Exhibit No.:
Witness: Michael Gorman
Type of Exhibit: Direct Testimony
Issue: Return on Equity
Sponsoring Parties: Missouri Industrial Energy Consumers
Case No.: ER-2007-0002

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a AmerenUE for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area	)))))	**Case No. ER-2007-0002**

Direct Testimony of

Michael Gorman

On Behalf of

Missouri Industrial Energy Consumers

December 15, 2006

BRUBAKER & ASSOCIATES, INC.
ST. LOUIS, MO 63141-2000

Project 8632

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BRYAN CAVE

BY HAND DELIVERY

December 15, 2006

FILED[2]
DEC 15 2006
Missouri Public Service Commission

Cully Dale
Missouri Public Service Commission
200 Madison Street
Jefferson City, MO 65101

RE: Case No. ER-2007-0002

Dear Judge Dale:

Attached for filing on behalf of the Missouri Industrial Energy Consumers in the above-referenced case are an original and eight (8) copies each of the Direct Testimony and Schedules of Maurice Brubaker, the Direct Testimony and Schedules of Jim Selecky, the Direct Testimony and Schedules of Mike Gorman and both the Highly Confidential (HC) and Non-Proprietary (NP) versions of the Direct Testimony and Schedules of Jim Dauphinais.

Thank you for your assistance in bringing this filing to the attention of the Commission.

Very truly yours,

Diana Vuylsteke

Diana M. Vuylsteke

DMV:ln

attachment

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STATE OF MISSOURI)
) SS
COUNTY OF ST. LOUIS)

Affidavit of Michael Gorman

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

1. My name is Michael Gorman. I am a consultant with Brubaker & Associates, Inc., having its principal place of business at 1215 Fern Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000. We have been retained by the Missouri Industrial Energy Consumers in this proceeding on their behalf.

2. Attached hereto and made a part hereof for all purposes are my direct testimony and schedules, which were prepared in written form for introduction into evidence in Missouri Public Service Commission Case No. ER-2007-0002.

3. I hereby swear and affirm that the testimony and schedules are true and correct and that they show the matters and things they purport to show.

Michael Gorman

Subscribed and sworn to before this 14th day of December 2006.

CAROL SCHULZ
Notary Public - Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires: Feb. 26, 2008

Notary Public

My Commission Expires February 26, 2008.

BEFORE THE PUBLIC SERVICE COMMISSION
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Direct Testimony of Michael Gorman

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A My name is Michael Gorman and my business address is 1215 Fern Ridge Parkway, Suite 208, St. Louis, MO 63141-2000.

Q WHAT IS YOUR OCCUPATION?

A I am an energy advisor and a consultant in the field of public utility regulation and a managing principal in the firm of BAI (Brubaker & Associates, Inc.).

Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A These are set forth in Appendix A to my testimony.

Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A I am appearing on behalf of the Missouri Industrial Energy Consumers (MIEC). Member companies purchase substantial amounts of electricity from AmerenUE (AmerenUE or Company).

Q WHAT IS THE SUBJECT OF YOUR TESTIMONY?

A I will recommend a fair return on common equity and an overall rate of return for AmerenUE.

I also intended to address incentive compensation. However, AmerenUE has not timely responded to numerous data requests that are required for me to address this issue. Therefore, I will address it in my rebuttal testimony.

The fact that I do not address an issue should not be interpreted as approval of any position taken by AmerenUE.

Q PLEASE SUMMARIZE YOUR RATE OF RETURN RECOMMENDATIONS.

A I recommend the Missouri Public Service Commission ("MPSC" or the "Commission") award AmerenUE a return on common equity within my recommended range of 9.2% to 10.3%. Absent an adjustment for performance, the award should be at the 9.8% midpoint.

My recommended 9.8% return on equity for AmerenUE is based on constant growth Discounted Cash Flow ("DCF"), Risk Premium ("RP") and Capital Asset Pricing Model ("CAPM") analyses.

As set forth below in my testimony, I show that a 9.8% return on equity is fair compensation based on the risk of AmerenUE's Missouri regulated utility operations, and will provide AmerenUE with the opportunity to produce earnings and cash flow financial metrics that will support its current "BBB" investment grade bond rating, and will actually help to support an "A" bond rating, a one notch improvement to AmerenUE's current bond rating. As such, my recommended rate of return will fairly compensate AmerenUE's investors and help maintain AmerenUE's financial integrity, credit standing and access to capital.

I respond to AmerenUE witness Ms. Kathleen C. McShane's proposed 12.0% return on equity, and demonstrate why she has significantly overstated AmerenUE's current market cost of common equity or return on equity.

I respond to AmerenUE witness Dr. James H. Vander Weide's recommended 12.2% return on equity for AmerenUE in this proceeding. I show that his recommended return on equity is excessive because it overstates a reasonable DCF and risk premium cost of equity for regulated utility operations and therefore would result in excessive and unjust rates for Missouri customers.

I also discuss below the reasons for my proposed rejection of both Ms. McShane's and Dr. Vander Weide's proposed financial adjustment to the proxy group return on equity to reflect the alleged difference between AmerenUE's market financial risk and book financial risk. This financial risk equity return adjustment is unjust, unreasonable and is based on an erroneous assessment of investment risk. Further, this financial risk adjustment is contrary to well-accepted methodologies used by regulatory commissions, including the Missouri Public Service Commission, to estimate a fair rate of return that fairly compensates investors, preserves the utility's financial integrity, and support just and reasonable rates.

AMERENUE CREDIT STANDING

Q PLEASE SUMMARIZE AMERENUE'S CURRENT CREDIT STANDING AND ACCESS TO CAPITAL.

A AmerenUE has a corporate bond rating from S&P and Moody's of "BBB+" and "A2," respectively.

AMERENUE'S PROPOSED CAPITAL STRUCTURE

Q WHAT CAPITAL STRUCTURE IS THE COMPANY REQUESTING TO USE TO DEVELOP ITS OVERALL RATE OF RETURN FOR ELECTRIC OPERATIONS IN THIS PROCEEDING?

A The proposed capital structure, as supported by AmerenUE witness Mr. Lee Nickloy for AmerenUE utilities is shown below in Table 1.

TABLE 1

AmerenUE Proposed Capital Structure
(December 31, 2005)

Description	AmerenUE Percent of Total Capital
Long-Term Debt	45.420%
Short-Term Debt	0.099%
Preferred Equity	2.040%
Common Equity	52.441%
Total Financial Capital Structure	*100.000%*

Source: Direct Testimony of Lee R. Nickloy, Schedule LRN-E1-1.

Q DO YOU RECOMMEND ANY ADJUSTMENTS TO THE CAPITAL STRUCTURE PROPOSED BY MR. NICKLOY TO SET AMERENUE'S RATES IN THIS PROCEEDING?

A No.

RETURN ON COMMON EQUITY

Q PLEASE DESCRIBE THE FRAMEWORK FOR DETERMINING A REGULATED COMPANY'S COST OF COMMON EQUITY.

A In general, determining a fair cost of common equity for a regulated utility has been framed by two decisions of the U.S. Supreme Court, in Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n of West Virginia, 26 U.S. 679 (1923) and Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944).

These decisions identify the general standards to be considered in establishing the cost of common equity for a public utility. Those general standards are that the authorized return should: (1) be sufficient to maintain financial integrity; (2) attract capital under reasonable terms; and (3) be commensurate with returns investors could earn by investing in other enterprises of comparable risk.

Q PLEASE DESCRIBE WHAT IS MEANT BY "UTILITY'S COST OF COMMON EQUITY."

A The utility's cost of common equity is the return investors expect, or require, in order to make an investment. Investors expect to achieve their return requirement from receiving dividends and from stock price appreciation.

Q PLEASE DESCRIBE THE METHODS YOU HAVE USED TO ESTIMATE THE COST OF COMMON EQUITY FOR AMERENUE.

A I have used several models based on financial theory to estimate AmerenUE 's cost of common equity. These models are: (1) the constant growth discounted cash flow model ("DCF"), (2) the bond yield plus equity risk premium model, and (3) a capital asset pricing model ("CAPM"). I have applied these models to a group of publicly

traded utilities that I have determined represent the investment risk of an electric utility similar to AmerenUE. I discuss this comparable utility group below.

Q HOW DID YOU DEVELOP A DCF ANALYSIS AND RISK PREMIUM ESTIMATES FOR AMERENUE?

A I used a proxy group of publicly traded electric utilities that I determined to be comparable in risk to AmerenUE. This proxy group was then used to estimate the market required return on publicly traded companies that are similar in investment risk to AmerenUE.

My electric utility proxy risk group was developed as follows:

1. I started with all the electric utilities followed by The Value Line Investment Survey.

2. I removed companies that did not meet the following risk factor criteria:

   a. Investment grade bond ratings from S&P and Moody's.
   b. Common equity ratios within the range of 40% to 60%.
   c. No suspension of dividends over the last two years.
   d. Consensus growth rates available.
   e. Business profile scores in the range of 4 to 6 from S&P.
   f. No significant merger and acquisition activity.
   g. No non-regulated business risk.

As shown on my Schedule MPG-1, my electric proxy group is a reasonable risk proxy to AmerenUE. My electric group has an S&P and Moody's bond rating of "BBB+" and "A3," which is comparable to AmerenUE ratings of "BBB+" and "A2," respectively. My electric proxy group has a S&P business profile score of 5, which is identical to AmerenUE's score. The common equity ratio for my group is 49%, which is comparable to AmerenUE's 52%.

DISCOUNTED CASH FLOW MODEL

Q PLEASE DESCRIBE THE DCF MODEL.

A The DCF model posits that a stock price is valued by summing the present value of expected future cash flows discounted at the investor's required rate of return (ROR) or cost of capital. This model is expressed mathematically as follows:

$$Po = \frac{D1}{(1+K)^1} + \frac{D2}{(1+K)^2} \quad \ldots \quad \frac{D\infty}{(1+K)^\infty} \quad \text{where} \qquad \text{(Equation 1)}$$

Po= Current stock price
D = Dividends in periods 1 - ∞
K = Investor's required return

This model can be rearranged in order to estimate the discount rate or investor required return, "K." If it is reasonable to assume that earnings and dividends will grow at a constant rate, then Equation 1 can be rearranged as follows:

$$K = D1/Po + G \qquad \text{(Equation 2)}$$

K = Investor's required return
D1 = Dividend in first year
Po = Current stock price
G = Expected constant dividend growth rate

Equation 2 is referred to as the "constant growth" annual DCF model.

Q PLEASE DESCRIBE THE INPUTS TO YOUR CONSTANT GROWTH DCF MODEL.

A As shown under Equation 2 above, the DCF model requires a current stock price, expected dividend, and expected growth rate in dividends.

Q WHAT STOCK PRICE AND DIVIDEND HAVE YOU RELIED ON IN YOUR CONSTANT GROWTH DCF MODEL?

A I relied on the average of the weekly high and low stock prices over a 13-week period ending November 10, 2006. An average stock price is less susceptible to market

price variations than is a spot price. Therefore, an average stock price is less susceptible to aberrant market price movements, which may not be reflective of the stock's long-term value.

A 13-week average stock price is short enough to contain data that reasonably reflects current market expectations, but is not too short a period to be susceptible to market price variations that may not be reflective of the security's long-term value. Therefore, in my judgment, a 13-week average stock price is a reasonable balance between the need to reflect current market expectations and to capture sufficient data to smooth out aberrant market movements. I used the most recently paid quarterly dividend, as reported in the Value Line Investment Survey. This dividend was annualized (multiplied by 4) and adjusted for next year's growth to produce the D1 factor for use in Equation 2 above.

Q WHAT DIVIDEND GROWTH RATES HAVE YOU USED IN YOUR DCF MODEL?

A There are several methods one can use in order to estimate the expected growth in dividends. However, for purposes of determining the market required return on common equity, one must attempt to estimate what the consensus of investors believe about the dividend or earnings growth rate, and not what an individual investor or analyst may use to form individual investment decisions.

Security analysts' growth estimates have been shown to be more accurate predictors of future returns than growth rates derived from historical data.[1/] They are more reliable estimates and, assuming the market generally makes rational investment decisions, analysts' growth projections are the most likely growth estimates that are built into stock prices.

[1]*See e.g.*, David Gordon, Myron Gordon, and Lawrence Gould, "Choice Among Methods of Estimating Share Yield," The Journal of Portfolio Management, Spring 1989.

For my constant growth DCF analysis, I have relied on a consensus, or mean, of professional security analysts' earnings growth estimates as a proxy for the investor consensus dividend growth rate expectations. I used the average of three sources of customer growth rate estimates, including Zack's Advisor, Reuters, and Thomson Financial or First Call. All consensus analyst projections used were available on November 13, 2006, as reported on-line. Each consensus growth rate projection is based on a survey of security analysts. The consensus estimate is a simple arithmetic average or mean of surveyed analysts' earnings growth forecasts. A simple average of the growth forecast gives equal weight to all surveyed analysts' projections. It is problematic as to whether any particular analyst's forecast is most representative of general market expectations. Therefore, a simple average, or arithmetic mean, of analyst forecasts is a good proxy for market consensus expectations. The growth rates I used in my DCF analyses are shown on Schedule MPG-2.

Q WHAT ARE THE RESULTS OF YOUR ANNUAL CONSTANT GROWTH DCF MODEL?

A As shown on Schedule MPG-3, the DCF return for my electric group is 9.2%.

Q DO YOU HAVE ANY COMMENTS CONCERNING THE RESULTS OF YOUR DCF ANALYSIS?

A Yes. I believe the results of my constant growth DCF analysis, and a DCF analysis in general in today's marketplace, reflect rational investment financial metrics and reflect today's very low cost capital market. Therefore, the DCF results are reasonable.

Q **WHY DO YOU BELIEVE YOUR DCF REFLECTS CONSERVATIVE GROWTH PROJECTIONS?**

A The consensus analysts' growth rate for my electric proxy group is 5.16%. This growth rate is a reasonable long-term growth rate, appropriate for a constant growth DCF model for several reasons. First, a growth rate for my proxy group is reasonably consistent with the five-year and ten-year projected GDP growth of 5.1%, and considerably higher than the five-year and ten-year projected GDP inflation growth of 2.4%.[2]

Utilities' dividend growth cannot sustain a growth rate that exceeds the growth rate of the overall economy. The growth rate of the utility's service territory is the proxy for the sustainable long-term growth rate of earnings. Utilities invest in plant to meet sales growth, and sales growth in turn is tied to economic activity. Hence, nominal GDP growth is a proxy for the highest sustainable long-term growth rate of the utility.

However, growth of utility companies has historically been tied to the rate of inflation. This is because utilities typically pay out a very high percentage of earnings as dividends, thus limiting the reinvestment of earnings and the growth to their companies' business platforms. The growth rate used in my DCF analysis is much higher than expected inflation rates, and nears the maximum sustainable growth estimate as proxied by the GDP growth factor. The fact that my growth rate is bracketed in this manner by high and low reasonable growth rate proxies clearly indicates a very strong and relatively high growth rate used in my DCF estimate.

[2] Blue Chip Economic Forecasts, October 10, 2006, at 15.

Moreover, my proxy group's projected growth rate of 5.16% is considerably higher than the historical growth rate the proxy groups have achieved over the last five to ten years, and that projected over the next three to five years. As shown on Schedule MPG-4, the historical dividend growth rates of my electric proxy group is substantially lower than the nominal GDP growth.

Q WHY DO YOU BELIEVE YOUR DCF RESULT REFLECTS RATIONAL COMPANY FINANCIAL METRICS AND DIVIDEND EXPECTATIONS?

A The dividend fundamentals of companies included in my comparable group show strong and consistent earnings strength in relation to dividends. This indicates that current and projected earnings support dividends and permit the continued predictable growth in dividends.

For example, my electric comparable group had a 2005 dividend payout ratio of approximately 66%, and a dividend to book ratio of 6.4%. The dividend payout ratio represents the percentage of earnings paid out as dividends. Traditionally, utility companies have paid out approximately 70% of their earnings as dividends. Value Line's projected dividend to book and payout ratio for my electric proxy group is 6.1% and 60%, respectively. A payout ratio of 60% suggests that my proxy group companies' earnings will support dividends and retain earnings to produce future growth to earnings and dividends at today's current low capital market costs of less than a 100% return on equity.

RISK PREMIUM MODEL

Q PLEASE DESCRIBE YOUR BOND YIELD PLUS RISK PREMIUM MODEL.

A This model is based on the principle that investors require a higher rate of return ("ROR") to assume greater risk. Common equity investments have greater risk than bonds because bonds have more security of payment in bankruptcy proceedings than common equity and the coupon payments on bonds represent contractual obligations. In contrast, companies are not required to pay dividends on common equity, or to guarantee returns on common equity investments. Therefore, common equity securities are considered to be more risky than bond securities.

This risk premium model is based on two estimates of an equity risk premium. First, I estimated the difference between the required return on utility common equity investments and Treasury bonds. The difference between the required return on common equity and the bond yield is the risk premium. I estimated the risk premium on an annual basis for each year over the period 1986 through September 2006. The common equity required returns were based on regulatory commission-authorized returns for electric utility companies. Authorized returns are typically based on expert witnesses' estimates of the contemporary investor-required return.

The second equity risk premium method is based on the difference between regulatory commission-authorized returns on common equity and contemporary "A" rated utility bond yields. This time period from 1986 through September 2006 was selected because over that period public utility bond yields have consistently traded at a premium to book value. This is illustrated on my Schedule MPG-5, where the market to book ratio since 1986 for the electric utility industry was consistently above 1.0. Therefore, over this time period, regulatory authorized returns were sufficient to support market prices that at least exceeded book value. This is an indication that

regulatory authorized returns on common equity supported a utility's ability to issue additional common stock, without diluting existing shares. This further indicates that utilities were able to access equity markets without a detrimental impact on current shareholders.

Based on this analysis, as shown on Schedule MPG-6, the average indicated equity risk premium of authorized electric utility common equity returns over U.S. Treasury bond yields has been 5.0%. Of the 21 observations, 15 indicated risk premiums fall in the range of 4.4% to 5.9%. Since the risk premium can vary depending upon market conditions and changing investor risk perceptions, I believe using an estimated range of risk premiums provides the best method to measure the current return on common equity using this methodology.

As shown on Schedule MPG-7, the average indicated authorized electric utility common equity returns over contemporary Moody's utility bond yields over the period 1986 through September 2006 was 3.64%. Removing the three highest and lowest risk premium estimates produces an electric equity risk premium in the range of 3.0% to 4.4%.

Q BASED ON HISTORICAL DATA, WHAT RISK PREMIUM HAVE YOU USED TO ESTIMATE AMERENUE'S COST OF EQUITY IN THIS PROCEEDING?

A The equity risk premium should reflect the relative market perception of risk in the utility industry today. I have gauged investor perceptions in utility risk today on Schedule MPG-8. On that schedule, I show the yield spread between utility bonds and Treasury bonds over the last 25 years. As shown on this exhibit, the current utility bond yield spreads for "A" rated and "Baa" rated utility bonds are 1.09% and 1.34%, respectively. These utility bond yield spreads over Treasury bond yields are among the lowest yield spreads in the last 25 years, and are below the 25-year

average "A" and "Baa" yield spreads of 1.60% and 1.97%, respectively. Hence, this comparison of utility bond yield spreads indicates the market perception of utility risk to be below the average industry risk over this historical time period.

Recognizing a robust nature and the current market's low-risk valuation of utility investments, I believe it is appropriate to use an average market equity risk premium to estimate the current market-required return on equity. Hence, I relied on a market equity premium over Treasury bonds of 5.2% (midpoint of the 4.4% to 5.9% range), and an equity risk premium over utility bond yields of 3.7% (midpoint of the 3.0% to 4.4% range), as described above.

Q HOW DID YOU ESTIMATE AMERENUE'S COST OF COMMON EQUITY WITH THIS MODEL?

A I added a projected long-term Treasury bond yield to my estimated equity risk premium over Treasury yields. Blue Chip Financial Forecasts projects the 30-year Treasury bond yield to be 5.1%, and a 10-year Treasury bond to be 5.0%.[3/] Using the projected 30-year bond yield of 5.1%, and an electric equity risk premium of 5.2%, produces an estimated common equity return of 10.3%.

I next added my equity risk premium over utility bond yields to a current 13-week average yield on "Baa" rated utility bonds for the period ending November 11, 2006, of 6.26% - rounded to 6.3%. The current "Baa" utility bond yields are developed on Schedule MPG-9. Adding the utility bond equity premium of 3.7% to a "Baa" rated bond yield of 6.3% produces a cost of equity in the range of 10.0%.

My risk premium analyses produce an average return estimate of 10.2%, based on the range of 10.0% to 10.3%.

3/ Blue Chip Financial Forecasts, November 1, 2006 at 2.

CAPITAL ASSET PRICING MODEL

Q PLEASE DESCRIBE THE CAPM.

A The CAPM method of analysis is based upon the theory that the market required ROR for a security is equal to the risk-free ROR, plus a risk premium associated with the specific security. This relationship between risk and return can be expressed mathematically as follows:

Ri = Rf + Bi x (Rm - Rf) where:

Ri = Required return for stock i
Rf = Risk-free rate
Rm = Expected return for the market portfolio
Bi = Beta - Measure of the risk for stock;

The stock specific risk term in the above equation is beta. Beta represents the investment risk that cannot be diversified away when the security is held in a diversified portfolio. When stocks are held in a diversified portfolio, firm-specific risks can be eliminated by balancing the portfolio with securities that react in the opposite direction to firm-specific risk factors (e.g., business cycle, competition, product mix and production limitations).

The risks that cannot be eliminated when held in a diversified portfolio are nondiversifiable risks. Nondiversifiable risks are related to the market in general and are referred to as systematic risks. Risks that can be eliminated by diversification are regarded as nonsystematic risks. In a broad sense, systematic risks are market risks, and nonsystematic risks are business risks. The CAPM theory suggests that the market will not compensate investors for assuming risks that can be diversified away. Therefore, the only risk that investors will be compensated for are systematic or nondiversifiable risks. The beta is a measure of the systematic or nondiversifiable risks.

Q PLEASE DESCRIBE THE INPUTS TO YOUR CAPM.

A The CAPM requires an estimate of the market risk-free rate, the company's beta, and the market risk premium.

Q WHAT DID YOU USE AS AN ESTIMATE OF THE MARKET RISK-FREE RATE?

A I used Blue Chip Financial Forecasts' projected 30-year Treasury bond yield of 5.1%. The current 30-year bond yield is 5.1% (Blue Chip Financial Forecasts, November 1, 2006 at 2).

Q WHY DID YOU USE LONG-TERM TREASURY BOND YIELDS AS AN ESTIMATE OF THE RISK-FREE RATE?

A Treasury securities are backed by the full faith and credit of the United States government. Therefore, long-term Treasury bonds are considered to have negligible credit risk. Also, long-term Treasury bonds have an investment horizon similar to that of common stock. As a result, investor-anticipated long-run inflation expectations are reflected in both common stock required returns and long-term bond yields. Therefore, the nominal risk-free rate (or expected inflation rate and real risk-free rate) included in a long-term bond yield is a reasonable estimate of the nominal risk-free rate included in common stock returns.

Treasury bond yields, however, do include risk premiums related to unanticipated future inflation and interest rates. Therefore, a Treasury bond yield is not a risk-free rate. Risk premiums related to unanticipated inflation and interest rates are systematic or market risks. Consequently, for companies with betas less than one, using the Treasury bond yield as a proxy for the risk-free rate in the CAPM analysis can produce an overstated estimate of the CAPM return.

Q WHAT BETA DID YOU USE IN YOUR ANALYSIS?

A I relied on the group median Value Line beta estimate for my electric proxy group of 0.80, as shown on my Schedule MPG-10.

Q DO YOU RECOMMEND A CAREFUL CONSIDERATION OF A UTILITY BETA FOR USE IN A CAPM STUDY?

A Yes. Utility betas have been increasing over the last five years, as shown on Schedule MPG-10, largely because electric utility stocks have outperformed the overall market. While this increasing beta gives the impression of increasing risk, that interpretation is incorrect.

Indeed, electric utility risk factors have been decreasing as these companies revert to a back-to-basics investment strategy that lower their operating risks, and they have been divesting non-regulated businesses to reduce debt and strengthen balance sheets, which is lowering risk. Value Line notes this in a recent review of the electric utility industry. Value Line states as follows:

> "**Better Finances**
> This decade, utilities have distanced themselves from risky unregulated business forays, including commodities trading, foreign energy operations, water services and aircraft leasing. Currently, *Dominion Resources* plans to sell its oil and gas production business, *Duke* is spinning its mid-stream gas operations to shareholders, *Northeast Utilities* is divesting its merchant power generation business, and *Progress Energy* is shedding power plant and natural gas assets. Such actions have improved earnings performance and strengthened capital ratios. Companies are targeting a nearly equal weighting of debt and equity on their balance sheets, a goal that should be met by 2009-2011.
> Revenue-backed and tax-exempt bonds will provide economical funding for planned capital improvements. This will further support overall finances." (The Value Line Investment Survey, Electric Utility (East) Industry, December 1, 2006, p. 157)

Further, Value Line notes an increase in the common equity ratio and fixed charge coverage ratio over the last three to five years. These Value Line parameters indicate lower financial risk and stronger earnings and cash flow coverages of financial obligations. This reduces utilities' risk and limits the variability to market factors that can inhibit the utilities' ability to meet investors' earnings and cash flow expectations.

These risk reductions have resulted in robust stock return performance for electric utility stocks, as shown on my Schedule MPG-11. As illustrated on this schedule, electric utility stocks have out performed the market over the last five years. This utility stock performance has contributed to an increase in betas and given the impression the electric utility stock variability is comparable to the overall market, but other risk factors clearly show that that is a false indication. Reliance on the group median beta, which is a beta that is stronger that the beta has been over the last five years, and is more reflective of the majority of the individual company betas included in my proxy group.

Q HOW DID YOU DERIVE YOUR MARKET PREMIUM ESTIMATE?

A I derived two market premium estimates, a forward-looking estimate and one based on a long-term historical average.

The forward-looking estimate was derived by estimating the expected return on the market (S&P 500) and subtracting the risk-free rate from this estimate. I estimated the expected return on the S&P 500 by adding an expected inflation rate to the long-term historical arithmetic average real return on the market. The real return on the market represents the achieved return above the rate of inflation.

The Ibbotson and Associates' Stocks, Bonds, Bills and Inflation 2006 Year Book publication, at 120, estimates the historical arithmetic average real market return over the period 1926-2005 as 9.1%. A current five-year consensus analyst inflation projection, as measured by the Consumer Price Index, is 2.3% (Blue Chip Financial Forecasts, November 1, 2006 at 2). Using these estimates, the expected market return is 11.6%[4]. The market premium then is the difference between the 11.6% expected market return, and my 5.1% risk-free rate estimate, or 6.5%.

The historical estimate of the market risk premium was also estimated by Ibbotson and Associates in the Stock, Bonds, Bills and Inflation, 2006 Year Book at 31. Over the period 1926 through 2005, Ibbotson's study estimated that the arithmetic average of the achieved total return on the S&P 500 was 12.3%, and the total return on long-term Treasury bonds was 5.8%. The indicated equity risk premium is 6.5% (12.3% - 5.8% = 6.5%).

Q WHAT ARE THE RESULTS OF YOUR CAPM ANALYSIS?

A As shown on Schedule MPG-12, based on the market risk premium of 6.5%, a risk free rate of 5.1%, and a beta of 0.80, the CAPM estimated return on equity is 10.3%.

RETURN ON EQUITY SUMMARY

Q BASED ON THE RESULTS OF YOUR RATE OF RETURN ON COMMON EQUITY ANALYSES DESCRIBED ABOVE, WHAT RETURN ON COMMON EQUITY DO YOU RECOMMEND FOR AMERENUE?

A Based on my analyses, I estimate AmerenUE's current market cost of equity to be 10.0%.

[4] (1.023) * (1.091) – 1 = 11.6%.

TABLE 2

Return on Common Equity Summary

Description	Percent
Constant Growth DCF	9.2%
Risk Premium	10.2%
CAPM	10.3%

My recommended return on equity of 9.8% is at the midpoint of my estimated return on equity range for AmerenUE of 9.2% to 10.3%. The high end of my estimated range is based on my CAPM and risk premium analyses, and the low end of my estimated range is based on my DCF analysis.

FINANCIAL INTEGRITY

Q WILL YOUR RECOMMENDED OVERALL RATE OF RETURN SUPPORT AMERENUE'S CURRENT BOND RATING FROM S&P?

A Yes. I have reached this conclusion by comparing the key credit rating financial ratios for AmerenUE at the Company's proposed capital structure and my return on equity to S&P's benchmark financial ratios for an "A" rated utility and a "BBB" rated utility with an S&P business profile score of 5, AmerenUE's profile score.

Q PLEASE DESCRIBE S&P'S USE OF THE FINANCIAL BENCHMARK RATIOS IN ITS CREDIT RATING REVIEW.

A S&P evaluates a utility's credit rating based on an assessment of its financial and business risks. A combination of financial and business risks equates to the overall assessment of the Company's total credit risk exposure. S&P publishes a matrix of

financial ratios that defines the level of financial risk as a function of the level of business risk.

S&P rates a utility's business risk based on a business profile score of 1, lowest risk, up to 10, highest risk. Integrated electric utilities typically have a business profile score from S&P of 4, 5 or 6, while T&D electric utilities' profile scores primarily range from 2 to 4.

S&P publishes ranges for three primary financial ratios that it uses as guidance in its credit review for utility companies. The three primary financial ratio benchmarks it relies on in its credit rating process include: (1) funds from operations ("FFO") to debt interest expense, (2) FFO to total debt, and (3) total debt to total capital.

Q HOW DID YOU APPLY S&P'S FINANCIAL RATIOS TO TEST THE REASONABLENESS OF YOUR RATE OF RETURN RECOMMENDATIONS?

A I calculated each of S&P's financial ratios based on AmerenUE's cost of service for retail operations, including the debt interest attributable to CWIP accruing AFUDC. While S&P would normally look at consolidated AmerenUE corporate financial ratios in its credit review process, my investigation in this proceeding is to judge the reasonableness of my proposed cost of capital for AmerenUE's Missouri utility regulated operations. Hence, I am attempting to determine whether the rate of return and cash flow generation opportunity reflected in my proposed cost of capital for AmerenUE will support its investment grade bond ratings and financial integrity.

Q PLEASE DESCRIBE THE RESULTS OF THIS CREDIT METRIC ANALYSIS FOR AMERENUE.

A The S&P financial metric calculation for AmerenUE is developed on my Schedule MPG-13. In constructing this analysis, I reflected my recommended 9.8% return on equity and the Company's recommended capital structure.

As shown on my Schedule MPG-13, based on an equity return of 9.8%, AmerenUE will be provided an opportunity to produce a Funds From Operations ("FFO") to debt interest expense ratio of 4.9x. This FFO to interest coverage ratio is above the range of S&P's benchmark ratio guideline of 4.5x to 3.8x for an "A" rated utility company with a business profile score of 5.

AmerenUE's total debt ratio to total capital is 45.8% at the Company's proposed capital structure. This is within S&P's "A" rated utility range of 42% to 50%.

Finally, AmerenUE's retail operations FFO to total debt coverage at a 9.8% equity return would be 21.2%, which is near the top (strong) of S&P's financial metric range of 15% to 22% for a "Baa" rated utility company.

At my proposed capital structure and return on equity, AmerenUE's financial metrics are supportive of an "A" utility bond rating, which is an improvement to AmerenUE's current bond rating of "BBB."

Q HOW WOULD AMERENUE'S CREDIT METRICS LOOK IF THE COMMISSION AWARDED AMERENUE A RETURN ON EQUITY AT THE LOW END OF YOUR RECOMMENDED RANGE?

A If the Commission awarded AmerenUE a return on equity at the low end of my recommended range, its credit metrics would still support its current "BBB" bond rating. Specifically, with a return on equity of 9.2%, AmerenUE's FFO to debt interest rate coverage ratio would be reduced only to 4.8x, which is still consistent with an "A"

bond rating; its FFO to total debt would drop to 20%, which is still a strong "BBB" bond rating, and; its total debt ratio would not be impacted by a lower return on equity.

As such, a return on equity at the low end of my recommended 9.2% to 10.2% return on equity range will support AmerenUE's financial integrity, its current bond rating, and fairly compensate investors for its investment risk.

RESPONSE TO AMERENUE WITNESSES' RETURN ON EQUITY RECOMMENDATIONS

Q WHAT RETURN ON COMMON EQUITY IS AMERENUE PROPOSING IN THIS PROCEEDING?

A AmerenUE is proposing a return on common equity of 12.0%. AmerenUE's proposed return on equity is based on the analyses of Ms. McShane and Dr. Vander Weide.

I will respond to these two witnesses' development of a proxy group and market cost of equity for the proxy group separately. Both witnesses propose a financial risk adjustment to the proxy group's estimated market required return to derive a fair return for AmerenUE's book capital structure used to set rates in this proceeding. This financial risk adjustment is fundamentally flawed, is inconsistent with traditional ratemaking methods of establishing fair compensation for regulated utility operations, and is based on flawed and erroneous assessment of financial risk. For the reasons set forth below, Dr. Vander Weide's and Ms. McShane's own analyses, excluding their erroneous equity return add-ons, confirm my finding that a reasonable return on equity for AmerenUE in this proceeding is under 10%.

EQUITY RETURN ADD-ON FOR DIFFERENTIALS IN FINANCIAL AND CAPITAL STRUCTURE RISK

Q ARE AMERENUE'S RATE OF RETURN WITNESSES PROPOSING A RETURN ON EQUITY ADD-ON TO REFLECT THEIR BELIEF THAT AMERENUE'S FINANCIAL RISK OR CAPITAL STRUCTURE RISK IS GREATER THAN THAT OF THE PROXY GROUPS AND THEREFORE JUSTIFY A RETURN ON EQUITY ADD-ON?

A Yes. AmerenUE witness McShane proposes to increase her 11.0% return on equity estimated from her proxy groups, to a recommended 12.0% return for AmerenUE in this proceeding. Ms McShane argues that a one-percentage point add-on premium is appropriate because her proxy electric utility sample market value common equity ratio is 62%, which exhibits less financial risk than AmerenUE's book value common equity ratio of 52%. To account for this difference in the value of common equity relative to AmerenUE's book value common equity, she argues that a return on equity add-on premium is appropriate.

Similarly, AmerenUE's witness Dr. Vander Weide recommends to increase his estimated return on equity of 11.5% for his proxy group up to 12.2% for AmerenUE for the same reason. Dr. Vander Weide asserts that this return on equity add-on is appropriate because AmerenUE's filed capital structure in this proceeding embodies greater financial risk than embodied in the common equity ratio estimate for his comparable proxy companies (at 6),

Q HAVE DR. VANDER WEIDE AND MS. MCSHANE RECOMMENDED REASONABLE ADJUSTMENTS TO THEIR PROXY GROUPS' ESTIMATED RETURN ON EQUITY TO PRODUCE A FAIR RETURN ON EQUITY FOR AMERENUE IN THIS PROCEEDING?

A No. The witnesses' return on equity adjustments are flawed and should be rejected for several reasons, including the following:

- The witnesses do not propose return on equity adjustments based on total investment risk assessment of AmerenUE in comparison to the proxy groups. Rather, the return on equity adjustments are based on their estimate of financial risk alone.

- The witnesses' assessment of financial risk is flawed because it does not properly evaluate the financial risk differential between the proxy groups and AmerenUE.

- The witnesses' financial risk assessment is flawed because it fails to recognize that a company's market stock price and market value are tied to its earnings and cash flow on book value. Hence, book value financial risk is already capturing a company's stock price.

- The witnesses' proposed adjustment is actually a thinly veiled market to book ratio adjustment to the return on equity estimate. Market to book ratio adjustments for regulated authorized returns on equity are widely rejected as flawed and unreasonable and should also be rejected in this proceeding.

Q WHY DO YOU BELIEVE THE FINANCIAL RISK EQUITY RETURN ADD-ON IS FLAWED BECAUSE IT DOES NOT REFLECT TOTAL INVESTMENT RISK?

A Witnesses McShane and Vander Weide state they are adjusting the proxy group's return on equity to reflect the difference between AmerenUE's market capital structure or financial risk and its book capital structure or financial risk. A measure of this differential risk is based on a market value common equity ratio in comparison to a book value common equity ratio. As such, the witnesses are completely ignoring all other and relevant risk factors in developing this proposed return premium.

Specifically, the witnesses' measure of financial risk ignores the difference in operating risk of AmerenUE in comparison to the other companies, which is significant. Security analysts' evaluation of a utility company's risk considers total investment risk assessment not only a limited financial risk assessment that the AmerenUE witnesses are focusing on. For example, the Value Line Investment

Survey in reviewing different company stocks considers stock price variability, industry fundamentals and financial risk measures including fixed charge coverage ratios, balance sheet leverage, and earnings interest coverage.

S&P in its credit rating review of the utilities considers both business and financial risk in assessing the overall credit standing of the utility. S&P's business risk considers regulatory risk, management risk, competitive risk, as well as the utility's supply and customers' diversity. All of these risk assessments are an indication of the utility's ability to generate revenue, control costs and manage cash flow needed to support financial obligations. In assessing financial risk, S&P also considers balance sheet risk and earnings, and cash flow coverage of fixed obligations.

In significant contrast, witnesses McShane and Vander Weide only consider capital structure financial risk in supporting their proposed equity return add-on.

Q WHY DO YOU BELIEVE THE WITNESSES HAVE INACCURATELY MEASURED FINANCIAL RISK?

A The witnesses have inaccurately measured financial risk because it does not reflect investors' expectations or security analysts' assessment of the financial risk of the underlying enterprises. Hence, their methodology is fundamentally flawed and does not accurately evaluate differences in financial risk.

Specifically, security analysts' reports typically identify the utilities' financial risk in terms of capital structure leverage risk, and cash and earnings coverage of obligations (i.e., debt, lease and contractual). For example, capital structure risk is certainly a significant risk element of total financial risk, but other important considerations include how expensive is the debt interest, and the utility's earnings and cash flow coverage of the debt interest obligation. If the utility is able to issue debt at a below industry average interest rate, and its balance sheet risk is

comparable to other companies, it is possible for the utility to have lower financial risk even though it has comparable capital structure leverage risk.

Further, utilities have financial risk in addition to the utility's balance sheet risk. For example, S&P also considers off-balance-sheet financial obligations for such things as long-term purchased power agreements, and operating lease agreements in evaluating financial risk. To the extent AmerenUE has less off-balance-sheet purchased power contracts, the utilities included in Ms. McShane's and Dr. Vander Weide's comparable groups could have greater financial risk even if they had comparable balance sheet risk. The significance of this off-balance-sheet debt was ignored by Ms. McShane and Dr. Vander Weide.

For all of these reasons, Ms. McShane and Dr. Vander Weide have not provided a complete and thorough review of differences in financial risk between the proxy groups and AmerenUE. Therefore, their conclusion that AmerenUE's return on equity should be increased in order to compensate for differences in financial risk is based on the flawed and erroneous analysis, and does not properly consider total investment risk.

Q IS IT CORRECT TO CONCLUDE THAT THERE IS A DIFFERENCE BETWEEN AMERENUE'S MARKET VALUE FINANCIAL RISK AND BOOK VALUE FINANCIAL RISK?

A No. A utility's market value of equity is based on the earnings and cash flow strength of the underlying stock. A utility's underlying stock earnings and cash flow are based on its book value financial risk. Hence, the stock price already reflects its book value financial risk, hence no adjustment to the equity return is needed.

Specifically, to the extent a company has higher book leverage risk, there is greater uncertainty of that company's ability to produce earnings and cash flow. That

greater uncertainty in earnings and cash flow would be reflected by the stock market price and hence market value equity ratio.

It is not accurate for the Ameren witnesses to claim there is material difference in the market value financial risk and the book value financial risk. Indeed, the market value of the underlying stock is based on the book value earnings and cash flow of the company and hence book value leverage risk or book value equity ratio.

Q WHY DO YOU BELIEVE THAT THE WITNESSES' SO-CALLED FINANCIAL RISK ADJUSTMENT IS ACTUALLY A MARKET-TO-BOOK RATIO ADJUSTMENT IN DISGUISE?

A The witnesses' financial risk adjustment is essentially adjusting a market return on equity in order to apply it to a book value. They are in effect asserting that since the market value of a utility's stock is greater than its book value, the market return when applied to book value must be adjusted.

Q IS A MARKET-TO-BOOK RATIO ADJUSTMENT REASONABLE?

A No. A market-to-book ratio adjustment will provide the utility with excessive earnings opportunities, which results in unjust utility prices. Consider an example. Using Ms. McShane's return estimate, and ignoring all the flaws I have listed above, assume AmerenUE is faced with two alternative investment opportunities: (1) re-purchase its own stock or (2) make incremental investments in utility plant. These are two comparable risk investments, because a utility stock price is based on its return on utility plant.

If Ms. McShane's recommendations were adopted, AmerenUE could earn 12% by making utility plant investments, but could only earn a return of 11.0% by repurchasing its own stock. The 12% utility plant return includes Ms. McShane's 100

basis point financial risk adjustment that would be applied to book value utility plant investments. The 11.0% return would be based on market investments including utility stock.

In order to avoid this economic incentive to over-invest in utility plant because it provides an inflated risk adjusted return opportunity, the Missouri Public Service Commission should reject the Ameren witnesses' proposed financial risk add-on to a return on equity estimated from the proxy groups. Excluding this equity risk add-on, in the example above, AmerenUE would be provided an opportunity to earn the same rate of return on incremental utility plant investments of 11.0%, as it could earn by making a comparable risk of repurchasing its own stock, 11.0%. Regulation attempts to mimic a competitive marketplace, and in a competitive marketplace, a company cannot earn windfall profits by expanding its investments to meet customer demand. In order to ensure that AmerenUE's rates are just and reasonable in this proceeding, Ameren's return opportunities for incremental plant investments should be comparable to its return opportunities of repurchasing its own stock. Hence, no financial risk adjustment, or market to book ratio adjustment to the authorized return on equity should be allowed.

REVIEW OF MS. MCSHANE'S RETURN ON EQUITY ESTIMATE

Q HOW DID MS. MCSHANE ARRIVE AT HER 12.0% RETURN ON EQUITY REQUEST FOR AMERENUE?

A Ms. McShane's recommendation is based on a discounted cash flow analysis, a risk premium analysis, and comparable earnings analysis. Using these models and a group of companies Ms. McShane estimates to be comparable in risk to AmerenUE, she estimates a market required return for her comparable risk proxy groups of

11.0%. She then adds 100 basis points to this proxy group estimated return to reflect her belief that the authorized return on equity should be increased by a 100 basis point premium to reflect a financial risk premium as discussed above.

Table 3, Column 1 below summarizes Ms. McShane's return on equity findings, and Column 2 shows how her recommendation would change with appropriate adjustments to her DCF and risk premium studies, and a rejection of her comparable earnings analysis for the reasons set forth below.

TABLE 3

AmerenUE Return on Equity Estimates

Line	Description	McShane Return (1)	Adjusted Return (2)
1	DCF	10.0%	9.5%
2	CAPM Analysis	12.0%	10.2%
3	Equity Risk Premium Test	11.25%	10.1%
4	Average	11.0%	9.9%
5	Comparable Earnings Analysis	14.0% - 14.6%	Reject

As shown above and discussed below, with reasonable inputs and the rejection of unreasonable return on equity "add-ons," Ms. McShane's methodologies support my 9.8% recommended return on equity.

Q IS MS. MCSHANE'S 100 BASIS POINT FINANCIAL RISK RETURN ADD-ON REASONABLE?

A No. Her financial risk premium is flawed for the reasons discussed above and should be rejected.

Q PLEASE DESCRIBE MS. MCSHANE'S DCF STUDY.

A Ms. McShane performed a constant growth and two-stage growth DCF studies on her proxy group companies. Ms. McShane's traditional DCF result for these companies falls in the range of 9.2% to 11.0%, as shown on Schedules KCM-E4-1 and KCM-E5-1 of her testimony.

The results of her two-stage growth DCF model produced a return of 9.4% as developed on her Schedule KCM-E6-1.

Ms. McShane then summarizes her constant growth and two-stage growth models and concludes that these unadjusted average DCF results indicate a return on equity of 10.0% (McShane direct at 40).

Q DO MS. MCSHANE'S ESTIMATED DCF RETURNS SUPPORT A 10.0% RETURN ON EQUITY?

A No. Ms. McShane's three DCF return estimates indicate a return on equity in the range of 9.4% up to 10.7%. The high end of that range is excessive because current consensus analysts' growth rate projections are not sustainable and produce excessive DCF return estimates.

Specifically, on her Schedule KCM E4-1, her mean DCF return of 10.7% is based on acceptable model inputs, however, for reasons set forth below, the group average IBES growth rate of 6.7% overstates a reasonable estimate of a long-term sustainable growth rate for utility companies at this time. As a result, since current consensus growth rates do not represent reasonable sustainable long-term growth rate estimates, primary weight should be given to Ms. McShane's two-stage DCF model and little to no weight given to her constant growth DCF model.

On her Schedule KCM E5-1, she shows a group average mean return estimate of 11.0%. However, that average return estimate is significantly biased by

one estimate that blatantly exaggerates a fair return on equity for regulated utility operations. Specifically, TXU Corp. produced a DCF return using a Value Line growth rate estimate of 30%, which produced a DCF return of 34.0%. TXU Corp.'s earnings reflect unregulated merchant generation, including nuclear generation subsidiaries, as well as retail regulated operations. Further, TXU Corp.'s earnings are recovering, therefore, three to five-year earnings growth projections represent accelerated growth to reflect earnings recovery, rather than sustainable long-term growth rate estimates.

Removing TXU Corp. from Ms. McShane's Schedule KCM E-5-1 would lower the group average mean estimated DCF return of 11.0% down to 9.6%. A 9.6% return estimate reflects the mean growth rate estimate of approximately 4.9%, which is a much more reasonable estimate of long-term sustainable growth for utility companies. It also corroborates her two-stage DCF result using IBES growth rates.

I believe that Ms. McShane's two-stage DCF result produces the most reasonable estimate because it reflects the high expected three to five-year growth of the companies, and a growth rate declining to a lower stainable level thereafter. The two-stage model produces a DCF return of 9.4%. The average growth rate in her Value Line estimate, excluding TXU, also produces a reasonable result of 9.6%. However, I am concerned about the reliance on Value Line because it is a single growth estimate rather than a consensus of analysts' growth projections. Nevertheless, giving some weight to the adjusted Value Line DCF return of 9.6%, and primary weight to her consensus analyst growth rate two-stage DCF return estimate of 9.4% would indicate a DCF return of 9.5%.

Q PLEASE EXPLAIN WHY MS. MCSHANE'S IBES GROWTH RATE ESTIMATE OF 6.7% FOR HER PROXY GROUP OVERSTATES A REASONABLE SUSTAINABLE LONG-TERM GROWTH RATE ESTIMATE FOR A DCF MODEL AT THIS TIME.

A Ms. McShane's DCF study shown on Schedule KCM E4-1 reflects a group average growth rate of 6.7%. Her 6.6% growth rate is shown on her Schedule KCM-E4-1. On that schedule, under Column 4, the 6.7% average growth rate is significantly impacted by several companies that have abnormally high growth rates over the next three to five years. Those abnormally high growth rates include Entergy Corp. of 10.1%, PNM Resources of 10.0%, PPL Corp. of 9.1%, and TXU Corp. of 10.9%.

These companies' three to five-year growth rate projections by IBES, which may be appropriate for the three to five-year time period forecasted, are not reasonable estimates of long-term sustainable growth. Indeed, these growth rates reflect significant non-regulated investment activities, such as for Exelon Corp. and Entergy's non-regulated nuclear merchant generation subsidiaries that have higher risk and much higher earnings growth potential than do regulated utility operations. Also, Entergy's earnings growth rate over the next three to five years will reflect recovery to the corporate earnings caused by hurricane damage and a bankrupt operating utility affiliate in New Orleans, Louisiana. As such, lower earnings caused by these unusual events, Entergy's earnings will recover to a sustainable level, which will indicate an abnormally high growth rate during this earnings recovery period. However, the earnings growth over the next three to five years is not a sustainable long-term growth rate estimate for Entergy.

Further, Edison International has strong earnings growth largely attributable to its unregulated subsidiary. In a similar fashion, TXU Corp. has non-regulated generation investment in Texas that provides very strong earnings growth given

today's high gas prices. Further, TXU is evaluating significant additions to its coal-fired generation in Texas that likely have very strong earnings growth prospects.

These earnings growth prospects are not characteristic of regulated low-risk utility operations. Further, these growth rates are not sustainable even for high growth non-regulated investment opportunities. The growth rate outlook for these companies in the merchant generation side of the business likely reflect the need for new generating capacity in many regions of the country, but will produce high margins if the demand is met by solid-fuel resources. These margins, of course, will depend on the level of natural gas prices and market clearing prices in those regions, but currently the market appears to have the sense of a robust outlook for these types of investments. After capacity reserve margins and additional base load investments are made around the country, it is reasonable to expect that these growth rates would decline to more long-term sustainable levels in the future. In any event, these growth rates are not appropriate for low risk regulated utility operations.

As such, Ms. McShane's DCF growth rates using her IBES growth rates do not reasonably reflect long-term sustainable growth rate estimates for her proxy group. Therefore, I recommend rejection of this DCF estimate as an overstatement of utilities' long-term sustainable growth and an overstatement of a reasonable DCF return estimate.

Q ARE THERE OTHER REASONS TO REJECT HER CONSENSUS GROUP IBES GROWTH RATE ESTIMATES?

A Yes. Her proxy group average IBES growth rate of 6.7% significantly exceeds the maximum sustainable long-term growth rate. Specifically, her long-term utility growth cannot exceed the growth in their service area economy. Utilities make investments in utility plant to meet sales growth. Sales growth normally attracts economic activity

in their service area. Currently, the projected growth rate of the U.S. economy is approximately 5.1%. (Blue Chip Financial Forecasts, November 2006, page 2) Hence, it is neither rational nor reasonable to expect these companies' long-term growth rates to average 6.7% when the economy they serve is growing at 5.1%. For this reason, it is appropriate and rational to expect that while these companies may grow at an accelerated rate over the next three to five years, that growth rate will eventually subside to a more long-term sustainable growth level. Ms. McShane's two-stage growth rate reflects this rational expectation and produces a much more reasonable DCF return estimate than does her constant growth rate DCF model, which relies on an unsustainable high short-term growth rate.

Q PLEASE SUMMARIZE MS. MCSHANE'S CAPM ANALYSIS.

A Ms. McShane relies on the risk-free rate in the range of 5.0% to 5.5% (p. 30), a beta of 0.90 (p. 36), and a market risk premium of 7.5% (p. 35). Using this data, she concludes that her CAPM analysis indicates a return for AmerenUE in the range of 11.7% to 12.25 (p. 37).

Q IS MS. MCSHANE'S CAPM ANALYSIS REASONABLE?

A No. I have two major issues with Ms. McShane's CAPM analysis. First, her market risk premium is significantly overstated. Second, her use of a beta estimate of 0.90 significantly overstates the risk of a regulated utility operation, such as AmerenUE.

Q HOW WOULD MS. MCSHANE'S CAPM ANALYSIS CHANGE WITH A MORE REASONABLE MARKET RISK PREMIUM ESTIMATE AND A BETA THAT REFLECTS LOW RISK REGULATED OPERATIONS?

A Adjusting Ms. McShane's CAPM analysis to reflect the market risk premium of 6.5%, the current projected 10-year Treasury bond yield of 5.01% and a beta of 0.80 would reduce her CAPM return estimate of 11.75% to 12.0%, down to 10.2%. The appropriateness of this alternative market risk premium and beta estimate are discussed below.

Q HOW DID MS. MCSHANE DEVELOP HER MARKET RISK PREMIUM RANGE IN THE DEVELOPMENT OF HER CAPM?

A She used two methods to estimate a market risk premium. First, she estimated the difference between the income return on 20-year Treasury securities, and the total achieved return on equity securities over the period 1926 – 2005 (7.1%) and 1947 – 2005 (7.0%). She then increased the market risk premium from 7.0% up to 7.5%, by including a 50 basis points adder. She argued that the adder was appropriate because the historical market risk premium was based on the difference between a 10-year Treasury bond yield and a 20-year Treasury bond yield (McShane direct, pp. 33-34).

Her forward-looking equity risk premium was based on a DCF analysis of the S&P 500 and her projected risk-free rate. Using a dividend yield on the S&P 500 of 1.9%, and a growth rate of 10.6%, she estimated a DCF return for the S&P 500 of 12.7%. From this, she subtracted her 10-year Treasury note forecasted yield of 5.0% to 5.5%, to produce a forward-looking market risk premium in the range of 7.2% - 7.7%. Based on these two studies, she concludes the market risk premium is 7.5% (McShane direct, p. 35).

Q IS MS. MCSHANE'S HISTORICAL MARKET RISK PREMIUM ESTIMATE OF 7.5% REASONABLE?

A No. There are several flaws in Ms. McShane's historical market risk premium. First, the source of her data, Ibbotson and Associates', estimates a historical total return on equity securities above the achieved return on Treasury bonds to be 6.5% for the period 1927 through 2005.[5] This 6.5% equity risk premium is the actual historical market risk premium earned on market investments (12.3%) relative to the returns earned on long-term Treasury bond investments. (5.8%)

In contrast, Ms. McShane's market risk premium is overstated because she used only income Treasury returns, not total returns on Treasury investment. This is not reasonable for at least two reasons.. First, the income return on Treasury securities is a forward-looking expected return if the Treasury bond is held to maturity. The income return ignores annual capital gains/losses on Treasury securities. In contrast, her total return on equities is a backward looking historical review that includes both income return and capital gains/losses. Hence, her market risk premium is based on the mismatch of a forward-looking expected income return on Treasuries, and historical actual achieved total returns on market equity securities. This mismatch of forward-looking income returns and historical achieved total returns inflates her estimated market risk premium.

Second, her use of only the income return on Treasury bonds represents an investment annual performance that cannot rationally be expected by investors. Specifically, investors understand that investments in Treasury bond securities will produce both cash coupon yields, based on the income return, and the expectations of bond price changes on an annual basis over the expected holding period. Hence,

[5] Ibbotson SBBI 2006 Yearbook at 31.

a risk free proxy based on an investment that is not reflective of investors' expectations cannot rationally reflect the market's risk free rate built into market security prices. Hence, her development of an equity risk premium is simply based on an unrealistic premise and does not capture rational expectations.

Third, Ms. McShane's proposal to increase the market risk premium by 50 basis points to reflect the difference between a 20-year Treasury yield and a 10-year Treasury yield is without merit and is a blatant manipulative adjustment designed to increase her CAPM return estimate. The projected interest rates on 10-year 20-year and 30-year long-term Treasury securities are currently nearly identical. For example, the Blue Chip Financial Forecasts' return on 10-year Treasury bond yields is 5.0%, and its projected return on 30-year Treasury bonds is 5.1% (The Blue Chip Financial Forecasts, November 1, 2006 at 2). Hence, Ms. McShane's 0.50% historical adder spread of 10-year and 20-year Treasury yields is not reflective of the current market or forecasted yields next year. Therefore, adding the claimed historical Treasury spread biases and inflates her CAPM return estimate.

Q IS MS. MCSHANE'S FORWARD-LOOKING MARKET RISK PREMIUM ESTIMATE REASONABLE?

A No. Ms. McShane's forward-looking market risk premium is also inflated and unreliable. Ms. McShane's DCF return on the market of 12.7% is wildly exaggerated and not reasonable. Indeed, Ms. McShane's S&P 500 DCF return estimate is driven by a growth rate estimate on the market of 10.6% (at 35). This S&P 500 growth rate is over twice the expected long-term growth of the overall U.S. economy as measured by the GDP of 5.1%. Further, this growth rate is significantly higher than the historical growth rate of the market of approximately 7.8%, as measured from the capital gains

of Ibbotson & Associates over the period 1926 through the end of 2005 (SBBI 2006 Yearbook at 119).

This S&P 500 growth rate Ms. McShane relied on is not a reasonable long-term sustainable growth rate projection for the S&P 500. By significantly overstating the S&P 500 growth rate estimate as she has done, Ms. McShane has significantly overstated the DCF return on the market, and thus significantly overstates the market risk premium estimate.

Q DOES VALUE LINE PROJECT A RETURN ON MARKET EQUITIES?

A Yes. Value Line's data includes a current yield on 1,700 securities followed by the Value Line Investment Survey of 1.6%, and three to five-year projected capital gains for the same stock index of 35%.[6] This data indicates an expected total market return over the next three to five years of 9.4%. The Value Line projection is much different than the 12.6% estimated by Ms. McShane. Using a 5.5% risk-free rate and market expected return of 10.4%, indicates a market risk premium of 3.9%.

Using the Value Line market return projection and Ms. McShane's market return projections as high/low estimates, indicates an average market return estimate of approximately 11.1% ((12.7 + 9.4)/2). Subtracting from this the projected Treasury bond yield of 5% would indicate a market risk premium of around 6.1%. This projected market risk premium is very similar to the historical achieved market risk premium of 6.5% that I used in my analysis and therefore corroborates the reasonableness of that historical actual market risk premium.

[6] The Value Line Investment Survey, November 24, 2006, Summary and Index.

Q PLEASE DESCRIBE MS. MCSHANE'S UTILITY EQUITY RISK PREMIUM STUDIES.

A Ms. McShane estimated a return for AmerenUE of 11.5% based on her equity risk premium studies. She conducted two studies, one based on historical achieved returns on LDCs, and a second one based on forward looking DCF returns for electric utilities.

In her historical equity risk premium study, Ms. McShane calculated the equity risk premiums for the S&P and Moody's gas distribution index over the period 1947 - 2005 compared to the 10-year U.S. Treasury bond income return. Using this methodology, she estimated a risk premium over Treasury bonds of 6.0%. To this she added a 0.5% yield spread of 10-year versus 20-year Treasury bond yields to produce a risk premium of 6.5% (McShane direct at 38).

In her forward looking DCF based equity premium estimates, she subtracted a 10-year Treasury yield from a DCF return estimate for a sample of electric utilities. Based on this DCF risk premium study, she estimated a 5.3% equity risk premium over 10-year Treasury bond yields over the period 1998 through the last quarter 2006 (McShane direct at 38-39).

Q IS MS. MCSHANE'S EQUITY RISK PREMIUM OF 6.5% BASED ON ELECTRIC UTILITY DCF ACHIEVED RETURNS OVER THE PERIOD 1947-2005 REASONABLE?

A No. Ms. McShane estimates the risk premium for electric utilities by looking at the achieved return on electric utility equity securities, relative to the income return on U.S. Treasury bonds. This overstates the equity risk premium because she is ignoring capital gains and losses on 20-year Treasury bonds over this time period.

The total achieved return on U.S. Treasury bonds over the period 1947-2005 is 6.3%, not 6.1% as used by Ms. McShane in her study.

Using this actual historical investment return on U.S. Treasury bonds over this time period would result in the electric equity risk premium of 5.0% based on a total achieved return on electric stocks of 11.3%, less a total achieved return on Treasury bonds of 6.3%. Similarly, Ms. McShane's estimated equity risk premium over Moody's gas distribution stocks would decrease from 6% down to 5.8%, reflecting the total achieved return on Treasury securities.

Reflecting these reduced equity risk premiums for electric utility stocks of 5% and a projected long-term Treasury bond yield of 5.1% would indicate a return on equity for AmerenUE in this proceeding of 11.1%.

Q IS MS. MCSHANE'S DERIVED PROSPECTIVE EQUITY RISK PREMIUM OVER ELECTRIC UTILITY STOCKS REASONABLE?

A No. The range of equity risk premiums estimated by Ms. McShane of 3% up to 6% is largely dependent on the IBES growth rate used to derive the DCF cost estimate. This is shown on her Schedule KCM E8-1. As noted previously in this testimony, the DCF growth rate must reflect the long-term sustainable growth rate estimate. A long-term sustainable growth rate estimate can never exceed the nominal expected growth of the U.S. economy, currently around 5.1%.

Further, Ms. McShane's forward-looking equity risk premium is largely dependent on the result of a DCF return estimate. Hence, this methodology does not provide a complementary estimate to her own DCF return estimate for her electric utility stocks. As such, this risk premium study is not a complement to a DCF study, but rather is in effect a more complicated and historical review of DCF returns relative to bond yields.

Second, Ms. McShane's study estimated an equity risk premium over a short-term 10-year Treasury bond yield. 10-year Treasury bond yields are more volatile than a longer-term Treasury bond yield, and thus produce a more volatile equity risk premium estimate. A shorter-term Treasury maturity is not as reasonable a bond instrument to use to estimate equity risk premium because there is such a differential in investment horizons. Specifically, common equity has an infinite investment horizon, which is best proxied by long-term Treasury instruments, and not short-term or intermediate term securities. Further, relying on long-term utility bond yields also will produce meaningful input to estimate a risk premium return using this data.

Q HOW WOULD MS. MCSHANE'S EQUITY RISK PREMIUM CHANGE IF LONG-TERM TREASURY INSTRUMENTS WERE USED IN THE ANALYSIS, AS WELL AS UTILITY BOND YIELDS?

A As shown on my Schedule MPG-14, I adjusted Ms. McShane's Schedule KCM E8-1 to include 20-year Treasury yields, and on Page 2 of Schedule MPG-14 to include "A" rated utility yields. Using 20-year Treasury securities produces an equity risk premium of 4.7%, significantly lower than the 5.3% estimated by Ms. McShane. Using "A" rated utility bond yields produces a risk premium over utility bond yields of 3.2%. Reflecting a projected Treasury bond yield of 5.1% and a current "A" rated utility bond yield would produce return on equity estimates of 9.8% and 9.2%, respectively. These estimates are far superior to Ms. McShane's estimate because they reflect debt securities with comparable investment horizons to common equity and develop a common equity return without an arbitrary adjustment for historical Treasury yield spreads.

Q WITH YOUR ADJUSTMENT TO HER RISK PREMIUM STUDIES, WHAT RETURN ON EQUITY IS A REASONABLE ESTIMATE FOR AMERENUE?

A As discussed above, with appropriate adjustments to Ms. McShane's risk premium studies, the models would produce a reasonable and accurate return on equity for AmerenUE in the range of 9.2% to 11.1%. The midpoint of this estimated range is 10.1%.

Q PLEASE DESCRIBE MS. MCSHANE'S COMPARABLE EARNINGS ANALYSIS.

A From a group of publicly traded competitive companies, followed by S&P's Research Insight database, Ms. McShane identified several companies she believed to be comparable in risk to electric utilities. To select companies she relied on the following:

1. Removed growth companies of less than $50 million common equity.
2. Value Line betas of one or more were removed.
3. Removed thinly traded companies.
4. Removed companies that had not paid dividends in any year 1999 through 2005.
5. Isolated the companies to remove companies whose earnings were outside one standard deviation of the group average.
6. Eliminated companies that had Value Line safety rankings of 4 or higher, and had below investment grade bond ratings.

This process produced a sample group of what she considered to be a low risk U.S. competitive company group consisting of 139 companies. For the period 1994 through 2005, she estimated an average earned return on book equity of 14.0% to 14.5% for her sample group, and a Value Line projected three to five-year return on book equity for her proxy group of 14.6%.

Q **DOES MS. MCSHANE'S COMPARABLE EARNINGS ANALYSIS PRODUCE REASONABLE RESULTS FOR ESTIMATING AMERENUE'S AUTHORIZED RETURNS ON EQUITY?**

A No. Ms. McShane's comparable earnings result of 14.0% to 14.5% is seriously flawed on its face. Importantly, this accounting-based return on equity method produces returns that are significantly higher than the market-based (DCF and risk premium) return on equity results. The accounting-based return does not measure the current cost of capital necessary to attract capital in the marketplace. An accounting return is not derived from the market valuation of security prices. Consequently, it does not measure investors' return requirements. This is an important distinction because if the accounting returns on equity are lower than the market required return on equity, then the utility's ability to attract capital could be impaired. Conversely, if the accounting return on equities significantly exceed the utility's market cost of capital, then utility rates would be adjusted much higher than necessary to fairly compensate investors and maintain their ability to attract capital. Hence, the methodology is flawed because it does not estimate a fair risk adjusted return on equity that fairly compensates the AmerenUE for making utility plant investments.

Because of the severe deficiencies in this methodology, and her failure to accurately account for AmerenUE's lower operating risk, Ms. McShane's comparable earnings analysis should be rejected.

RESPONSE TO DR. VANDER WEIDE

Q WHAT RETURN ON EQUITY DID DR. VANDER WEIDE ESTIMATE FOR AMERENUE?

A Dr. Vander Weide estimated AmerenUE's return on equity to be 12.2%. He arrived at this recommended return by first estimating a return on equity for an electric and gas proxy group of 11.5%. He then added 70 basis points to this proxy group estimated return on equity to account for the difference between the proxy group's market financial risk and AmerenUE's book financial risk.

As outlined in more detail above, the proposed equity return add-on should be rejected because it is not based on an assessment of total investment risk. It is based on a flawed assessment of differentials in financial risk between AmerenUE and the proxy group, and is not an accepted adjustment normally used in regulatory proceedings to authorize a fair return on equity for regulated utility operations.

Q HOW DID DR. VANDER WEIDE ESTIMATE THE 11.5% RETURN ON EQUITY BEFORE HIS FINANCIAL RISK ADJUSTMENT?

A Dr. Vander Weide supports his return on equity based on a discounted cash flow analysis, an ex-ante and ex-post risk premium analysis, and a capital asset pricing model. Dr. Vander Weide applies these models to a proxy group of electric companies and natural gas companies to develop his return estimates. These models, as he has used them, develop a common equity return of 11.5%.

Q IS DR. VANDER WEIDE'S CURRENT MARKET REQUIRED RETURN ON EQUITY OF 11.5% FOR HIS TWO PROXY GROUPS A REASONABLE RETURN ON EQUITY ESTIMATE FOR AMERENUE?

A No. Dr. Vander Weide's 11.5% return on equity is excessive. His return on equity results are shown below in Table 4, Column 1. In Column 2, I show my adjustments to Dr. Vander Weide's analyses, which reduce his equity return from 11.5% to 9.9%. Hence, as set forth below, with reasonable corrections, Dr. Vander Weide's own analyses support my recommended return on equity for AmerenUE.

TABLE 4

Dr. Vander Weide's Return on Common Equity Summary

Description	Dr. Vander Weide's Return* (1)	Adjusted Results (2)
DCF	10.7%	9.5%
Ex-Ante Risk Premium	11.0%	9.5%
Ex-Post Risk Premium	11.4%	10.4%
CAPM (Historical)	11.7%	10.3%
CAPM (DCF)	12.8%	Reject
Average	11.5%	9.9%

Q PLEASE DESCRIBE DR. VANDER WEIDE'S DCF ANALYSES.

A On his Schedules JVW-1 and JVW-2, Dr. Vander Weide performed a DCF analysis on a broad based group of electric and LDC gas companies. Based on this assessment, Dr. Vander Weide's electric group indicated an adjusted dividend yield of 4.32% and an average growth rate of 6.29%, which produced a DCF return of 10.61%. His gas group produced an adjusted yield of 3.43% and an average growth rate of 7.42% while supporting a DCF return of 10.84%. He then averaged the results of these two analyses together to arrive at his estimated DCF return of 10.7%.

Q **IS DR. VANDER WEIDE'S DCF RETURN A REASONABLE ESTIMATE FOR AMERENUE IN THIS PROCEEDING?**

A No. Dr. Vander Weide's DCF return analysis should be rejected for the following reasons. First, Dr. Vander Weide provided no analysis that showed that either his electric or LDC gas proxy groups reasonably approximate the investment risk of AmerenUE. Indeed, a review of these companies clearly show that there are many companies that have considerably more risk than AmerenUE.

Second, the average growth rate used to develop his two DCF numbers is excessive. Indeed, the electric group average growth of 6.29% and gas LDC growth rate of 7.84% are unreasonable estimates of long-term sustainable growth. A DCF analysis requires a growth rate that reasonably reflects long-term sustainable growth.

Also, Dr. Vander Weide's average is based on the market weight, rather than the simple average. By applying the market weight, he is giving inordinately high weight to certain company's estimates based on their market valuation. Adjusting the average of his return estimate to the simple average rather than the market weighted average lowers his electric DCF return to 10.0% from 10.61% and his gas return to 9.96% from 10.84%. There is no rational reason to apply more weight to larger companies than to smaller companies. As such, Dr. Vander Weide's market weighted average is simply manipulating the value of the proxy group and inflated his DCF return estimate. These adjustments are shown on my Schedule MPG-15.

Finally, Dr. Vander Weide used the quarterly version of the DCF model to estimate a market required return. A quarterly DCF model reflects the reinvestment of dividend returns throughout the year. The flaw in relying on the quarterly version of the DCF model is that it allows investors to earn the reinvestment return on dividends twice. Specifically, they earn it a first time by increasing the authorized return on

equity used to set the utility's rates. This increases the utility's earnings and provides for the reinvestment return in the utility's allowed rate of return. Second, the investors can earn the reinvestment return themselves after the utility pays dividends and the investors reinvest those dividends in other enterprises of corresponding risk. Hence, use of a quarterly version of the DCF return to estimate a regulatory authorized return allows investors to earn the reinvestment return on dividends twice – once through the regulatory authorized return on equity, and a second time after the dividends are actually paid to investors and reinvested by investors.

The quarterly version of the DCF return overstates a fair rate of return to use for setting rates. Therefore, Dr. Vander Weide's DCF return estimate should be rejected.

Q WHY HAVE YOU CONCLUDED THAT DR. VANDER WEIDE'S PROXY ELECTRIC AND GAS GROUPS CONTAIN COMPANIES WITH MORE RISK THAN AMERENUE?

A Dr. Vander Weide's electric and gas groups contain companies that are not reasonable risk proxies for AmerenUE. Specifically, the business risk and financial risk of many of these companies is not a reasonable risk proxy for AmerenUE. For example, S&P provides an independent assessment of AmerenUE's business risk. S&P assigns AmerenUE a business profile score of 5, which indicates approximately average integrated utility business risk. In contrast, many of the companies included in Dr. Vander Weide's group have business profile scores of more than 6, more than one notch greater than AmerenUE. Those companies include Dominion Resources, Duke Energy, Great Plains Energy, MDU Resources, Otter Tail Corporation, PPL Corp., Sempra Energy, and TXU Corp. Further, many of these companies are in the process of either selling assets, or are in the process of merging. Those companies

include Alliant Energy, Northeast Utilities, PNM Resources, and WPS Resources. Finally, Entergy Corp.'s stock price likely reflects the bankruptcy protection filing of its New Orleans operating subsidiary. This bankruptcy filing has most likely impacted Entergy's stock price, and is adequate reason to exclude Entergy from the proxy group in this proceeding.

Q WHY DO YOU BELIEVE THAT DR. VANDER WEIDE'S ELECTRIC AND GAS GROUP AVERAGE GROWTH RATES EXCEED A REASONABLE ESTIMATE OF A LONG-TERM SUSTAINABLE GROWTH AND THUS HAVE OVERSTATED THE DCF RESULTS?

A Dr. Vander Weide's group average growth rates for his electric and gas groups are 6.29% and 7.84%, respectively. As noted above in response to Ms. McShane's testimony, a long-term sustainable growth rate cannot exceed the nominal projected growth in the GDP. The nominal GDP growth current is approximately 5.1%. Because Dr. Vander Weide's group average growth rates exceed a reasonable and rational assessment of what the utilities' long-term sustainable growth rates could be, his DCF returns are inflated, are not reliable, and should be rejected.

Q WHAT DCF RETURN WOULD BE PRODUCED USING ONLY COMPANIES COMPARABLE IN RISK TO AMERENUE AND REASONABLE ESTIMATES OF LONG-TERM SUSTAINABLE GROWTH?

A Ms. McShane's DCF analysis provides a better review of proxy companies that represent comparable risk companies to AmerenUE. Again, Dr. Vander Weide made no effort at all to estimate proxy companies that reasonably represent AmerenUE's investment risk. However, currently IBES growth rates are overstated for various reasons discussed above in response to Ms. McShane. As discussed above, Ms.

McShane's two-stage DCF growth rate captures abnormally high short-term earnings growth expectations for these companies, but also captures the rational expectation that growth would later subside to a more sustainable lower level. Ms. McShane's two-stage DCF analyses indicate a DCF return for AmerenUE of 9.4%. This is a much superior DCF return estimate than that produced by Dr. Vander Weide.

Q PLEASE DESCRIBE DR. VANDER WEIDE'S EX-ANTE RISK PREMIUM ANALYSIS.

A Based on a quarterly version of the discounted cash flow analysis of a group of electric and gas companies in comparison to the contemporary "A" rated utility bond yield, Dr. Vander Weide estimates a monthly risk premium for electric companies during the period September 1999 through April 2006, and for gas utilities during the period June 1998 through April 2006 (Schedules JVW-3 and JVW-4). Based on this monthly data, he creates a regression analysis that he asserts explains the inverse relationship between the equity risk premiums and the interest rates during the study time periods.

Using a forecasted yield on "A" rated utility bonds of 6.64%, he estimates a risk premium for electric companies of 4.24% and for gas companies of 4.43%.

Again, relying on his forecasted "A" rated utility bond yield of 6.64%, he estimates a return on equity for the electric companies of 10.9%, and gas companies of 11.1%. The midpoint of this estimated range is 11.0% (Vander Weide direct at 31).

Q IS DR. VANDER WEIDE'S EX-ANTE RISK PREMIUM ANALYSIS REASONABLE?

A No. This equity risk premium is overstated for several reasons. First, Dr. Vander Weide employs a quarterly version of the DCF model that overstates a DCF return for use in regulatory proceedings.

Second, Dr. Vander Weide arbitrarily chose his time periods for study. Importantly, the time period he relied on to estimate the equity risk premiums for his electric group is different than the time period he relied on for his gas group. This is important because he appears to have intentionally removed calendar year 1998 from his electric group risk premium study. This is likely because equity risk premiums measured during 1998 were significantly lower than they were in 1999 and thereafter. This is evident from a review of Ms. McShane's risk premium study as summarized on her Schedule KCM E8-1. Further, the equity returns are somewhat questionable because the accuracy of the equity risk premium depends entirely on the accuracy of the DCF return estimate. In effect, this risk premium study is tied to the accuracy of a DCF study. This is important because, as Ms. McShane found, in the Empire District Electric Company case the Commission found it appropriate to rely on more than one methodology to estimate the current market required return. (McShane direct at 2) Dr. Vander Weide's risk premium study here is essentially an extension of the DCF model, which does not provide a valid alternative test to a stand-alone DCF estimate.

Finally, Dr. Vander Weide's risk premium analysis overstates the cost of equity because he uses a projected "A" rated utility bond yield of 6.64% rather than the current yield of approximately 6.0%. As noted above, Treasury bond yield projections for calendar year 2007 are approximately identical to current yields. Hence, consensus economists are not expecting a significant change in long-term interest rates. Therefore, Dr. Vander Weide's expectation of significant increases to interest rates is unwarranted, unjust and should be rejected.

Q HOW DID DR. VANDER WEIDE'S USE OF A PROJECTED "A" RATED BOND YIELD INFLATE HIS RISK PREMIUM RESULT?

A The current "A" rated utility bond yield is approximately 6.0%. Dr. Vander Weide's projected yield of 6.64% is a 0.65 percentage point increase to the prevailing market rate for "A" rated utility bonds. Using the more appropriate current yield would reduce Dr. Vander Weide's ex-ante risk premium from 11.0% down to about 10.6%.

Q COULD AN EX-ANTE RISK PREMIUM ANALYSIS PRODUCE A REASONABLE RETURN ON EQUITY FOR AMERENUE IN THIS PROCEEDING?

A Yes. In her presentation, Ms. McShane offered a similar risk premium study related to 10-year Treasury bonds. Relying on Ms. McShane's ex-ante risk premium study provided on her Schedule KCM-E8-1, but adjusting it for 20-year Treasury yield rather than the 10-year Treasuries she used, and inserting Dr. Vander Weide's "A" rated utility bond yields, indicates a utility equity risk premium for the period 1998 – 2006 over Treasury bonds of 4.7%, and over "A" rated utility bonds of 3.2 percentage points.

Current and 2007 projected 30-year Treasury bond yields are approximately 5.1%. Currently using a risk premium of 4.7% indicates a return on equity of 9.8%. Using a current "A" rated utility bond yield of 6.0% and an equity risk premium of 3.2% indicates a market return on equity for AmerenUE of 9.2%. The average of these two risk premium estimates is 9.5%. These estimates are far superior to the inflated estimates produced by Dr. Vander Weide.

Q PLEASE DESCRIBE DR. VANDER WEIDE'S EX-POST RISK PREMIUM ANALYSIS.

A Dr. Vander Weide's ex-post risk premium analysis consists of reviewing the historical achieved returns on common equity investments from two proxy indexes, relative to the achieved return from investing in Moody's "A" rated utility bonds. Dr. Vander Weide estimates an equity risk premium in the range of 4.45% to 5.10%. The 4.45% equity risk premium is based on the achieved return of the S&P utility stock index relative to the achieved return on Moody's "A" rated utility bonds. The 5.10 percentage point equity risk premium is based on the achieved return of the S&P 500 relative to Moody's "A" rated utility bonds.

He adds these equity risk premiums to his projected "A" rated utility bond yield of 6.64%. With this method he estimates a return on equity for AmerenUE in the range of 11.1% to 11.7%, with a midpoint of 11.4% (Vander Weide direct at 37).

Q DOES DR. VANDER WEIDE'S EX-POST RISK PREMIUM ANALYSIS OVERSTATE A FAIR RETURN FOR AMERENUE?

A In part, yes. His equity risk premium based on a comparison of the S&P 500 return to "A" rated utility bond yields should be rejected because it does not produce an appropriate risk-adjusted return for AmerenUE. Dr. Vander Weide has not shown any evidence that the S&P 500 is an appropriate risk proxy index for AmerenUE's investment risk. Indeed, his CAPM analysis is an implicit admission that AmerenUE has a lower risk than the overall market. He admits AmerenUE has below market risk at p. 33 of his testimony. But then opines that an S&P 500 risk premium is a reasonable upper band.

However, the equity risk premium to the S&P 500 overstates a fair equity risk premium for AmerenUE.

His second ex-post analysis also is flawed. It compares the S&P utilities index to the yield on "A" rated utility bonds. The S&P utilities index also includes companies that may not be risk comparable to AmerenUE. Dr. Vander Weide has not shown that this index is an appropriate risk proxy for AmerenUE.

Nevertheless, applying the equity risk premium derived in this utility index analysis to the current "A" rated utility bond yield of 6.0%, rather than Dr. Vander Weide's exaggerated projected "A" rated utility bond yield of 6.64%, would produce an ex-post risk premium cost projection of about 10.4%, not the 11.4% return estimated by Dr. Vander Weide.

Q PLEASE DESCRIBE DR. VANDER WEIDE'S CAPM ANALYSIS.

A Dr. Vander Weide relies on a projected Treasury bond yield of 5.39%, a beta estimate for utility companies of 0.90 for electric and 0.88 for gas, and estimates of the market risk premium of 7.1% and 8.35%. With these parameters, Dr. Vander Weide estimates a CAPM return in the range of 11.7% to 12.8%.

Q IS DR. VANDER WEIDE'S CAPM ANALYSIS REASONABLE?

A No. Dr. Vander Weide's CAPM result is overstated, largely because his estimated risk premium for the marketplace is overstated and not supported, and he relies on excessive beta estimates. First, his market risk premium estimate is based on Ibbotson & Associates' market return relative to Treasury bond income returns. Ms. McShane also used this analysis. Dr. Vander Weide's risk premium should be rejected for the same reasons I listed above concerning Ms. McShane's historical market risk premium based on Treasury income returns.

Q **ARE THERE ANY FLAWS IN DR. VANDER WEIDE'S FORWARD LOOKING RETURN ESTIMATE?**

A Yes. Dr. Vander Weide estimates a second CAPM analysis and market risk premium based on a DCF return for the S&P 500 of 13.75%, less his risk free rate estimate of 5.39%. This implies a market risk premium of 8.35%. Dr. Vander Weide's estimated return of 13.75% reflects his DCF analysis on the dividend paying stocks in the S&P 500. Because he has only reflected a DCF analysis on the companies that are currently paying dividends, he has likely overstated the growth prospects and expected return on the S&P 500. Indeed, there are equity securities in the marketplace that don't pay dividends, and are not expected to grow at the same rate as other companies. Hence, his analysis of the S&P 500 is incomplete and likely overstates the expected market return.

The dividend yield on the S&P 500 is approximately 1.9% currently, as estimated by Ms. McShane at p. 35 of her direct testimony. Hence, a 13.75% DCF return on the market implies a growth rate of approximately 11.85%. This growth rate is more than two times the expected growth in the U.S. economy of 5.1%, and therefore does not reflect a reasonable sustainable long-term growth rate for the stock market that is required by the DCF model. Further, the expected growth of the market of 11.85% is higher than the historical growth of the market of 7.8%, as estimated by Ibbotson & Associates over the period 1926 – 2005 (SBBI 2006 Yearbook at 119). Dr. Vander Weide's growth rate projection for the S&P 500 is excessive and irrational.

The stock market simply cannot grow at twice the rate of the U.S. economy over an indefinite period of time. Further, there is no reasonable justification for the assumption that the growth rate will be more than 50% stronger than the long-term historical growth rate. Dr. Vander Weide's DCF return on the market is significantly

overstated, which inflates his market risk premium and CAPM return estimates. Dr. Vander Weide's DCF and CAPM are significantly overstated and should be rejected.

Q DO YOU HAVE ANY EVIDENCE ON WHAT AN APPROPRIATE RETURN ON THE MARKET WOULD BE?

A Yes. As noted above, based on historical real returns on the market and forward looking inflation expectations, the projected return on the market is around 12.3%. Relying on Value Line's 1,700 stocks and Value Line's three to five-year capital appreciation and current dividend yield implies a return on the market of 9% to 10%. With these parameters, relative to a projected 2007 Treasury bond yield of around 5.1%, the indicated market risk premium would be approximately 6.5%. This market risk premium is conservative in relationship to today's capital market cost and produces a far more reasonable estimate of the CAPM return than the inflated risk premiums relied on by Dr. Vander Weide.

Q WHAT BETA ESTIMATES DID DR. VANDER WEIDE USE IN HIS CAPM ANALYSIS?

A Dr. Vander Weide used a beta estimate for his electric stocks of 0.90, and 0.88 for his gas companies.

Q WHY DO YOU BELIEVE THESE BETA ESTIMATES ARE OVERSTATED?

A As discussed above, Dr. Vander Weide's two proxy groups contain companies that have considerably higher risk than that of AmerenUE's regulated utility operations in Missouri. Indeed, as shown on his Schedules JVW 8-2 and JVW-3, his proxy groups include certain companies that have beta estimates of one or greater. This would indicate that these regulated electric utility companies have greater risk than the

overall stock market. This conclusion contradicts most of Dr. Vander Weide's other testimony, recognizing that regulated utility operations are low risk investments. The high beta estimates, as I discussed earlier in my testimony, are largely the function of two significant factors. First, utility betas have been increasing recently, not because their risks have been increasing, but rather because utility stocks have out performed the overall market over the last five years. These beta estimates are measured based on stock price performance over the last five years, and a robust recovery in utility stock performance over that time in relation to the marketplace has given the false impression that utility stock risk is increasing. A careful review of more detailed risk factors for utilities indicate that their risks are not increasing, but rather are decreasing to consistent.

Second, and most importantly concerning Dr. Vander Weide's group, is that many of the companies included in this group have risks much greater than that of AmerenUE. Specifically, many of the companies have merchant generation affiliates or commodity trading operations, which have caused significant price volatility in their stocks, and uncertainty that is uncharacteristic of low risk regulated operations. These higher operating risk investments expose these companies to greater market risk which is reflected in their stock price volatility and higher beta estimates. Since Dr. Vander Weide has included companies with greater risk than AmerenUE in his proxy group, he has overstated the beta for use in this proceeding.

Q WHAT WILL BE AN APPROPRIATE AND REASONABLE BETA ESTIMATE TO USE IN THE CAPM STUDY FOR AMERENUE IN THIS PROCEEDING?

A AmerenUE's beta, as shown on Dr. Vander Weide's schedule is currently 0.75. A review of the median beta estimate for Dr. Vander Weide's group, Ms. McShane's

group and my proposed group, indicates a beta estimate of around 0.8 is currently the most accurate assessment of electric utility systematic risk.

Q WHAT IS A REASONABLE CAPM RETURN ESTIMATE USING THE PARAMETERS YOU DISCUSSED ABOVE?

A Using a beta estimate of 0.80, a market risk premium of 6.5% and a current Treasury bond yield projection of 5.1%, indicates a reasonable CAPM return estimate for AmerenUE in this proceeding to be 10.3%.

Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A Yes, it does.

Appendix A

Qualifications of Michael Gorman

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A Michael P. Gorman. My business mailing address is P. O. Box 412000, 1215 Fern Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000.

Q PLEASE STATE YOUR OCCUPATION.

A I am a consultant in the field of public utility regulation and a managing principal with Brubaker & Associates, Inc., energy, economic and regulatory consultants.

Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A In 1983 I received a Bachelors of Science Degree in Electrical Engineering from Southern Illinois University, and in 1986, I received a Masters Degree in Business Administration with a concentration in Finance from the University of Illinois at Springfield. I have also completed several graduate level economics courses.

In August of 1983, I accepted an analyst position with the Illinois Commerce Commission (ICC). In this position, I performed a variety of analyses for both formal and informal investigations before the ICC, including: marginal cost of energy, central dispatch, avoided cost of energy, annual system production costs, and working capital. In October of 1986, I was promoted to the position of Senior Analyst. In this position, I assumed the additional responsibilities of technical leader on projects, and my areas of responsibility were expanded to include utility financial modeling and financial analyses.

In 1987, I was promoted to Director of the Financial Analysis Department. In this position, I was responsible for all financial analyses conducted by the staff. Among other things, I conducted analyses and sponsored testimony before the ICC on rate of return, financial integrity, financial modeling and related issues. I also supervised the development of all Staff analyses and testimony on these same issues. In addition, I supervised the Staff's review and recommendations to the Commission concerning utility plans to issue debt and equity securities.

In August of 1989, I accepted a position with Merrill-Lynch as a financial consultant. After receiving all required securities licenses, I worked with individual investors and small businesses in evaluating and selecting investments suitable to their requirements.

In September of 1990, I accepted a position with Drazen-Brubaker & Associates, Inc. In April 1995 the firm of Brubaker & Associates, Inc. (BAI) was formed. It includes most of the former DBA principals and Staff. Since 1990, I have performed various analyses and sponsored testimony on cost of capital, cost/benefits of utility mergers and acquisitions, utility reorganizations, level of operating expenses and rate base, cost of service studies, and analyses relating industrial jobs and economic development. I also participated in a study used to revise the financial policy for the municipal utility in Kansas City, Kansas.

At BAI, I also have extensive experience working with large energy users to distribute and critically evaluate responses to requests for proposals (RFPs) for electric, steam, and gas energy supply from competitive energy suppliers. These analyses include the evaluation of gas supply and delivery charges, cogeneration and/or combined cycle unit feasibility studies, and the evaluation of third-party asset/supply management agreements. I have also analyzed commodity pricing

indices and forward pricing methods for third party supply agreements. Continuing, I have also conducted regional electric market price forecasts.

In addition to our main office in St. Louis, the firm also has branch offices in Phoenix, Arizona; Corpus Christi, Texas; and Plano, Texas.

Q HAVE YOU EVER TESTIFIED BEFORE A REGULATORY BODY?

A Yes. I have sponsored testimony on cost of capital, revenue requirements, cost of service and other issues before the regulatory commissions in Arizona, California, Delaware, Georgia, Illinois, Indiana, Iowa, Louisiana, Michigan, Missouri, New Mexico, New Jersey, Oklahoma, Oregon, Tennessee, Texas, Utah, Vermont, Washington, West Virginia, Wisconsin, Wyoming, and before the provincial regulatory boards in Alberta and Nova Scotia, Canada. I have also sponsored testimony before the Board of Public Utilities in Kansas City, Kansas; presented rate setting position reports to the regulatory board of the municipal utility in Austin, Texas, and Salt River Project, Arizona, on behalf of industrial customers; and negotiated rate disputes for industrial customers of the Municipal Electric Authority of Georgia in the LaGrange, Georgia district.

Q PLEASE DESCRIBE ANY PROFESSIONAL REGISTRATIONS OR ORGANIZATIONS TO WHICH YOU BELONG.

A I earned the designation of Chartered Financial Analyst (CFA) from the Charter Financial Analyst Institute. The CFA charter was awarded after successfully completing three examinations which covered the subject areas of financial accounting, economics, fixed income and equity valuation and professional and ethical conduct. I am a member of CFA's Financial Analyst Society.

AmerenUE

Comparable Group

Line	Electric Utility	Bond Ratings S&P[1] (1)	Bond Ratings Moody's[1] (2)	Business Profile Rating[3] (3)	2005 Common Equity Ratios Value Line[2] (4)	2005 Common Equity Ratios AUS (5)
1	Alliant Energy	A-	A2	6	53%	54%
2	Ameren Corp.	A-	A3	6	53%	50%
3	DTE Energy	BBB+	A3	6	45%	40%
4	FirstEnergy Corp.	BBB	Baa1	6	52%	44%
5	IDACORP, Inc.	A-	A3	5	50%	49%
6	NiSource Inc.	BBB	Baa2	4	48%	45%
7	OGE Energy	BBB+	Baa2	6	51%	51%
8	Pinnacle West Capital	BBB-	Baa1	5	57%	52%
9	Puget Energy Inc.	BBB	Baa2	4	46%	43%
10	SCANA Corp.	A-	A1	4	47%	44%
11	Southern Co.	A	A2	4	44%	42%
12	Wisconsin Energy	A-	A1	5	47%	42%
13	Xcel Energy Inc.	A-	A3	5	47%	43%
14	**Average**	**BBB+**	**A3**	**5**	**49%**	**46%**
15	AmerenUE	BBB+	A2	5	52%[4]	

Sources:

[1] AUS Utility Reports; October, 2006.

[2] The Value Line Investment Survey; September 1, September 29, November 10, 2006.

[3] U.S. Utilities and Power Ranking List, March 24, 2006.

[4] Schedule LRN -G1-1.

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Growth Rate Estimates

Line	Electric Utility	Zacks Estimated Growth %[1] (1)	Zacks Number of Estimates[1] (2)	Reuters Estimated Growth %[2] (3)	Reuters Number of Estimates[2] (4)	Thomson Estimated Growth %[3] (5)	Thomson Number of Estimates[3] (6)	AVG of Growth Rates (7)
1	Alliant Energy	4.00%	2	N/A	N/A	5.00%	1	4.50%
2	Ameren Corp.	6.10%	5	N/A	N/A	3.75%	4	4.93%
3	DTE Energy	4.33%	3	5.25%	4	4.50%	2	4.69%
4	FirstEnergy Corp.	5.67%	6	6.17%	6	6.40%	5	6.08%
5	IDACORP, Inc.	4.67%	3	4.67%	3	4.67%	3	4.67%
6	NiSource Inc.	3.33%	6	3.50%	8	3.33%	6	3.39%
7	OGE Energy	5.00%	1	N/A	N/A	6.17%	2	5.59%
8	Pinnacle West Capital	6.75%	4	6.10%	6	5.00%	3	5.95%
9	Puget Energy Inc.	7.00%	1	5.14%	7	4.83%	3	5.66%
10	SCANA Corp.	4.67%	6	4.35%	6	4.35%	6	4.46%
11	Southern Co.	4.67%	9	4.70%	10	4.78%	9	4.72%
12	Wisconsin Energy	7.40%	5	N/A	N/A	7.79%	6	7.60%
13	Xcel Energy Inc.	4.33%	5	5.14%	7	5.27%	6	4.91%
14	**Average**	**5.22%**	**4**	**5.00%**	**6**	**5.06%**	**4**	**5.16%**

Sources:

[1] www.zacksadvisor.com, Detailed Research on November 13, 2006.

[2] www.investor.reuters.com, Earnings Estimates on November 13, 2006.

[3] http://ec.thomsonfn.com, Earnings Estimates on November 13, 2006.

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Constant Growth DCF Model

Line	Electric Utility	13-Week AVG Stock Price[1] (1)	AVG (%) Growth (2)	Annual Dividend[2] (3)	Adjusted Yield (4)	Constant Growth DCF (5)
1	Alliant Energy	$ 36.82	4.50%	$ 1.15	3.27%	7.77%
2	Ameren Corp.	$ 52.95	4.93%	$ 2.54	5.03%	9.96%
3	DTE Energy	$ 42.55	4.69%	$ 2.06	5.07%	9.76%
4	FirstEnergy Corp.	$ 57.13	6.08%	$ 1.80	3.34%	9.42%
5	IDACORP, Inc.	$ 38.40	4.67%	$ 1.20	3.27%	7.94%
6	NiSource Inc.	$ 21.93	3.39%	$ 0.92	4.34%	7.72%
7	OGE Energy	$ 36.88	5.59%	$ 1.33	3.81%	9.40%
8	Pinnacle West Capital	$ 45.93	5.95%	$ 2.00	4.61%	10.56%
9	Puget Energy Inc.	$ 22.92	5.66%	$ 1.00	4.61%	10.27%
10	SCANA Corp.	$ 40.62	4.46%	$ 1.68	4.32%	8.78%
11	Southern Co.	$ 34.73	4.72%	$ 1.55	4.68%	9.40%
12	Wisconsin Energy	$ 43.61	7.60%	$ 0.92	2.27%	9.86%
13	Xcel Energy Inc.	$ 20.99	4.91%	$ 0.89	4.46%	9.37%
14	**Average**	**$ 38.11**	**5.16%**	**$ 1.47**	**4.08%**	**9.2%**

Sources:

[1] http://moneycentral.msn.com, downloaded on November 13, 2006.

[2] The Value Line Investment Survey; September 1, September 29, November 10, 2006.

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GDP and Dividend Growth Rates

Line	Electric Group	Dividend Growth			Inflation (CPI)*			Nominal GDP*	
		Past 5 Years[1]	Past 10 Years[1]	3-5 Years Projection[1]	Past 5 Years[2]	Past 10 Years[2]	3-5 Years Projection[2]	Past 5 Years[1]	Past 10 Years[1]
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1	Alliant Energy	-12.5%	-6.0%	6.0%					
2	Ameren Corp.	N/A	0.5%	N/A					
3	DTE Energy	N/A	N/A	0.5%					
4	FirstEnergy Corp.	2.5%	1.5%	5.0%					
5	IDACORP, Inc.	-6.0%	-3.0%	-2.0%					
6	NiSource Inc.	1.0%	3.0%	0.5%					
7	OGE Energy	N/A	N/A	2.0%					
8	Pinnacle West Capital	6.5%	11.0%	5.0%					
9	Puget Energy Inc.	-11.5%	-6.0%	1.5%					
10	SCANA Corp.	2.0%	0.5%	4.5%					
11	Southern Co.	1.0%	2.0%	4.0%					
12	Wisconsin Energy	-11.0%	-5.0%	4.5%					
13	Xcel Energy Inc.	-11.0%	-5.0%	5.5%					
14	**Average**	**-3.9%**	**-0.6%**	**3.1%**	**2.7%**	**2.5%**	**2.2%**	**5.2%**	**5.3%**

Sources:

[1] The Value Line Investment Survey; May 12, June 2, June 30, 2006.

[2] The Value Line Investment Survey; September 1, September 29, November 10, 2006.

Michael Gorman
Schedule MPG-4

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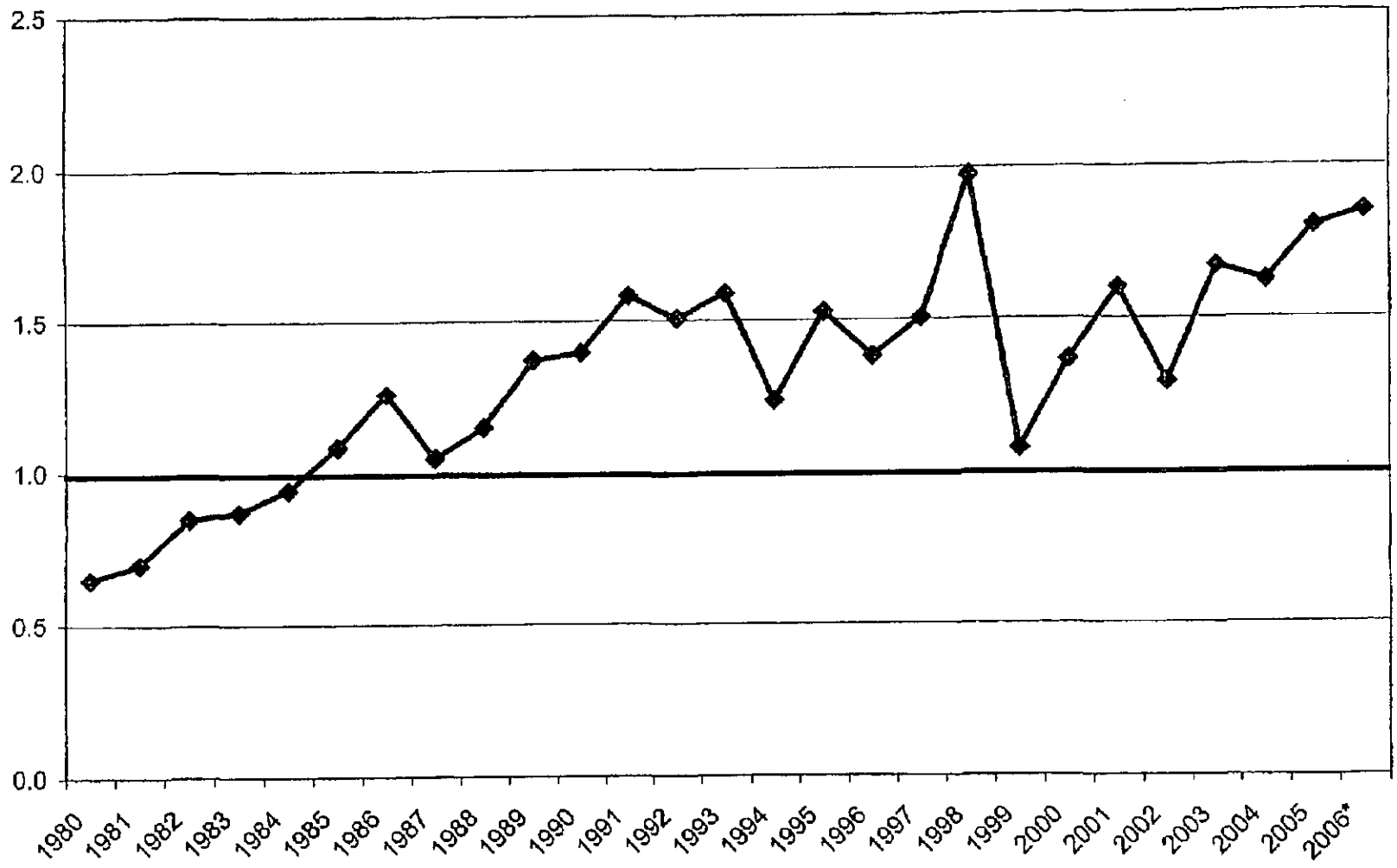
Electric Common Stock Market/Book Ratio



Sources:
2002-2005: AUS Utility Reports.
1980 - 2000: Mergent Public Utility Manual, 2003; at a15, and a17.
* The data for 2006 includes the period Jan-Sept, 2006.

Michael Gorman
Schedule MPG-5

AmerenUE

Equity Risk Premium - Treasury Bond

Line	Date	Treasury Bond Yield[1] (1)	Authorized Electric Returns[2] (2)	Indicated Risk Premium (3)
1	1986	7.78%	13.93%	6.15%
2	1987	8.59%	12.99%	4.40%
3	1988	8.96%	12.79%	3.83%
4	1989	8.45%	12.97%	4.52%
5	1990	8.61%	12.70%	4.09%
6	1991	8.14%	12.55%	4.41%
7	1992	7.67%	12.09%	4.42%
8	1993	6.59%	11.41%	4.82%
9	1994	7.37%	11.34%	3.97%
10	1995	6.88%	11.55%	4.67%
11	1996	6.71%	11.39%	4.68%
12	1997	6.61%	11.40%	4.79%
13	1998	5.58%	11.66%	6.08%
14	1999	5.87%	10.77%	4.90%
15	2000	5.94%	11.43%	5.49%
16	2001	5.49%	11.09%	5.60%
17	2002	5.42%	11.16%	5.74%
18	2003	5.02%	10.97%	5.95%
19	2004	5.05%	10.73%	5.68%
20	2005	4.65%	10.54%	5.89%
21	2006[3]	5.05%	10.34%	5.29%
22	**Average**	**6.69%**	**11.70%**	**5.02%**

Sources:

[1] Economic Report of the President, January, 2001 and the St. Louis Federal Reserve Bank Website.

[2] Regulatory Research Associates, Inc., Regulatory Focus, Jan.90-Dec.05.

[3] The data for 2006 includes the period Jan-Sept, 2006.

AmerenUE

Equity Risk Premium - Utility Bond

Line	Date	Average "A" Rating Utility Bond Yield[1] (1)	Authorized Electric Returns[2] (2)	Indicated Risk Premium (3)
1	1986	9.58%	13.93%	4.35%
2	1987	10.10%	12.99%	2.89%
3	1988	10.49%	12.79%	2.30%
4	1989	9.77%	12.97%	3.20%
5	1990	9.86%	12.70%	2.84%
6	1991	9.36%	12.55%	3.19%
7	1992	8.69%	12.09%	3.40%
8	1993	7.59%	11.41%	3.82%
9	1994	8.31%	11.34%	3.03%
10	1995	7.89%	11.55%	3.66%
11	1996	7.75%	11.39%	3.64%
12	1997	7.60%	11.40%	3.80%
13	1998	7.04%	11.66%	4.62%
14	1999	7.62%	10.77%	3.15%
15	2000	8.24%	11.43%	3.19%
16	2001	7.78%	11.09%	3.31%
17	2002	7.36%	11.16%	3.80%
18	2003	6.57%	10.97%	4.40%
19	2004	6.01%	10.73%	4.72%
20	2005	5.66%	10.54%	4.88%
21	2006[3]	6.14%	10.34%	4.20%
22	**Average**	**8.16%**	**11.70%**	**3.64%**

Sources:

[1] Mergent Public Utility Manual, Mergent Weekly News Reports, 2003.

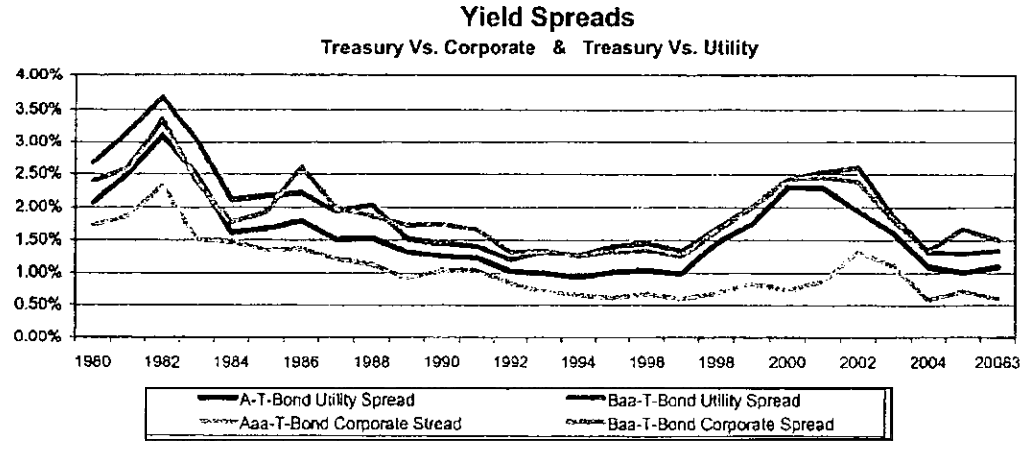
[2] Regulatory Research Associates, Inc., Regulatory Focus, Jan.90-Dec.05.

[3] The data for 2006 includes the period Jan-Sept, 2006.

AmerenUE

Annual Average Yields

Line	Year	T-Bond Yield[1]	Public Utility Bond Yields A[2]	Public Utility Bond Yields Baa[2]	A-T-Bond Spread	Baa-T-Bond Spread	Corporate Bond Yields Aaa[1]	Corporate Bond Yields Baa[1]	Aaa-T-Bond Spread	Baa-T-Bond Spread
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1	1980	11.27%	13.34%	13.95%	2.07%	2.68%	11.94%	13.67%	1.73%	2.40%
2	1981	13.45%	15.95%	16.60%	2.50%	3.15%	14.17%	16.04%	1.87%	2.59%
3	1982	12.76%	15.86%	16.45%	3.10%	3.69%	13.79%	16.11%	2.32%	3.35%
4	1983	11.18%	13.66%	14.20%	2.48%	3.02%	12.04%	13.55%	1.51%	2.37%
5	1984	12.41%	14.03%	14.53%	1.62%	2.12%	12.71%	14.19%	1.48%	1.78%
6	1985	10.79%	12.47%	12.96%	1.68%	2.17%	11.37%	12.72%	1.35%	1.93%
7	1986	7.78%	9.58%	10.00%	1.80%	2.22%	9.02%	10.39%	1.37%	2.61%
8	1987	8.59%	10.10%	10.53%	1.51%	1.94%	9.38%	10.58%	1.20%	1.99%
9	1988	8.96%	10.49%	11.00%	1.53%	2.04%	9.71%	10.83%	1.12%	1.87%
10	1989	8.45%	9.77%	9.97%	1.32%	1.52%	9.26%	10.18%	0.92%	1.73%
11	1990	8.61%	9.86%	10.06%	1.25%	1.45%	9.32%	10.36%	1.04%	1.75%
12	1991	8.14%	9.36%	9.55%	1.22%	1.41%	8.77%	9.80%	1.03%	1.66%
13	1992	7.67%	8.69%	8.86%	1.02%	1.19%	8.14%	8.98%	0.84%	1.31%
14	1993	6.59%	7.59%	7.91%	1.00%	1.32%	7.22%	7.93%	0.71%	1.34%
15	1994	7.37%	8.31%	8.63%	0.94%	1.26%	7.96%	8.62%	0.66%	1.25%
16	1995	6.88%	7.89%	8.29%	1.01%	1.41%	7.59%	8.20%	0.61%	1.32%
17	1996	6.71%	7.75%	8.17%	1.04%	1.46%	7.37%	8.05%	0.68%	1.34%
18	1997	6.61%	7.60%	7.95%	0.99%	1.34%	7.26%	7.86%	0.60%	1.25%
19	1998	5.58%	7.04%	7.26%	1.46%	1.68%	6.53%	7.22%	0.69%	1.64%
20	1999	5.87%	7.62%	7.88%	1.75%	2.01%	7.04%	7.87%	0.83%	2.00%
21	2000	5.94%	8.24%	8.36%	2.30%	2.42%	7.62%	8.36%	0.74%	2.42%
22	2001	5.49%	7.78%	8.02%	2.29%	2.53%	7.08%	7.95%	0.87%	2.46%
23	2002	5.42%	7.36%	8.02%	1.94%	2.60%	6.49%	7.80%	1.31%	2.38%
24	2003	4.96%	6.57%	6.83%	1.61%	1.87%	5.67%	6.77%	1.10%	1.81%
25	2004	5.05%	6.14%	6.37%	1.09%	1.32%	5.63%	6.39%	0.58%	1.34%
26	2005	4.65%	5.66%	5.93%	1.01%	1.29%	5.37%	6.32%	0.72%	1.67%
27	2006[3]	5.05%	6.14%	6.39%	1.09%	1.34%	5.65%	6.55%	0.60%	1.50%
28	**Average**	**7.97%**	**9.57%**	**9.93%**	**1.60%**	**1.97%**	**8.79%**	**9.87%**	**1.07%**	**1.91%**



Notes:

[1] St. Louis Federal Reserve Bank.

[2] Mergent Public Utility Manual 2003. Moodys Daily News Reports.

[3] The data for 2006 includes the period Jan-Sep, 2006.

Michael Gorman
Schedule MPG-8

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Series "A" and "Baa" Utility Bond Yields

Line	Date	"A" Rating Utility Bond Yield (1)	"Baa" Rating Utility Bond Yield (2)
1	11/10/06	5.80%	6.04%
2	11/03/06	5.93%	6.16%
3	10/27/06	5.92%	6.17%
4	10/20/06	6.04%	6.30%
5	10/13/06	6.06%	6.33%
6	10/06/06	5.97%	6.24%
7	09/29/06	5.90%	6.17%
8	09/22/06	5.92%	6.19%
9	09/15/06	6.06%	6.32%
10	09/08/06	6.07%	6.34%
11	09/01/06	6.06%	6.30%
12	08/25/06	6.13%	6.36%
13	08/18/06	6.19%	6.42%
14	**Average**	**6.00%**	**6.26%**

Source:
www.moodys.com, Bond Yields and Key Indicators.

AmerenUE

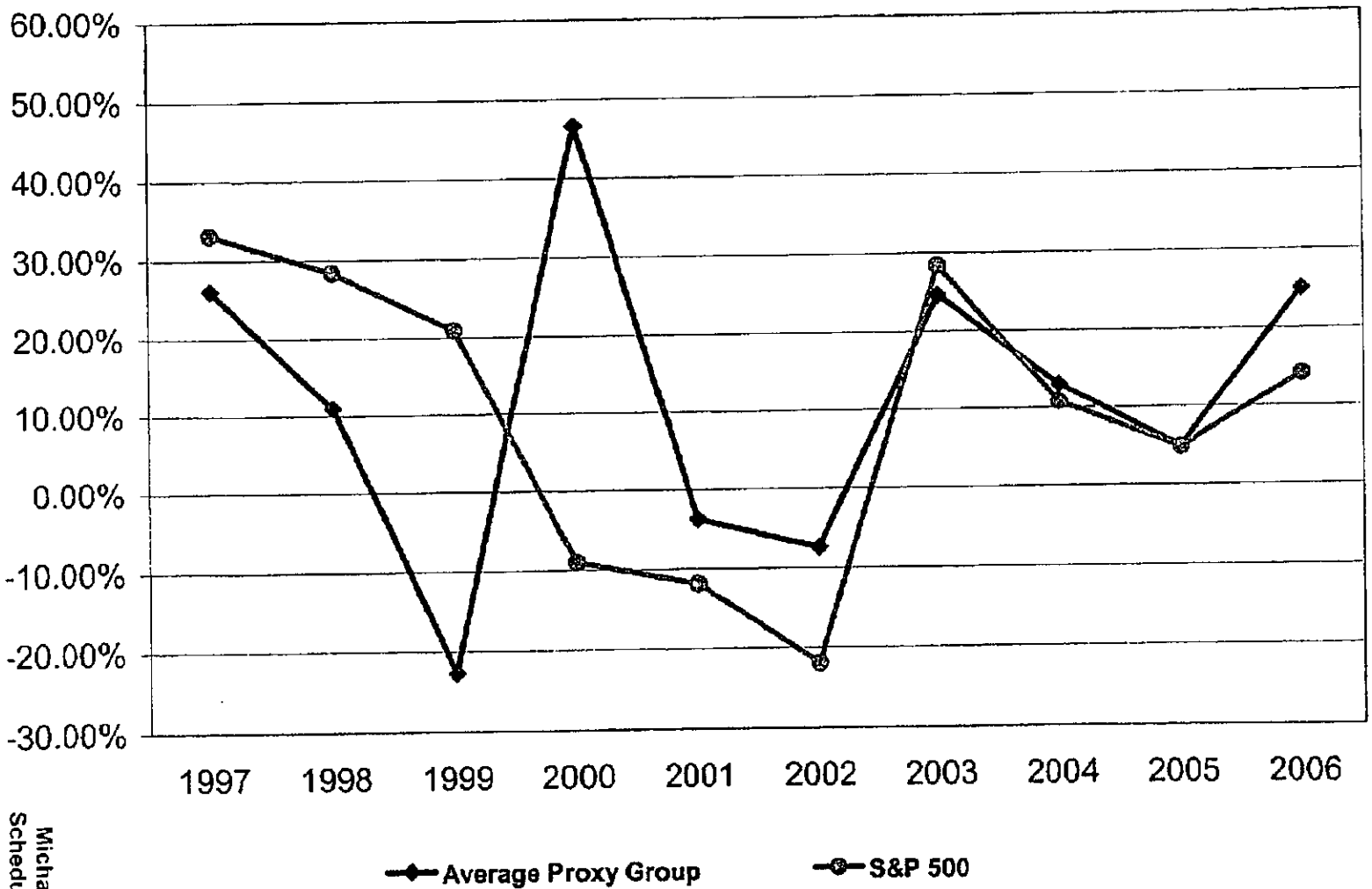
Comparable Group Beta

Line	Electric Utility	Historical Beta 2001 (1)	2002 (2)	2003 (3)	2004 (4)	2005 (5)	5-Yr. AVG (6)	Current Beta (7)
1	Alliant Energy	0.55	0.65	0.70	0.80	0.85	0.71	0.90
2	Ameren Corp.	0.55	0.60	0.65	0.75	0.75	0.66	0.75
3	DTE Energy	0.55	0.60	0.60	0.65	0.70	0.62	0.75
4	FirstEnergy Corp.	0.55	0.55	0.70	0.75	0.75	0.66	0.80
5	IDACORP, Inc.	0.50	0.60	0.75	0.85	0.95	0.73	1.00
6	NiSource Inc.	0.45	0.50	0.65	0.75	0.80	0.63	0.90
7	OGE Energy	0.45	0.55	0.60	0.70	0.75	0.61	0.75
8	Pinnacle West Capital	0.45	0.55	0.70	0.85	0.90	0.69	1.00
9	Puget Energy Inc.	0.55	0.60	0.65	0.75	0.80	0.67	0.80
10	SCANA Corp.	0.45	0.55	0.60	0.70	0.75	0.61	0.80
11	Southern Co.	N/A	N/A	0.65	0.65	0.65	0.65	0.65
12	Wisconsin Energy	0.50	0.55	0.60	0.70	0.70	0.61	0.80
13	Xcel Energy Inc.	N/A	0.60	0.70	0.80	0.80	0.73	0.90
14	**Average**	**0.50**	**0.58**	**0.66**	**0.75**	**0.78**	**0.66**	**0.83**
15	**Median**	**0.50**	**0.58**	**0.65**	**0.75**	**0.75**	**0.66**	**0.80**

Source:
The Value Line Investment Survey; September 1, September 29, November 10, 2006.

Michael Gorman
Schedule MPG-10

Total Stock Return



Michael Gorman
Schedule MPG-11

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CAPM Return Estimate

Line	Description	Historical Premium (1)
1	Risk Free Rate[1]	5.1%
2	Risk Premium[2]	6.5%
3	Beta[3]	0.80
4	CAPM	10.3%

Line	Description	Prospective Premium (1)
5	Risk Free Rate[1]	5.1%
6	Risk Premium[2]	6.5%
7	Beta[3]	0.80
8	CAPM	10.3%
9	**CAPM Average**	**10.3%**

Sources:

[1] Blue Chip Financial Forcasts; August 1, 2006 at 2.

[2] SBBI; 2006 at pp. 31 & 120.

[3] The Value Line Investment Survey; September 1, September 29, November 10, 2006.

AmerenUE

S&P Credit Rating Financial Ratios at ROE of 9.8%

Line	Description	Ratio at 9.8% Equity Return (1)	S&P "A" Rating (BP: 5) Benchmark* (2)	S&P "BBB" Rating (BP: 5) Benchmark* (3)	Reference (4)
1	Rate Base	$ 5,854,574			SCHEDULE GSW-E36.
2	Weighted Common Return	5.12%			Page 2, Line 4, Col. 4.
3	Income to Common	$ 299,634			Line 1 x Line 2.
4	Depreciation & Amortization	$ 269,345			SCHEDULE GSW-E36 minus an adjustment of $118.2 million**
5	Funds from Operations (FFO)	$ 568,979			Sum of Line 3 and Line 4
6	Weighted Interest Rate	2.48%			Page 2, Sum of Line 1 and 2, Col. 4.
7	Interest Expense	$ 145,240			Line 1 x Line 6.
8	FFO Plus Interest	$ 714,219			Line 5 + Line 7.
9	FFO Interest Coverage	4.9x	4.5x - 3.8x	3.8x - 2.6x	Line 8 / Line 7.
10	Total Debt Ratio	45.8%	42% - 50%	50% - 60%	Page 2, Sum of Line 1 and 2, Col. 2.
11	FFO to Total Debt	21.2%	30% - 22%	22% - 15%	Line 5 / (Line 1 x Line 10).

Source:
* Standard and Poors. New Business Profile Scores Assigned to U.S. Utility and Power Companies; Financial Guidelines Revised; June 2, 2004.
** Depreciation adjustment proposed by MIEC witness James Selecky.

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Rate of Return at 9.8% ROE

Line	Description	Amount (1)	Weight (2)	Cost (3)	Weighted Cost (4)
1	Long-Term Debt	$ 2,551,919,839	44.964%	5.43%	2.44%
2	Short-Term Debt	$ 45,093,124	0.795%	5.11%	0.04%
3	Preferred Stock	$ 114,502,040	2.017%	5.19%	0.10%
4	Common Equity	$ 2,963,961,528	52.224%	9.80%	5.12%
5	**Total**	**$ 5,675,476,531**	**100.00%**		**7.70%**

Source:
Schedule LRN-E5-1.

AmerenUE

Equity Risk Premium - 20-Yr Treasury Yield (McShane)

Line	Year	Quarter	Expected Dividend Yield (1)	I/B/E/S Growth Forecast (2)	DCF Cost (3)	20-Year Treasury Yield* (4)	Risk Premium (5)
1	1998	q1	5.1	3.6	8.7	6.0	2.7
2		q2	5.1	3.8	8.9	5.9	2.9
3		q3	5.0	4.3	9.2	5.6	3.6
4		q4	4.8	4.4	9.1	5.4	3.8
5	1999	q1	5.4	4.4	9.8	5.7	4.1
6		q2	5.2	4.5	9.7	6.1	3.6
7		q3	5.5	4.5	10.1	6.4	3.7
8		q4	6.2	4.7	10.9	6.6	4.3
9	2000	q1	6.7	4.8	11.5	6.6	4.9
10		q2	6.0	5.2	11.3	6.3	4.9
11		q3	5.3	5.6	10.9	6.1	4.8
12		q4	4.4	6.0	10.4	5.9	4.5
13	2001	q1	4.5	6.1	10.6	5.6	5.0
14		q2	4.3	6.9	11.2	5.8	5.4
15		q3	4.6	7.4	12.0	5.6	6.3
16		q4	4.7	7.2	11.9	5.5	6.4
17	2002	q1	4.6	6.7	11.3	5.7	5.5
18		q2	4.7	6.6	11.3	5.8	5.6
19		q3	6.0	6.5	12.5	5.2	7.3
20		q4	5.6	6.2	11.8	5.0	6.8
21	2003	q1	5.2	5.8	10.9	4.9	6.0
22		q2	4.3	5.3	9.6	4.6	5.0
23		q3	4.2	4.9	9.2	5.2	4.0
24		q4	4.1	4.7	8.8	5.2	3.6
25	2004	q1	4.0	4.7	8.7	4.9	3.8
26		q2	4.0	5.0	9.0	5.4	3.6
27		q3	3.8	5.3	9.1	5.1	4.0
28		q4	3.8	5.2	9.0	4.9	4.1
29	2005	q1	3.9	5.4	9.2	4.8	4.5
30		q2	3.7	5.3	9.0	4.6	4.4
31		q3	3.5	5.5	9.1	4.5	4.6
32		q4	3.8	6.4	10.2	4.8	5.4
33	2006	q1	3.9	6.8	10.7	4.8	5.9
34	**Mean**		**4.7**	**5.4**	**10.2**	**5.5**	**4.7**
35	**Median**		**4.6**	**5.3**	**10.1**	**5.6**	**4.5**

Source:
WP KCM E8 G8
*St. Louis Federal Reserve Bank

AmerenUE

Equity Risk Premium - 'A' Utility Yield (McShane)

Line	Year	Quarter	Expected Dividend Yield (1)	I/B/E/S Growth Forecast (2)	DCF Cost (3)	'A' Utility Yield (4)	Risk Premium (5)
1	1998	q1	5.1	3.6	8.7	7.1	1.6
2		q2	5.1	3.8	8.9	7.1	1.8
3		q3	5.0	4.3	9.2	7.0	2.2
4		q4	4.8	4.4	9.1	7.0	2.2
5	1999	q1	5.4	4.4	9.8	7.1	2.7
6		q2	5.2	4.5	9.7	7.5	2.2
7		q3	5.5	4.5	10.1	7.9	2.2
8		q4	6.2	4.7	10.9	8.0	2.8
9	2000	q1	6.7	4.8	11.5	8.3	3.2
10		q2	6.0	5.2	11.3	8.5	2.8
11		q3	5.3	5.6	10.9	8.2	2.7
12		q4	4.4	6.0	10.4	8.0	2.3
13	2001	q1	4.5	6.1	10.6	7.7	2.9
14		q2	4.3	6.9	11.2	7.9	3.3
15		q3	4.6	7.4	12.0	7.6	4.3
16		q4	4.7	7.2	11.9	7.6	4.3
17	2002	q1	4.6	6.7	11.3	7.6	3.6
18		q2	4.7	6.6	11.3	7.5	3.8
19		q3	6.0	6.5	12.5	7.1	5.3
20		q4	5.6	6.2	11.8	7.1	4.7
21	2003	q1	5.2	5.8	10.9	6.8	4.1
22		q2	4.3	5.3	9.6	6.4	3.2
23		q3	4.2	4.9	9.2	6.6	2.6
24		q4	4.1	4.7	8.8	6.3	2.4
25	2004	q1	4.0	4.7	8.7	6.1	2.6
26		q2	4.0	5.0	9.0	6.4	2.5
27		q3	3.8	5.3	9.1	6.1	3.0
28		q4	3.8	5.2	9.0	5.9	3.0
29	2005	q1	3.9	5.4	9.2	5.7	3.5
30		q2	3.7	5.3	9.0	5.4	3.5
31		q3	3.5	5.5	9.1	5.5	3.6
32		q4	3.8	6.4	10.2	5.8	4.4
33	2006	q1	3.9	6.8	10.7	5.9	4.8
34	**Mean**		**4.7**	**5.4**	**10.2**	**7.0**	**3.2**
35	**Median**		**4.6**	**5.3**	**10.1**	**5.6**	**3.0**

Source:
WP KCM E8 G8

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Discounted Cash Flow Model - Electric (Vander Welde)

Line	Electric Utility	Last Dividend (1)	Dividend (2)	Stock Price (3)	Annual Growth (4)	Market Cap $ (Mil) (5)	Cost of Equity (6)	Div. Yield (7)	1/4 DCF (8)	Annual Growth DCF Model (9)
1	Alliant Energy	0.288	1.22242	$ 31.882	6.93%	3,827	10.76%	0.92%	10.85%	10.79%
2	Amer. Elec. Power	0.370	1.52123	$ 35.117	2.93%	13,170	7.26%	1.06%	7.34%	7.27%
3	Ameren Corp.	0.635	2.77000	$ 50.202	5.00%	10,181	10.52%	1.28%	10.41%	10.31%
4	Consolidated Edison	0.575	2.44117	$ 44.473	3.44%	10,513	8.93%	1.30%	8.89%	8.79%
5	Dominion Resources	0.690	3.14322	$ 72.980	10.50%	25,931	14.81%	0.97%	14.74%	14.68%
6	DTE Energy	0.515	2.22582	$ 41.498	4.33%	7,207	9.69%	1.25%	9.61%	9.51%
7	Duke Energy	0.310	1.31297	$ 28.598	5.26%	26,764	9.85%	1.10%	9.80%	9.82%
8	Empire	0.320	1.36266	$ 22.277	3.00%	594	9.12%	1.45%	9.05%	8.92%
9	Energy East Corp.	0.290	1.21853	$ 24.562	4.33%	3,580	9.29%	1.19%	9.35%	9.26%
10	Entergy Corp.	0.540	2.44340	$ 70.012	8.40%	15,078	11.89%	0.79%	11.78%	11.74%
11	FirstEnergy Corp.	0.450	1.83761	$ 49.913	4.60%	17,043	8.28%	0.91%	8.42%	8.37%
12	Great Plains Energy	0.415	1.75946	$ 28.437	2.65%	2,114	8.84%	1.47%	8.77%	8.64%
13	Hawaiian Electric	0.310	1.32572	$ 26.702	3.63%	2,160	8.59%	1.17%	8.53%	8.44%
14	IDACORP Inc.	0.300	1.29623	$ 32.293	4.67%	1,458	8.68%	0.94%	8.61%	8.56%
15	MDU Resources	0.190	0.84321	$ 35.019	8.25%	4,412	10.66%	0.55%	10.62%	10.60%
16	NiSource Inc.	0.230	0.97962	$ 20.460	3.37%	5,752	8.16%	1.13%	8.10%	8.02%
17	Northeast Utilities	0.175	0.77932	$ 19.658	8.50%	2,524	12.46%	0.91%	12.42%	12.36%
18	NSTAR	0.303	1.28722	$ 28.462	5.00%	2,895	9.52%	1.08%	9.54%	9.47%
19	OGE Energy	0.333	1.40385	$ 28.452	2.67%	2,704	7.60%	1.18%	7.56%	7.48%
20	Otter Tail Corp.	0.288	1.21949	$ 29.433	4.75%	872	8.89%	0.99%	8.91%	8.85%
21	Pepco Holdings*	0.260	1.10534	$ 23.192	5.50%	4,323	10.27%	1.14%	10.31%	10.23%
22	Pinnacle West Capital	0.500	2.15581	$ 40.558	6.20%	3,994	11.52%	1.25%	11.53%	11.44%
23	PNM Resources	0.220	0.94614	$ 24.292	9.96%	1,752	13.85%	0.93%	14.00%	13.94%
24	PPL Corp	0.275	1.14567	$ 30.157	9.09%	11,070	12.89%	0.93%	13.12%	13.07%
25	Progress Energy	0.605	2.55791	$ 43.847	3.50%	10,713	9.33%	1.39%	9.33%	9.21%
26	Puget Energy Inc.	0.250	1.07486	$ 21.060	4.00%	2,401	9.10%	1.20%	9.03%	8.94%
27	SCANA Corp.	0.420	1.71438	$ 39.908	4.50%	4,447	8.80%	1.06%	8.97%	8.90%
28	Sempra Energy	0.300	1.27777	$ 46.790	5.88%	11,656	8.61%	0.65%	8.52%	8.60%
29	Southern Co.	0.373	1.61655	$ 33.115	4.67%	23,679	9.55%	1.14%	9.47%	9.39%
30	TXU Corp.	0.413	1.80955	$ 49.153	10.88%	27,074	14.15%	0.86%	14.65%	14.61%
31	Vectren Corp.	0.305	1.26612	$ 26.473	3.33%	2,053	8.11%	1.16%	8.17%	8.09%
32	Wisconsin Energy	0.230	0.99219	$ 40.123	7.56%	4,610	10.03%	0.58%	10.05%	10.03%
33	WPS Resources	0.585	2.50613	$ 51.597	6.83%	1,974	11.69%	1.11%	11.59%	11.51%
34	Xcel Energy Inc.	0.215	0.92755	$ 18.562	4.29%	7,414	9.29%	1.17%	9.21%	9.12%
35	**AVERAGE**	0.366		$ 35.566	5.54%		10.03%	1.07%	10.04%	9.97%
36	**MKT WTG AVERAGE**				6.29%		10.61%	1.03%	10.66%	10.59%

Source:
Vander Welde Direct, Schedule JVW-1.

Michael Gorman
Schedule MPG-15
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Discounted Cash Flow Model - Gas (Vander Weide)

Line	Electric Utility	Last Dividend (1)	Dividend (2)	Stock Price (3)	Annual Growth (4)	Market Cap $ (Mill) (5)	Cost of Equity (6)	Div. Yield (7)	1/4 DCF (8)	Annual Growth DCF Model (9)
1	AGL Resources	0.370	1.46238	$ 35.452	4.43%	2,766	8.55%	1.06%	8.86%	8.79%
2	Atmos Energy	0.315	1.36835	$ 26.467	5.40%	2,159	10.57%	1.21%	10.51%	10.42%
3	Equitable Resources	0.210	0.96441	$ 36.042	9.80%	4,279	12.48%	0.60%	12.38%	12.36%
4	New Jersey Resources	0.360	1.49790	$ 44.517	5.25%	1,232	8.61%	0.82%	8.70%	8.65%
5	NICOR Inc.	0.465	1.97394	$ 40.673	3.10%	1,788	7.95%	1.15%	7.90%	7.81%
6	Northwest Natural Gas	0.345	1.48345	$ 34.468	5.38%	966	9.68%	1.01%	9.66%	9.60%
7	Oneok, Inc.	0.300	1.25910	$ 30.940	6.42%	3,244	10.49%	0.98%	10.61%	10.55%
8	Peoples Energy	0.545	2.37092	$ 36.498	4.53%	1,412	11.03%	1.51%	10.91%	10.77%
9	Questar, Inc.	0.225	1.05177	$ 74.760	11.57%	6,972	12.98%	0.31%	12.92%	12.91%
10	South Jersey	0.225	0.95156	$ 27.728	5.30%	775	8.73%	0.82%	8.76%	8.72%
11	WGL Holdings Inc.	0.338	1.42983	$ 30.218	3.75%	1,440	8.48%	1.13%	8.47%	8.39%
12	**AVERAGE**	**0.336**		**$ 37.978**	**5.90%**		**9.96%**	**0.96%**	**9.97%**	**9.91%**
13	**MKT WTG AVERAGE**				**7.42%**		**10.84%**	**0.81%**	**10.85%**	**10.80%**

Source:
Vander Weide Direct, Schedule JVW-2.