow and credit metrics during an active construction period. The state's electric utilities are permitted to seek implementation of fuel adjustment clauses (FACs) and environmental cost recovery mechanisms (ECRMS). … We continue to accord Missouri regulation an Average/2 rating.[6]

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[4] Regulatory Research Associates. "State Regulatory Evaluations." July 15, 2009.

[5] <u>Ibid</u>.

[6] Regulatory Research Associates. "Missouri Public Service Commission." Quoted section updated 7/22/09.

Q. In addition to RRA, have other firms provided rankings of state commissions?

A. Yes. Barclays Capital, in the firm's previously-referenced annual regulatory study, includes an evaluation of state utility commissions from an investor perspective.[7] Tier 1 is deemed "Lowest Cost of Capital" and Tier 5, "Highest Cost of Capital." Barclays bases its rankings on 6 criteria: 1) elected versus appointed commissions; 2) mechanisms for more consistent, timely, and transparent regulation, or not; 3) allowed ROEs; 4) settlements versus litigation 5) rate levels; and 6) a subjective investor friendliness rating. In its July 2009 assessment, the investment firm ranked Missouri in "Tier 4" on this scale.[8] This ranking indicates that the perception of the Missouri regulatory environment is one that affords a somewhat above average cost of capital relative to other states.

An additional point regarding the Barclays ranking bears mention. According to the score derived from the firm's analytical criteria referenced above, the tally for Missouri regulation was 8.96, which placed it 32nd (along with two other commissions) among the 48 state commissions evaluated from an investor perspective. This statistic confirms that the Missouri regulatory environment is perceived as offering a cost of capital setting that is somewhat more expensive than those in other U.S. states.

Q. Are there additional inferences to be drawn from investors' general views of regulation?

A. Yes. One of the key factors analysts use to evaluate the quality of a regulatory climate is the consistency of a commission's decisions. Investors value certainty, fairness, stability,

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[7] The Barclays Capital utility analytical team was previously domiciled at Lehman Brothers. The team has authored the annual regulatory study since 2004.

[8] Barclays Capital, Capital Management, op. cit.

and predictability; a lack of consistency in a commission's actions or decisions serves to increase the investment risk associated with a utility. With an unpredictable track record of regulatory decisions and actions, or decisions that appear arbitrary or insensitive to economic realities, investors are unable to anticipate reliably the future actions of a commission. That in turn depresses valuations—i.e., lowers the price of a stock and increases a company's cost of borrowing.

Q. What bearing does the investor regulatory rankings you've referenced have on the current proceeding?

A. While RRA's opinion of Missouri regulation is that it is reasonably constructive, Barclays' comparative analysis suggests that the Missouri regulatory climate results in costs of capital levels above those in other states. One of the factors analysts value most in assessing a potential investment is consistently and predictability; the state regulatory perception study I conducted for the Edison Electric Institute confirmed that fact.

This is a precarious time for the electric utility industry. With companies—AmerenUE among them—facing soaring construction, environmental, and other costs, and requiring reasonable access to the capital markets to fund those requirements, supportive regulation is critical. The Commission is viewed as having provided such treatment recently because it has allowed reasonable ROEs and approved fuel adjustment clauses ("FACs"), leading investors to expect a continuation of a constructive regulatory environment in the state prospectively.

Q. Turn now, please, to the viewpoint of equity investors and their opinion of the Company and its regulatory situation. How do investors generally perceive the Company and its parent?

A. At the current time, there is only moderate support among investors for an investment in Ameren. According to data provided by First Call/Thomson Reuters, of the five firms with an investment opinion on the company, two are "sell"—one of which recently moved to a "Conviction Sell"—or "underweight." Three firms rate Ameren "hold," "neutral," or "equal weight." Opinions from additional firms not included in the First/Call/Thomson Reuters data base are "hold." No firms publicly rate the stock a "Buy."

Q. What is the basis for the investment firms' anemic or negative investment stance on the parent?

A. The key factors security analysts point to in supporting their investment position are a weak earnings outlook and concerns about state regulation, which in my experience are two critical considerations in utility stock selection. For example, Hillard Lyons, which rates Ameren "Neutral," explained:

> **We maintain our Neutral rating on Ameren**. Although the stock continues to trade at a discount to the group, we feel the discount is warranted due to the uncertainty surrounding the company's earnings outlook and the possible need to issue additional equity. It will also be important, in our view, for AEE to earn better rates of return on its utility businesses.[9]

In changing its investment opinion on the company last fall, J.P. Morgan noted:

> We are downgrading Ameren to Underweight from Neutral. While we believe the shares may not decline in absolute value, we expect the stock to underperform

[9] Hilliard Lyons. "Ameren Corp. Company reports higher and better than expected second quarter earnings. We maintain our Neutral rating." August 11, 2009.

> its peers' as the company faces an EPS drop in 2010E, continued underearning at its utilities, and a weak demand outlook.[10]

Q. Do investors consider regulation a risk factor for the Company?

A. Yes. In my estimation, it is a paramount risk, and one pointed to by a number of analysts. Citi, for example, in enumerating risks associated with investing in Ameren, stated:

> We rate Ameren Corporate High Risk due to its exposure to commodity markets and challenging regulatory regimes. ~56% of the company's consolidated earnings come from regulated operations and the remaining ~44% come from the company's merchant generation fleet.
>
> Earnings at the regulated utilities should increase over the next few years as the company seeks rate relief in Missouri and Illinois. The amount of earnings increase will depend on decisions by the Illinois and Missouri state utility commissions, which have been regarded by investors as challenging regulatory regimes.[11]

While Citi cites the risk associated with Ameren's merchant generation activities, the investment firm correctly emphasizes the risk associated with the regulatory business, which comprises over half of corporate earnings. Of that regulated business, Missouri accounts for the lion's share.

Q. But you stated previously that investors generally believe that the Missouri PSC recently has provided the Company with constructive treatment.

A. That is correct. While Missouri regulation historically was considered by investors to be less than supportive, the Commission's decision in Case No. ER-2008-0318, rendered in January 2009, was viewed positively. The two most salutary aspects of that order cited by investors were the 10.76% allowed ROE and the implementation of a fuel adjustment clause. Jesup & Lamont, for example, had a favorable view of the rate order decision:

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[10] J.P. Morgan. "Ameren Corp. Positive Catalysts Unlikely." October 22, 2009.

[11] Citi. "Ameren: Dividend Cut 40% to $1.54/Share. Earnings Outlook is Dependent [On] Further Rate Relief & Power Market Conditions." February 18, 2009.

> We consider this order to be constructive given that they [AmerenUE] received roughly 65% of the requested revenue increase, a fuel clause was implemented, and the 10.75 [sic]% allowed ROE is modestly higher than recent national averages. … The order contained the following constructive comment, 'The Commission finds that this rate of return will allow AUE to compete in the capital market for the funds needed to maintain its financial health.'[12]

Q. If Missouri regulation is now viewed more constructively, please explain why investors have investment hesitancy regarding Ameren.

A. When investors consider an investment in the parent, they must look at the company as a whole, including the Illinois jurisdiction and merchant generation operations. There have been some concerns regarding those areas, though Illinois regulation is also viewed as having improved recently. But Missouri remains a key investor focus, given the degree to which it contributes to the parent's overall earnings profile. As investment firm Edward Jones recently opined:

> We believe the regulatory situation for Ameren is below-average. Missouri has historically been a poor regulatory environment with inadequate support for the company and its investors. In past years, Ameren lost incentive-driven rates and suffered a $110 million rate cut in its 2001 electric rate case. With recent changes in the commission, we see the potential for improvement, but expect it to be gradual. Consistent with this view, the company was granted a $162 million increase in Missouri in 2009 and was also allowed to implement a fuel adjustment clause.[13]

The one lingering and very important problem in Missouri is regulatory lag.

Q. Please elaborate.

A. While investors place great emphasis on the absolute level of return on equity a company is permitted, of equal or perhaps greater importance is a utility's ability to actually earn that allowed return. With its utilization of an historic test year in setting rates, combined

[12] Jesup & Lamont, op. cit.

[13] Edward Jones. "Ameren: Earnings Results." October 30, 2009.

with other factors, Missouri regulation is unfortunately characterized by extensive regulatory lag. While some adjustments are permitted for known and measurable changes to certain expense categories, those updates are insufficient to allow utilities to earn at their allowed levels. This means that ROEs authorized by the PSC need to be toward the high end of the ranges determined by quantitative ROE analyses in order to provide a utility with at least a more reasonable opportunity to earn a fair, or closer to a fair, ROE.

Q. Are investors aware of the regulatory lag issue?

A. Yes, they are. Given the significant drag that regulatory lag imposes on earnings, the factor clearly is an impediment to investors having a more positive investment stance on the Company and its parent. For example, J.P. Morgan observed:

> Despite the strong [2Q09] quarter, we are reiterating our Neutral rating given AEE's ongoing significant regulatory lag and merchant headwinds. … In response to the current economic environment, the company also lowered its 2010-2013 capital expenditure forecast by ~$2B. We believe this is a positive step given the difficulty AEE faces earning reasonable rates of return on its utility investments.[14]

Q. Has investor attention been paid to the current proceeding?

A. Yes. Analysts are aware of the filing and some have expressed opinion regarding its outcome. For example, Edward Jones, which, as noted previously, is encouraged that the tone of Missouri regulation is improving, stated: "The company filed for a $402 million rate increases [sic] in Missouri in July 2009. We anticipate a fair ruling around June 2010 in Missouri."[15] Barclays Capital also commented on the filing:

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[14] J.P. Morgan. "Ameren Corp." Solid Beat in the Quarter and Guidance Reaffirmed; Positive – ALERT." August 6, 2009.

[15] Edward Jones, op. cit.

> On 7/24 AEE announced filing of a base rate case in Missouri seeking $402M of rate relief assuming an 11.5% ROE and 47.7% equity ratio with a final ruling required by June 2010. Key elements of the case include the fuel adjustment clause, implementation of the environmental recovery rider and reduction of regulatory lag.
>
> - - - - -
>
> Our forecast contribution for AmerenUE is below what the company's request implies and potentially a bit conservative overall. In addition we had not expected AEE to file the case until later in the year, so this move could help reduce regulatory lag.
>
> - - - - -
>
> Of note the average of the last 5 rate case ROEs in Missouri was 10.45%. Clearly, earned ROEs and allowed ROEs differ for several reasons and we would expect this to continue to be the case in Missouri.[16]

Q. What are the implications of investors' views of the current rate case?

A. Clearly, investors are optimistic, if cautiously so, that the Commission will render a constructive ruling for the Company in the current proceeding. An ROE allowance significantly below the existing authorized level of 10.76% would be viewed negatively by the investors upon whom the Company depends for important equity capital.

Q. To what extent is the potential for extensive, expensive carbon compliance costs for AmerenUE an investment issue?

A. I think that large expenditures for carbon reduction looms as a major concern for investors. As Jesup & Lamont noted, "…we believe the energy administration is likely to implement onerous climate policy change over the next few years that will impact coal-fired generation."[17] Because federal carbon legislation has not been enacted, it isn't possible yet to quantify the financial impact on the utility industry generally or AmerenUE specifically. But, given the importance of the climate issue globally, it is reasonable to expect that required expenditures will be substantial. The Company, with

[16] Barclays Capital. "Ameren Corp.: Rate Case Filing in Missouri." July 27, 2009.

[17] Ibid.

three-quarters of its generation fueled by coal, will undoubtedly be among those utilities most materially impacted, reinforcing concerns already present among investors.

Q. Please summarize equity investors' views of the Company and its regulatory situation.

A. Investors are very mindful that a substantial gap exists between AmerenUE's allowed and earned ROEs. While they are encouraged by constructive elements of the Missouri PSC's last rate decision for the Company—specifically, the 10.76% ROE and the approval of the Company's FAC request—investors also understand that the current under-earnings situation will persist for some time to come. With heavy capital expenditures and potential carbon requirements ahead, along with attendant financing needs, AmerenUE will need the ability to access the capital markets. Thus, it is imperative that the Commission continue in its decision in the current proceeding the constructive trend evidenced in the recent past, even with a challenging macroeconomic backdrop. In the event of a subpar outcome, future capital market access could become far more expensive or even unavailable.

IV. <u>INVESTORS' EXPECTATIONS FOR RETURN ON EQUITY FOR AMERENUE</u>

Q. What effect would you expect Staff and the intervenors' ROE recommendations to have on AmerenUE in the context of the current economic and financial uncertainty and investors' return expectations?

A. I believe an ROE award in the range recommended by Staff and the intervenors would be damaging. Staff's 9.0%-9.7% range and 9.35% midpoint, the lower end of Mr. Gorman's 9.5%-10.5% range and his 10.0% midpoint, and the lower end of Mr. Lawton's 9.3%-10.9% range and his 10.2% midpoint respective ROE proposals are inconsistent with today's economic realities and the returns investors require for the Company. Staff's recommendation in its entirety—the total parameters of which fall under 10%--would be particularly injurious to the Company, while the upper end of both Mr. Gorman's and Mr. Lawton's proposed ranges are more in line with a reasonable and fair ROE for AmerenUE. During a period of continuing elevated capital expenditures, investment risk remains high relative to what it was as recently as five years ago. As such, investors will need to be compensated for the increased risk associated with the Company's large capital expenditure program, particularly given the context of regulatory lag in which AmerenUE operates.

Q. Please comment on Staff's reference to the cost of equity discount rate in research reports issued by investment firms (Staff at 32-35).

A. In its Report, Staff mentioned several research reports issued by investment firms Goldman Sachs and Bank of America and the analytical methodology these firms employed. Specifically, Staff pointed to the cost of equity discount rates the firms used as support for its own low ROE recommendation. Dr. Morin's rebuttal testimony addresses in detail the methodological differences in the models referenced. I also believe that Staff makes an inappropriate comparison in pointing to the discount rates employed by the investment analysts in relation to establishing the required return on equity. The discount rate used in a dividend discount model is a valuation tool, used in stock selection. That rate is part of the process that attempts to determine how stocks are valued *relative to one another*—that is, whether a specific stock is undervalued or overvalued in respect to other investment opportunities. The discount rate utilized by investors in this fashion is not an indicator of the required, fair return on a utility's common stock equity, which is established through consideration of various methodologies and attendant factors in rate cases.

Q. Is it accurate, then, to say, that you disagree with Staff's using the data from the referenced research reports as support for its ROE recommendation?

A. Yes, it is accurate to say that I disagree with Staff's use of the data, as well as with its ROE proposal.

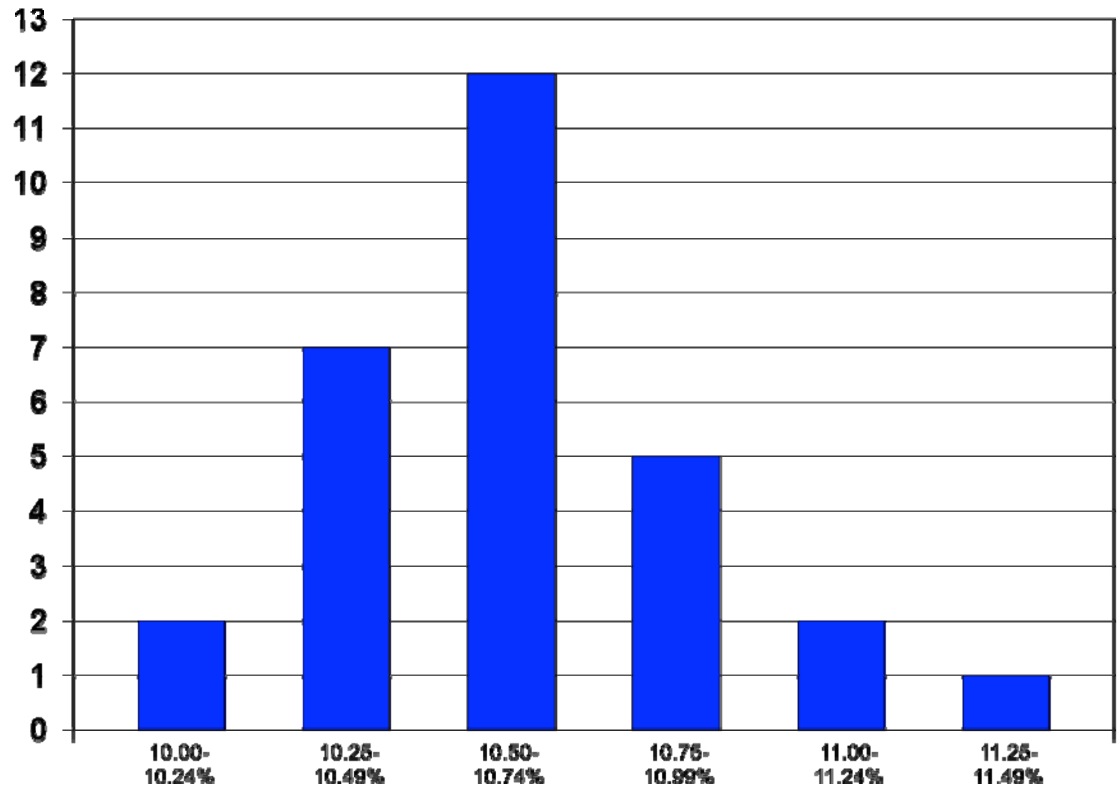
Q. Please comment on the trend in allowed ROEs.

A. Data from Regulatory Research Associates shows that the general trend in average ROE allowances was down until 2007, when the average for integrated utilities hit 10.47%. In 2008, upward movement to 10.59% was seen. That trend continued in 2009, when the average allowed ROE for integrated companies remained at 10.59%.

Q. How does this data relate to Staff's and the Intervenor witnesses' respective positions?

A. A look beyond the average sheds further light on the unreasonableness of their recommendations. As the following chart illustrates, in the twenty-nine rate case decisions rendered during 2009 for integrated electric companies in which an ROE was established, there were no ROE allowances nationwide as low as or equal to the 10% recommended by Mr. Gorman and 9.35% proposed by Staff. Only two decisions were equal to or below the 10.2% midpoint proposal of Mr. Lawton.

EQUITY RETURNS AUTHORIZED BY STATE COMMISSIONS, 2009



Source: Regulatory Research Associates

This data suggests that neither Staff's nor the Intervenor witnesses' ROE recommendations would meet investor expectations for the Company. Moreover, an authorized return at or near the levels proposed would put the Company at a distinct disadvantage in the competition for capital going forward. Adopting either the Staff or one of the Intervenor recommendations also would represent a step backward by the Commission in establishing a constructive, consistent regulatory framework for Missouri.

Q. Have other state regulatory Commissions taken investment plans and current conditions into account in their ROE decisions?

A. Yes. In January 2010, The Michigan Public Service Commission maintained the existing 11.00% ROE for Detroit Edison. In explaining its decision, the PSC stated: "The

Commission also finds that the evidence in the case supports an ROE of 11.00%. The Commission is persuaded that the economic conditions in Detroit Edison's service territory remain uncertain and that, although the financial markets have stabilized somewhat, access to credit remains uncertain as well. The Commission agrees with Detroit Edison that in light of the foregoing, the company's risk environment will continue to be challenging and that an ROE at the top of the Staff's recommended range is appropriate."[18] The Michigan PSC's decision for Detroit Edison highlights the importance of a utility's being authorized an ROE that is competitive with ROE levels granted to similar types of companies. As my testimony has described, the competition for capital is increasing, and a subpar ROE places a utility at a distinct disadvantage in its ability to secure capital.

Q. Can you point to examples of rate cases in which allowed ROEs disappointed investor expectations?

A. The Connecticut Commission of Public Utility Control's ruling in February 2009 in a United Illuminating rate case serves as a powerful example of investor disappointment. Not only was the company granted only a fraction of its request (though trackers for pension and other expenses were provided, as was revenue decoupling), but it also—and most importantly—was permitted only an 8.75% ROE. Admittedly, United Illuminating is a wires-only company, but its allowed ROE represented the lowest level granted to any electric utility in the country over the past 30-plus years. Investor response to this development was swift and brutal. Between February 3, the day before the regulators' ruling and March 9, when the stock finally reached a nadir, the price of UIL Holdings

[18] Detroit Edison, Michigan PSC Case No. U-15768, January 2010, at 20-21.

(the utility's parent) declined by 37%. That enormous loss of shareholder value stands as a vivid testament that the regulators' ruling did not meet investor expectations.

Q. Are there more recent examples of investor concern regarding a rate case ruling?

A. Yes. The Florida PSC, historically considered supportive, rendered separate decisions for Florida Power & Light Company ("FP&L") and Progress Energy Florida ("Progress") in mid-January that prompted harsh investor reaction, notice from credit rating agencies of potential downgrades, and announcement by the companies of planned reductions—draconian, in FP&L's case—of capital expenditures. In addition to denying most of the companies' respective requested rate increases, the Florida Commission granted allowed ROEs of 10.0% for FP&L and 10.5% for Progress. Those allowed levels contrasted with recommendations from the Commission Staff of 10.75% and 11.25%, respectively, for the two utilities. In commenting on the FP&L decision, Barclays Capital opined "We expect that the market will view the risk associated with doing business in Florida as having increased materially following the two rate case decisions this week, and would expect capital costs to increase accordingly."[19]

Q. What are the implications of the Florida rate decisions for this proceeding?

A. With both decisions, the utilities are left with little to no ability to earn their respective allowed ROEs. Because of this, as Barclays correctly observed, investment risk has risen in Florida and capital costs are expected to rise. Even with the $10 billion announced capital expenditure reduction by FP&L and the significant, but yet unquantified cut signaled by Progress, those capital programs will likely have to be financed with more

[19] Barclays Capital. "FPL Group: Change of Price Target; Rate Increase Request Largely Denied." January 14, 2010.

expensive dollars. Further, it is widely expected that both utilities will have to file another rate case in Florida this year.

Q. How do you believe that the Company's requested return on equity of 10.8% comports with investors' perceptions?

A. I believe that the investment community would find a 10.8% ROE supportive for the Company. It would represent a continuation of the constructive regulatory trend perceived to be underway in Missouri, help maintain the Company's financial health, and assist in maintaining access to the debt and equity capital markets.

Q. Why do return on equity awards vary among state commissions and companies?

A. As Dr. Morin's direct testimony sets forth, generic factors such as interest rates and industry issues contribute to a determination of return on equity, but in the final analysis, the appropriate ROE level and the ability to earn it is specific to the company in question. For example, as noted previously, the Company has a number of generic factors that increase its risk, coupled with company-specific issues, such as its major capital expansion program and the chronic gap between its authorized and earned returns, all of which should argue for a higher allowed ROE as compensation for that greater risk level.

Q. Could a return on equity award that is consistent with investor expectations also be expected to provide benefits to the Company's customers?

A. Absolutely. A higher ROE permits the realization of a stronger earnings stream. In turn, that can improve a company's stock's valuation prospects, which results in a higher stock price. Thus, when a company needs to tap the equity markets for capital required to meet customer needs, it can get more for its money. Said another way, each share sold brings more equity into a company with the same commitment by the company to generate earnings and pay dividends to support the value of that share. Importantly, customers' rates will eventually reflect this lower cost of capital.

Q. Please summarize what bearing the opinion and expectations of investors have on the current proceeding.

A. This is a precarious time for the electric utility industry. With companies—AmerenUE among them—facing continued high levels of construction, environmental, and other costs, and requiring reasonable access to the capital markets to fund those requirements, supportive regulation is critical. Investors are aware of these factors and expect the Commission to make decisions in light of them that will enable the Company to meet its investment and other requirements. If the Commission were to decrease the allowed ROE from the present level, it would send a signal to investors that the Commission may be changing its prior constructive approach. Rather, the Commission should recognize that current market conditions, current trends in ROE awards, and increased risks do not merit a decrease, but instead merit an ROE at or near the last allowed ROE of 10.76%.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT OF JULIE CANNELL

STATE OF NEW YORK)
) **ss**
CITY OF PURCHASE)

Michael Adams, 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 Rebuttal Testimony on behalf of Union Electric Company, d/b/a AmerenUE, consisting of 39 pages and Schedules JMC-ER n/a through JMC-ER n/a, 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
Julie M. Cannell

Subscribed and sworn to before me this 11th day of February, 2010.

Jane Romero.
Notary Public

My commission expires: 11/5/2011

JANE ROMERO
Notary Public, State of New York
No. 01RO6176895
Qualified in Westchester County
Commission Expires Nov. 5, 2011