EXHIBIT

306

Exhibit No.:
Issue: Rate of Return
Witness: Daniel J. Lawton
Type of Exhibit: Surrebuttal
Sponsoring Party: OPC
Case No: ER-2010-0036
Date Prepared: March 5, 2010

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Union Electric Company ,	§	
d/b/a Ameren UE's Tariffs to Increase its annual	§	**Case No. ER-2010-0036**
Revenues for Electric Service	§	
	§	

Surrebuttal Testimony

of

Daniel J. Lawton

On behalf of

Missouri Office of the Public Counsel

March 5, 2010

Public Counsel Exhibit No. 304
Date ________ Reporter ________
File No ________

AFFIDAVIT OF DANIEL J. LAWTON
FOR CASE NO. ER-2010-0036

STATE OF TEXAS §

COUNTY OF TRAVIS §

Daniel J. Lawton, being duly sworn on oath, says that he is the person identified in the foregoing prepared surrebuttal testimony and exhibits; and that such testimony was prepared by or under the direct supervision of said person; that such answers and/or information appearing therein are true and correct to the best of his knowledge and belief; and if asked the questions appearing therein, his answers would, under oath, be the same.

Daniel J. Lawton

Subscribed and Sworn to before me on this ~~5~~ 3th day of ~~March~~ February, 2010.

JANELLE M. EDMISTON
MY COMMISSION EXPIRES
May 21, 2013

My Commission Expires 5-21-2013

REBUTTAL TESTIMONY OF

DANIEL J. LAWTON

CASE NO. ER-2010-0036

Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Daniel J. Lawton. My business address is 701 Brazos, Suite 500, Austin, Texas, 78701.

Q2. ARE YOU THE SAME DANIEL J. LAWTON WHO PREVIOUSLY FILED DIRECT AND REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. Yes, I am.

Q3. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my testimony in the surrebuttal phase of these proceedings is to address the rebuttal testimony of Company witness Dr. Morin. I also have some brief comments regarding Mr. Murray's and Mr. Hill's testimony.

Q4. BASED ON THE REBUTTAL TESTIMONY, DO YOU HAVE ANY CHANGES OR ADDITIONS TO YOUR ORIGINAL RECOMMENDATIONS IN THIS CASE?

A. Yes. First, witness David Murray, at page 6, lines 1-2, points out a mathematical error in my direct testimony. The correct midpoint of the reasonable return range of 9.3% to 10.9% identified in my direct testimony is 10.1%, not the 10.2% in my direct testimony. Thus, the corrected equity return recommendation, based on the midpoint of the range of results, is 10.1%.

Second, the Company has provided an updated capital structure cost rates and overall return in the testimony of Mr. O'Bryan. The most current capital structure should be employed in setting rates in this case.

Third, the Company has identified a specific flotation expense associated with a recent equity infusion by the parent Ameren Corporation to AmerenUE.[1] Rather than adjust the equity return for flotation costs, these expenses should be normalized in cost of service over a five year period.

Q5. WHAT IS THE IMPACT OF THESE CORRECTIONS AND UPDATES?

A. I am recommending an equity return (corrected) of 10.1% and an overall return on capital of 8.058% employing the Company's updated capital structure. The capital structure and cost rates are discussed later in this testimony when I address Mr. O'Bryan's testimony.

Q6. DO YOU HAVE ANY GENERAL COMMENTS RELATED TO THE REBUTTAL TESTIMONY?

A. Staff asserts my recommendations are high or overstated while the Company asserts my results are low. Other than a correction in the calculation of my midpoint recommendation for equity return – I find nothing in the rebuttal testimony that would lead me to a different conclusion.

Q7. DO YOU HAVE ANY COMMENTS REGARDING STAFF WITNESS MURRAY'S REBUTTAL?

A. No. Mr. Murray and Mr. Hill make essentially the same arguments regarding my analysis. Thus, I address a couple of issues raised by Mr. Hill's rebuttal. I should note that while both Mr. Murray and Mr. Hill address a number of rebuttal issues ranging from comparable group selection, growth rates to comments on risk premium, I have generally limited my surrebuttal to the DCF growth rate issue. The reason I limit to DCF growth rate issues is because of Mr. Murray's statement at page 2, lines 1-6 of his rebuttal where he states:

> Staff's recommended ROE is lower than that of Dr. Morin, Mr. Gorman and Mr. Lawton due primarily to effect of the DCF growth rate estimates utilized in each witness' respective DCF methodologies. Although Dr. Morin, Mr. Gorman and

[1] Rebuttal Testimony Michael O'Bryan at 3:15-22.

> Mr. Lawton employ models other than the DCF in their cost of equity analyses, each of these witnesses' higher cost of equity estimates are driven primarily by their use of what I believe to be unsustainable growth rates….

Thus, issues unrelated to growth rates, in terms of Staff's rebuttal, do not appear relevant to the return on equity determination that is before the Commission.

Q8. AT PAGE 34 OF MR. HILL'S REBUTTAL, HE ASSERTS THAT YOU HAVE CHANGED YOUR DCF ANALYSIS IN THIS CASE, WHICH CAUSES YOUR RESULTS OR RECOMMENDATION TO BE HIGHER. DO YOU AGREE WITH MR. HILL'S ASSERTION?

A. No, Mr. Hill is not correct. He takes a small quote from my testimony in Case No. 200600285, before the Corporation Commission of the State of Oklahoma, and leaps to the erroneous conclusion that I did not rely on earnings growth forecasts in that Oklahoma case like I did in this case. All Mr. Hill needed to do was read a few more lines on that same page 12 of my Oklahoma testimony and he would have found the following:

> <u>Relying only on forecasted earnings per share estimates</u>, the growth rate average range can be narrowed to 5.25% to 6.17% as shown in Schedule (DJL-4). (emphasis added)

Then, at the very top of the next page of that same Oklahoma testimony the following is stated:

> In my opinion, the range of average growth rates of 5.25% to 6.17% shown at Schedule (DJL-4) provides a reasonable estimate of investor expectations of growth…

I have no reason to believe Mr. Hill to be misleading; I can only assume he didn't read the full growth rate discussion. Therefore, so there can be no misunderstanding, I have included the relevant pages from that Oklahoma testimony in my Schedule (DJL-SR1). The bottom line is that Mr. Hill's testimony asserting I have somehow changed my growth rate or constant growth DCF calculation is wrong.

Q9. MR. HILL, AT PAGE 35, LINES 28 TO 30, ASSERTS YOU RELY ON GROWTH RATE MEASURES THAT PRODUCE THE HIGHEST POSSIBLE RESULTS FOR YOUR DCF ANALYSIS. DO YOU HAVE ANY COMMENTS?

A. Yes, I have a number of comments. My testimony in this proceeding is to provide the Commission an independent assessment of the Company's cost of capital. The goal does not include either the highest or lowest cost of capital, but rather, the reasonable cost of capital for setting just and reasonable rates in this case. Thus, any claim that my analyses attempt to support some predetermined goal are without merit.

My analyses and evaluation of Ameren is consistent with how I go about the task of providing an independent assessment of any utility cost of equity request. I have relied on earnings growth forecasts of independent analyst estimates of the comparable companies. These published earnings forecasts are available to investors in the market place and, in my opinion, represent valuable information for determining the cost of equity.

The bottom line is that relying on published price, dividend and growth rate data and forecasts is not different or unique. Rather, in my experience, this is what regulatory authorities typically consider to determine a reasonable return for setting fair and just rates for consumers.

Q10. AT PAGE 33, LINE 21 THROUGH PAGE 34, LINE 4, MR. HILL DESCRIBES YOUR DIVIDEND YIELD CALCULATIONS. DO YOU HAVE ANY COMMENTS?

A. Yes, Mr. Hill is again incorrect. Mr. Hill asserts I increase the annualized dividend yield by the full amount of the DCF growth rates. I did not – rather I increased the annualized dividend by one half the growth rate to estimate the year ahead dividend yield. This issue was addressed earlier in my rebuttal testimony.

Q11. PLEASE SUMMARIZE YOUR COMMENTS ON MR. HILL'S REBUTTAL TESTIMONY.

A. Many of Mr. Hill's comments with regard to my testimony and analyses are incorrect. Moreover, none of Mr. Hill's comments would lead me to change my testimony or conclusions in this case.

While Mr. Hill may assert that all the analysts in this case are incorrect and have overstated equity return, the following table summarizes the current recommendations in this case:

Table 1
Summary of Equity Return Recommendations

		LOW	HIGH	RECOMMENDATION
1) Company	Dr. Morin	9.4%	11.5%	10.8%[2]
2) OPC	Mr. Lawton	9.3%	10.9%	10.1%[3]
3) MIEC	Mr. Gorman	9.5%	10.5%	10.0%
4) Staff	Mr. Murray	9.0%	9.7%	9.35%

Including the Company's updated analysis, there is significant overlap in the Company's OPC, MIEC and Staff ranges of results. The final recommended results of the parties differ, but overall are within about 70 basis points when reviewing MIEC, OPC and Staff. Based on these results, it is difficult to give Mr. Hill's arguments, that the return recommendations are substantially overstated or out of line with reason, much merit.

Q12. DO YOU HAVE ANY COMMENTS RELATED TO DR. MORIN'S UPDATED RETURN ON EQUITY RECOMMENDATION SETFORTH IN HIS REBUTTAL TESTIMONY AT PAGES 52-56?

A. Yes. As I noted in my rebuttal testimony, Dr. Morin's original cost of equity

[2] Dr. Morin rebuttal testimony at 55
[3] Lawton Direct Testimony, corrected in this surrebuttal testimony

recommendation of 11.50% is overstated and out of date, and in particular, the DCF results need to be updated. Dr. Morin's updated rebuttal analyses summarized at page 55, lines 6-14 of his rebuttal testimony, average about 10.6%. While Dr. Morin now recommends a 10.8% return on equity – his analyses (without a flotation adder) average about 10.6%.

Q13. DOES DR. MORIN IDENTIFY ANY RISKS THAT SUPPORT A HIGHER EQUITY RETURN?

A. At page 55, line 19, Dr. Morin attempts to justify his updated 10.8% equity return recommendation as "conservative" in light of industry average risks. First, he asserts a regulatory lag problem for AmerenUE.[4] But, when discussing regulatory lag, Dr. Morin ignores Ameren's updated capital structure proposed in this case pursuant to the Jointly Proposed Procedural Schedule, Related Procedural Items, and Test Year True-Up Cut-Off Date as discussed in the Rebuttal testimony of Company witness Michael G. O'Bryan. The Company's new or updated capital structure is adjusted to capture changes through December 31, 2009.[5] The updated capital structure, with a 51.126% equity ratio, incorporates the September 2009 equity infusion by AmerenUE's parent, Ameren Corporation.

Moreover, AmerenUE, with a 51.126% equity ratio, has a higher equity ratio than the average of the comparable risk companies.[6] Also, AmerenUE's updated capital structure has a higher equity ratio than the average electric utility reported in the Regulatory Research Associates Regulatory Focus January 8, 2010 report for January – December 2009.[7] Dr. Morin never addresses the lower financial risk (higher equity ratio) in his rebuttal. Thus, his 10.8% updated return on equity estimate is not conservative.

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[4] Dr. Morin rebuttal testimony at 55:21-26

[5] Rebuttal Testimony Michael O'Bryan at 2:5-12 and Schedule MGO-ER5

[6] See Direct Testimony of Daniel J. Lawton at Schedule (DJL-3)

[7] Rebuttal Testimony Dr. Morin at Exhibit RAM-ER11-3.

Q14. IN YOUR OPINION, DOES DR. MORIN'S UPDATED ANALYSIS SUPPORT A 10.8% EQUITY RETURN?

A. No. The updated analysis set forth at page 55 of his rebuttal testimony averages about 10.6%, with a midpoint of the full 9.4% - 11.5% range of about 10.5%. These results are without a flotation adjustment to the equity return. Further, adjusting his estimate downward by 20 to 30 basis points for financial risk results in about an equity return recommendation consistent with what I recommend in this case.

Q15. DO YOU HAVE ANY COMMENTS REGARDING THE REBUTTAL TESTIMONY OF COMPANY WITNESS MICHAEL O'BRYAN?

A. Yes. Mr. O'Bryan has provided, in his February 11, 2010 rebuttal testimony, an update of the capital structure and capital costs for the Company at December 31, 2009. Mr. O'Bryan's updated capital structure reflects a September 2009 equity increase as well as Dr. Morin's updated cost of equity recommendation.

Q16. IN YOUR OPINION, SHOULD THE COMMISSION CONSIDER THE UPDATED CAPITAL STRUCTURE IN THIS CASE?

A. Yes. The updated capital structure is a known and measurable change of the Company's capital costs and should be employed in establishing rates in this case.

Q17. HOW DOES THE USE OF THE UPDATED CAPITAL STRUCTURE IMPACT YOUR RECOMMENDATION IN THIS CASE?

A. My recommendation set forth in Table 6 in my direct testimony was based on the Company's filed capital structure and cost rates adjusted for a 10.2% equity return. The resulting overall return at that time was 7.961%.

Employing the updated capital structure and the corrected 10.1% equity return results in an overall return recommendation of 8.058% as shown in the following table:

Table 2
AmerenUE Updated Capital Structure as of December 31, 2009[8]

Description	Amount	Ratio	Cost	Weighted Cost
Long-term Debt	$3,655,810,419	47.390%	5.944%	2.817%
Preferred Stock	114,502,040	1.484%	5.189%	0.077%
Common Equity	3,944,011,192	51.126%	10.100%	5.164%
Total	$7,714,323,651	100.00%		8.058%

As can be seen from the above table, the recommended return is now 8.058% when the capital structure is updated and my equity return recommendation is corrected to 10.1%.

Q18. HAS THE COMPANY IDENTIFIED A SPECIFIC FLOTATION COST AMOUNT IN THE REBUTTAL TESTIMONY?

A. Yes. At page 3, line 22 of Mr. O'Bryan's rebuttal testimony; he identifies a flotation expense for AmerenUE of $13,703,966. If the Commission determines this $13.7 million expense is reasonable and should be recovered by the Company, then such amount should be amortized over a period of years with the annual amortization included in cost of service. An amortization period of five years is a reasonable period to recover these expenses.

Q19. WHY HAVE YOU IDENTIFIED A FIVE YEAR AMORTIZATION OR NORMALIZATION OF THESE FLOTATION EXPENSES?

A. Based on a review of Staff witness Murray's rebuttal testimony at page 32, a five year

[8] Capital Structure per Rebuttal Testimony M. O'Bryan, Ex. MGO-ER-5. Equity return cost rate of 10.2% per direct testimony.

normalization period appears to be what has been employed in previous cases. A five year normalization period is reasonable for this type of expense, if the Commission determines these flotation costs should be included in cost of service. As evidenced by the test year, cost of service issuance of equity is not an annual or recurring expense. Further, a rate case filing is generally not an annual occurrence. Thus, a five year period to normalize such expenses as Staff has recommended in prior cases is reasonable.

Q20. IN YOUR OPINION, SHOULD THE UNAMORTIZED BALANCE OF FLOTATION COSTS BE INCLUDED IN RATE BASE INVESTMENT?

A. No. Again, these costs are being normalized to reflect an annual or typical test year expense amount. There is no reason to include the unamortized amount in rate base investment.

Q21. DOES THIS CONCLUDE YOUR TESTIMONY IN THE SURREBUTTAL PHASE?

A. Yes.

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

APPLICATION OF PUBLIC SERVICE COMPANY	)	
OF OKLAHOMA, AN OKLAHOMA	)	
CORPORATION, FOR AN ADJUSTMENT IN ITS	)	CAUSE NO. 200600285
RATES AND CHARGES FOR ELECTRIC SERVICE	)	
IN THE STATE OF OKLAHOMA	)	

RESPONSIVE TESTIMONY

of

DANIEL J. LAWTON

on behalf of the

OFFICE OF THE ATTORNEY GENERAL

Diversified Utility Consultants, Inc.
12113 Roxie Drive
Austin, TX 78729

MARCH 20,2007

Common earnings growth rate forecasts may be found in the Value Line Investment survey ("Value Line") publication. These Value Line earnings estimates are five year projections in annual earnings. Again, Value Line is widely available to the public, and is a good source of earnings projections. Other earnings estimates are forecasted by Zacks as well as First Call projections, widely available on the internet at Zacks.com and Yahoo Finance respectively. Those earnings projections along with other stock specific financial data provide a range of estimates of earnings and are readily available at no cost.

Another growth estimate is referred to as the sustainable growth or retention ratio growth estimate. To project future growth in earnings under the sustainable growth method, one multiplies the fraction of a firm's earnings expected to be retained (not paid out as dividends) by the expected return on book equity. As a formula:

(growth = b x r)

Where:

b =1-(dividends per share/earnings per share)

r =earnings per share / net book value share

All the data necessary to calculate the elements of the sustainable growth method are available on a forecasted basis in Value Line.

Q. PLEASE EXPLAIN YOUR GROWTH RATE ANALYSIS.

A. I have included in my Schedule (DJL-4) the growth rates I have reviewed and/or relied on in my analysis. The first set of growth rates examined is the recent 5 year historical growth rates in earnings per share, dividends per share, and book value per share as reported by Value Line. The second set of growth rates is the Value Line forecasted growth rates in earnings per share, dividends per share, and book value per share for AEP and each company in the comparable group. The third set of growth rates examined is the Zacks forecasted growth rates in earnings. The fourth growth estimate considered is the First Call growth rates are readily available to investors at Yahoo Finance. In addition, I have examined the growth rates based on the retention ratio growth estimate. These calculations are included in my Schedule DJL-4.

The growth rates described above provide a range of estimates for each of the comparable companies. The resulting range of average growth rates for the group is from 3% to 5.83%. Relying only on forecasted earnings per share estimates from Zacks and Thomson First Call, the growth rate average range can be narrowed to 5.25% to 6.17% as shown in Schedule (DJL-4).

In my opinion, the range of average growth rates of 5.25% to 6.17% shown at Schedule (DJL-4) provides a reasonable estimate of investor expectations of growth for each of the companies in the group. The comparable AEP growth estimates is 4.2% to 5.0%. In contrast, Dr. Murry's constant growth DCF analysis employed a 4.58% to 5.50% growth rate average.[2]

Q. PLEASE SUMMARIZE YOUR CONSTANT GROWTH DCF COST OF EQUITY ESTIMATE FOR THE COMPARABLE GROUP.

A. In my view, investors expect a rate of growth in earnings per share of between 5.25% and 6.17% percent for this group. This growth rate range is consistent with the average projected growth rates presented in my Schedule (DJL-4). When the individual company percent growth rate range is added to the base dividend yield and the yield adjustment factor is included, the constant growth DCF investor return requirement for the group is 9.3% to 10.2%, as shown in Schedule (DJL-5). The AEP range shown in Schedule DJL-5 is 7.8% to 8.6%.

Q. WHAT IS THE DIVIDEND YIELD ADJUSTMENT FACTOR?

A. The dividend yield adjustment factor is used to reflect the future payment of dividends in the next 12 months. When an investor buys common shares in a company, it is the future dividends that will be received, not past dividends. To account for investor expectations of future dividend payments, I have increased the dividend by one-half the growth rate to reflect this investor expectation. This adjustment represents a reasonable approximation of the

[2] Dr. Murry Direct at Schedule (SCH-3).