STATE OF MISSOURI

PUBLIC SERVICE COMMISSION

TRANSCRIPT OF PROCEEDINGS

Evidentiary Hearing

November 21, 2008
Jefferson City, Missouri
Volume 15

In the Matter of Union Electric)
Company d/b/a AmerenUE's Tariffs)
To Increase Its Annual Revenues) Case No. ER-2008-0318
For Electric Service)

MORRIS L. WOODRUFF, Presiding,
DEPUTY CHIEF REGULATORY LAW JUDGE.

JEFF DAVIS, Chairman,
CONNIE MURRAY,
ROBERT M. CLAYTON III,
TERRY JARRETT,
KEVIN GUNN,
COMMISSIONERS.

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P R O C E E D I N G S

JUDGE WOODRUFF: Okay. Let's go ahead and get started. Welcome back for day two of the AmerenUE hearing. I believe we're ready to start today with mini openings on return on equity issue. So let's begin with AmerenUE.

MR. BYRNE: Thank you, your Honor. May it please the Commission?

I'm here today with my chart to talk about return on equity. In AmerenUE's last rate case, the Commission described the return on equity issue as a tangled thicket of conflicting opinions. And I think Mr. Thompson has attempted to present a thicket of opinions in this case in his chart in which he lists six or seven different parties with positions on return on equity that he posted up there, and almost all of those parties recommend a 10.2 percent return on equity.

Unfortunately, many of those parties who are supporting a 10.2 percent return on equity have presented no evidence on that issue whatsoever in this case. Specifically, Public Counsel has not presented any evidence in this case concerning return on equity. Neither has the State of Missouri, and neither has AARP and the Consumers Council of Missouri.

I think that these parties support a

10.2 percent return on equity because it is the lowest return on equity that they can argue with a straight face based on the evidence in this case, but they haven't presented any independent evidence to support their positions.

There are only four witnesses that have presented return on equity testimony in this case. Ms. LaConte, who testified yesterday, recommends a 10.2 percent return on equity on behalf of the Missouri Energy Group. Ms. LaConte is typically a class cost of service and rate design witness whose experience in estimating return on equities and conducting ROE analyses is quite limited, as she readily admitted.

Her analysis conducted in this case is also quite limited, and some of her analyses consisted simply of selected modifications of the analyses that AmerenUE's expert, Dr. Morin, performed which have the effect of lowering the ROE. Ms. LaConte's recommendation regarding the appropriate return on equity for AmerenUE should be afforded little weight.

That leaves Mr. Hill and Mr. Gorman. Mr. Hill on behalf of the Staff is recommending a 9.5 percent return on equity which, as Mr. Lowery said yesterday morning, is, in fact, ridiculously low. There are many technical flaws with Mr. Hill's analysis which

Dr. Morin explains in detail in his testimony.

But suffice it to say that Mr. Hill's recommendation is over 100 basis points below the national average of ROEs for integrated utilities. It is 50 basis points lower than the lowest ROE Ms. LaConte knew about during 2008 based on her testimony yesterday. His recommendation is 50 basis points below the cost of long-term secured debt that AmerenUE's affiliate Illinois Power Company issued in the last month.

His 9.5 percent recommendation is so low that not even the consumer advocate groups that have intervened in this case can support it. In determining an appropriate ROE for this case, Mr. Hill's recommendation should be given no consideration whatsoever.

I'm down to Mr. Gorman. A lot of people in this room respect Mr. Gorman as a rate of return analyst, and that includes AmerenUE. Although Dr. Morin has some technical disagreements with Mr. Gorman, we acknowledge that Mr. Gorman is experienced, he knows how to conduct various analyses, and he has conducted a series of thorough and complete analyses.

Our disagreement with Mr. Gorman primarily involves those of his analyses that he has elected to use and those that he has elected to discard in developing a final ROE recommendation. Specifically, Mr. Gorman has discarded the standard constant growth DCF analysis which has been regularly used by this Commission and which Mr. Gorman has used in 80 to 90 percent of the cases that he has testified in.

We believe that a proper examination of Mr. Gorman's own analyses, including the constant growth DCF analysis, coupled with adjustments to Mr. Gorman's analyses that are exactly like those approved by this Commission in the recent Empire case in which Mr. Gorman also testified, will result in an ROE very close to that which Dr. Morin is recommending and which would be reasonable for AmerenUE.

When the Commission considers the ROE issue, I would ask that you carefully review this chart which is, I believe, in Dr. Morin's rebuttal testimony and you've seen in opening statement. This chart shows the average ROEs awarded by utility commissions based on the Regulatory Research Associates data that this Commission has consistently relied on in past cases.

As you can see if you look close, the ROE for integrated electric utilities, almost all of which already have fuel adjustment clauses, has averaged close to 10.6 percent over the period that's covered by the chart, which starts January '05. The latest data for the quarter ended September 30th, 2009 shows an average ROE for integrated electric utilities of 10.62 percent for the 12 months ending September 30th, 2008. I'm sorry. I said 2009. For the 12 months ending September 30th, 2008, the average ROE for integrated electric utilities is 10.62 percent.

But even that data was before the current financial crisis, which has increased capital costs for all utilities. I would also note that, perhaps in an effort to keep them financially healthy, our chart shows that this Commission has recently awarded ROEs to Empire and KCPL in the range of 10.8 percent.

As Mr. Voss testified at length yesterday, AmerenUE's financial health is in jeopardy right now, and we need mainstream regulatory treatment with regard to our authorized ROE consistent with that being afforded to other utilities with whom we compete for capital. This chart shows the mainstream. We do not need a 10.2 percent return on equity as the consumer advocates argue. We need an ROE consistent with what our peers are being authorized and consistent with AmerenUE's recommendation.

I close by mentioning AmerenUE's witness on return on equity, Dr. Roger Morin. Dr. Morin is one of the most well-respected experts in the field of utility finance in the country and perhaps the world. He has spent a lifetime studying rate of return and utility finance issues. He is the author of a widely used textbook on the subject and Emeritus Professor of Finance at Georgia State University.

I urge you to carefully consider the testimony of Dr. Morin in addressing this issue. Thank you.

JUDGE WOODRUFF: Thank you. Opening for Staff.

MR. THOMPSON: Thank you, Judge. May it please the Commission?

Let me put my famous chart up. I wouldn't want to disappoint Mr. Byrne. Unfortunately, Daniel wasn't here to set it up earlier today. There we go.

We've just finished a presidential campaign in this country that seemed to me at least to last for about four years. It went on forever. And in that campaign, some of the candidates went down the road of negative campaigning, the road of bashing their opponent. And I'm sorry to see that Mr. Byrne went down that road in his opening statement.

I'm not going to bash Dr. Morin. Mr. Byrne is absolutely right when he tells you that Dr. Morin is a well-respected rate of return expert of national stature. That is true. However, it is also true that Mr. Hill is a well-respected rate of return expert of national stature.

And I'm not going to bash Ms. LaConte, who did a fine job, I thought, and whose testimony was entirely credible. Nor am I going to bash Mr. Gorman, who you've seen quite a few times in rate cases and who has always provided credible and very useful testimony.

You have a very hard job to do here. I'm glad I don't have to do it. You have to set the return on common equity for this state's biggest electric utility, a utility which many Missourians depend on. If you set it too high, there will be some people who can't afford to pay for electricity. Not just some people, there will be some businesses that may close their doors.

If you set it too low, then the health and vitality of this crucial utility will be damaged. This utility, in fact, is engaged in capital construction activities that are vital to the future of this state.

So you have a very important and very difficult job, one that the Law Judge sitting here referred to in a previous order as finding your way through a thicket. Well, that chart shows you the different recommendations that are before you, and it's an improvement on yesterday's chart because I've added at the top line Dr. Morin's latest recommendation, which is increased by 25 basis points to reflect the current economic crisis. And that crisis only adds to the difficulty of the job before you.

What does it require? Interest rates in some ways are going down, but capital is much more difficult to acquire. What's a commission to do?

Now, I am not competent to tell you which of these experts did it right and which of these experts did it wrong. I can hardly balance a checkbook. But you have ample testimony in front of you in the rebuttal and surrebuttal testimony filed by each of these experts where they make technical criticisms and evaluations of each other's work. I urge you to read all of that testimony very carefully.

But I can talk about one aspect. Before we get there, let's just talk about these recommendations a little bit. Each basis point is worth $492,000 in revenue requirement. From the lowest recommendation, 9.5 by Mr. Hill, to the highest recommendation, which is Dr. Morin's latest without fuel adjustment clause recommendation of 11.4, it's 190 basis points. You multiply that times 492,000 and that's a very large amount of money.

The thing you need to remember, and I'm not saying this to push your decision one way or the other, but the thing that you have to remember is return on equity is profit. This is the profit you are awarding

Ameren, and Ameren has a constitutional right to a profit. Absolutely. You must give them a profit because these assets are owned by private investors who have dedicated them to the public service, and in return they must have an opportunity for a return on that investment. Your job is to decide how much of a return. How much of a return.

Now, one thing I said I can comment on and I will. That's the return of the adder. Those are snakes, adders in fact. And the thing about a snake is if you mess with them they bite you. We see adders in these cases, don't we? We've seen adders before, oddly enough, often proposed by the company expert. Oddly enough. It's funny we don't ever see any subtracters, but logic would tell you there should be such a thing.

Think about some of the adders you've seen in previous rate cases. In UE's last rate case where the company experts were Dr. Vander Weide and Ms. McShane, they proposed adders to reflect UE's greater financial risk when compared to the proxy group. In Empire's 2006 rate case, Dr. Vander Weide proposed a 40 point adder to reflect Empire's greater financial risk.

In KCP&L's 2006 rate case, which was kind of an adder party, there were three different adders in the company's testimony, a 50 point adder for unusual construction risk, a 50 to 100 point adder for general management excellence, and then a 526 basis point adder to offset the risk that they would not make as many off-system sales as they had in the test year.

MR. BYRNE: Your Honor, I'm reluctant to object during an opening statement, but none of this is any evidence in the record in this case. I think it's improper to bring up in this case.

MR. THOMPSON: There's no adder in this case? I'm sorry.

MR. BYRNE: No evidence of what happened in the KCP&L and the Empire case.

MR. THOMPSON: Well, Mr. Byrne --

JUDGE WOODRUFF: I'll overrule the objection.

MR. THOMPSON: -- you're asking the Commission to consider other ROE awards.

I just want you to think about this adder, two different adders. We've got a flotation cost adder for a company that doesn't issue any stock. You should ask yourself some questions about the logical coherence of that adder. And then we've got a 25 basis point adder for the economic crisis.

Again, I am not competent to tell you whether that is an appropriate adjustment or not. But you're going to have three witnesses, three experts in front of you this morning who can tell you that, and I urge you to ask them that question.

That's all I have. Thank you very much.

JUDGE WOODRUFF: Thank you.

CHAIRMAN DAVIS: Judge, can I inquire of Mr. Thompson?

JUDGE WOODRUFF: Go right ahead.

CHAIRMAN DAVIS: Mr. Thompson, is it true that there are already a lot of people out there who cannot afford their electric bill?

MR. THOMPSON: Absolutely.

CHAIRMAN DAVIS: Do you think there's a high probability that there are going to be even more people facing that plight here in the next few months?

MR. THOMPSON: Absolutely.

CHAIRMAN DAVIS: So why should we give them any increase?

MR. THOMPSON: Staff's audit shows that an increase is necessary and deserved. This Commission must give this company adequate operating and maintenance money as shown by the test year annualized and normalized and an opportunity to earn a return on their investment. That's your obligation. Staff does not say that no increase is warranted here.

CHAIRMAN DAVIS: Did you select Mr. Hill as the witness for ROE?

MR. THOMPSON: No, sir.

CHAIRMAN DAVIS: Do you think in your opinion that AmerenUE is the least risky utility in the country right now?

MR. THOMPSON: No, sir.

CHAIRMAN DAVIS: You put on a witness who's recommending the lowest ROE in the country. You realize that?

MR. THOMPSON: Well, Mr. Chairman, there's two types of expert witnesses. And I've done a lot of litigating. Let me tell you about them. There's one type of expert witness that will tell you whatever you want to hear. I don't buy witnesses like that because, you know what, I don't believe them and neither does anybody else.

There's the other type of witness who does an independent study and will say whatever it is that their expertise leads them to, and that is what we've got here. If you don't like his testimony, by all means, don't follow it, but you are not going to hear from a whore.

CHAIRMAN DAVIS: Judge, I don't have any further questions.

JUDGE WOODRUFF: Public Counsel.

MR. MILLS: At this point I'm a little

afraid to make an opening statement. I will be very brief. Public Counsel supports the testimony both of Mr. Hill and of Ms. LaConte, but most especially Mr. Gorman. You've seen Mr. Gorman in a lot of cases lately. His recommendation is, as the Commission routinely finds, if not the most credible, among the most credible in the case. He does a very balanced approach, and I think you should find his testimony to be the most credible in this case.

One thing I would like to urge the Commission to do on this issue in particular is to, for the benefit of the parties in the future cases, to really get into the nuts and bolts of this issue, explain to the parties why you like the multi-stage DCF if you do, why you like the single-stage DCF if you do, why one is better than the other.

I think you're seeing and have been seeing over the last few years ROE recommendations that are all over the map and testimony that covers a lot more ground than it needs to because the parties at this point are not really comfortable with knowing what type of approach this Commission favors in terms of determining what an ROE is. We don't know whether the multi-stage DCF is better than the single-stage in the Commission's eye.

So I think it would be very helpful for the parties if the Commission would explain down to the nuts and bolts detail which testimony was most credible and why. Thank you.

JUDGE WOODRUFF: Opening for the State?

MR. IVESON: Thank you, Judge, Commissioners.

As I was preparing for this this morning, I couldn't get the testimony of Mr. Voss out of my mind. There were a number of things that kept coming back to me. One was his insistence that cheap cost of capital for the company would reduce costs for customers. Well, and on its face that makes sense, but how do we get to that nirvana of cheap capital costs?

Well, we get it by asking ratepayers to pay more now so that maybe they can get cheaper costs later. It seems to me that it's a pay now/pay later, and it's the ratepayers that pay. I don't think that should really be the consideration here. I don't think that getting a higher return on equity at this point in time should be viewed as a way of benefiting ratepayers.

Now, you don't need an expert to tell you that there's a credit crisis right now. You just have to read the newspapers or watch the news on TV, and everyone is feeling it right now. But the Commission can't fix that. They can't even fix that for Ameren. There are highly rated companies that are still having trouble getting capital. Banks just aren't lending money. Investors are just scared right now. So you're not going to be able to fix that.

What you have to do, again, I urge you, look at the long term and what the company needs to stay healthy over the long term.

Now, again, Mr. Voss testified as to what the company was doing in light of the current financial crisis, and they're deferring capital expenditures. That's a reasonable and prudent thing to do. Not cancelling them. He emphasized that. They're deferring capital expenditures, and they're putting on kind of a hiring freeze. They're being more careful about their new hires. Again, it's reasonable and prudent.

What they're not doing, what they're not being forced to do in this financial crisis is to lay off thousands of employees the way many companies are or to shut down plants the way many companies are. They are making a profit. They're just not making as big a profit as they would like to.

Now, the job of the Commission, I agree with Mr. Thompson, is a very difficult one in this case. There's a lot of factors to take into consideration. But your job is to figure out a fair and reasonable return for the company.

If you look at each of the experts that have provided testimony in this case, they all agree that to a large extent their analyses are subjective. They depend on the assumptions that they make. And so your job really in reviewing their testimony is to determine whose assumptions appear most reasonable to you as a Commission.

And I beg to disagree with Mr. Byrne. The reason the State is supporting a 10.2 percent return is because that's the analysis we went through. We reviewed very carefully all of the expert testimony, and we found that the assumptions made by Mr. Gorman were mainstream assumptions, they were reasonable, they were prudent, they took into consideration both the high and the low, and they reached a middle ground.

And we believe that if you review the testimony carefully, you will come to the same conclusion and grant the 10.2 percent return on equity. Thank you.

JUDGE WOODRUFF: Opening for MIEC.

MS. VUYLSTEKE: May it please the Commission?

MIEC's evidence, the testimony of Mr. Gorman, shows that a reasonable return for AmerenUE is 10.2 percent. This is the midpoint of Mr. Gorman's range of 9.8 percent to 10.5 percent. It's a return that would protect AmerenUE's financial health and compensate its shareholders for their investment risk.

His testimony shows that the electric utility industry is in a strong growth period. It is in a capital spending cycle that is producing strong growth in rate base earnings and dividends. The industry is in a strong growth period, attracting capital expenditures for meeting growing demand, environmental compliance and system upgrades and improvement.

Mr. Gorman's testimony shows that the market is attracted to the same characteristics as regulatory utility companies. Our recommended ROE will well maintain AmerenUE's position.

AmerenUE's ROE witness, Dr. Morin, recommends a return of 10.9 percent, but even his -- if you take Mr. Gorman's inputs into Dr. Morin's rate of return analysis, you'll find that he comes out with about the same result. If Mr. Morin's inputs had been more accurate, the results would have been similar to Mr. Gorman.

An unreasonably high return is going to unreasonably increase rates, and this will lead to an ultimate decline in AmerenUE's customer base, its service territories, economic viability, and will ultimately undermine AmerenUE's credit standing and ability to attract capital.

Thank you.

JUDGE WOODRUFF: Opening for MEG.

MS. LANGENECKERT: May it please the Commission?

The MEG has submitted direct and surrebuttal testimony of witness Billie Sue LaConte, Exhibit 650 through 652. One of the issues on which Ms. LaConte focused in her testimony was return on equity. The MEG recommends that AmerenUE receive an ROE of 10 percent if the Commission grants a fuel adjustment charge and 10.2 if the Commission does not grant an FAC.

After much zone of reasonableness testimony in May of 2000, the Commission approved an ROE of 10.2 for the company with no FAC. We contend that an ROE of 10.2 is again appropriate for AmerenUE if no FAC is granted. You heard a lot of pleas yesterday from many parties asking you to be conservative in your analysis of AmerenUE's rate increase request. The MEG is also asking you to do that.

Among the MEG members in this case are two large hospital systems, including the largest employer in the state. Those hospital systems are overwhelmed in this economy, not only by increased cost of doing business, but also by increased number of patients coming into their hospitals who cannot afford to pay for their health care and don't have insurance. Hospitals have a duty to serve patients whether they can pay or not. Not many businesses have that same duty. These health care companies cannot pass along these increased costs to other patients, just as they cannot pass along increased utility costs.

Yesterday Ms. Vuylsteke mentioned the concern of increased utility costs on economic development in Missouri. She also mentioned the closing of the Chrysler and Wholesome plants. Mr. Conrad told you of Noranda's concerns. This is just an example of how tenuous industry is in Missouri today.

Granting AmerenUE an ROE at the lower end of the zone of reasonableness may make the difference in another industry in Missouri also having to close its doors.

As you can see from the many pages of testimony filed by various parties on the return on equity issue, there are numerous ways to calculate return on equity. All of the methods rely on some formula. In case after case, this Commission has heard similar arguments about which formula is best, which inputs are best for each formula, how to weight the results of the different formulas and the inputs and what additional judgments should be applied.

Intelligent minds can and do differ on these points, but the arguments have nothing -- have done nothing to resolve the issues. In each case it seems we are recovering the same ground. For that reason, MEG witness LaConte has recommended in her testimony that the Commission consider establishing a generic approach to determine return on equity in future cases.

Under a generic approach, the Commission would determine the standard return on equity for a base year and the formula to adjust the return on equity in future years as the underlying input charges. This would save time and expense in each separate rate case, thereby giving the parties more certainty and simplifying the regulatory process.

Thank you.

JUDGE WOODRUFF: Opening for Noranda?

MR. CONRAD: Your Honor, I'm chastened by the old statement that it's better to remain silent and let people think you're stupid than to speak up and remove all doubt. I hadn't intended to say anything, but I am motivated by the passion demonstrated by the Commission's General Counsel to -- and with all due respect to counsel Thompson, I do not find, and I have them here and just looked, in either the Hope Natural Gas case or the Bluefield Waterworks case, which are the two seminal decisions from the United States Supreme Court in the mid '50s dealing with this issue, I do not find there an entitlement on the part of the utility to every -- to reimbursement of every expense that they have. Nor do I find entitlement to a profit.

And I'm not sure if Mr. Thompson realized he was making that statement because I heard him make a number of arguments and have not heard that statement before. But I think it is -- it is my position, based on some analysis of those cases over a few years, that a utility, whether in this jurisdiction or any jurisdiction, is constitutionally entitled under the 14th Amendment, and the 15th is applied thereby to the states, is entitled to an opportunity to earn a rate of return.

And I will bother to read for just a moment a phrase of Justice Butler, which is in the Bluefield Waterworks case. Public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments and other business undertakings which are attended by corresponding risk and uncertainty, but it has no constitutional right to profit such as are realized or anticipated in highly profitable enterprises or speculative ventures.

Justice Butler continues, the return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under efficient and economical management to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

I won't bore you. It's in black and white. You can find it on your own. I'm sure other parties will brief that issue. But I have for some time been concerned that there is a perception that is shifting that a utility is entitled to a particular rate of return or particular level of profit. I do not believe that honestly to be the case, your Honors.

I believe they are entitled to an opportunity to do that, but they have, in the words of Justice Butler, to exercise efficient and economical management in order to achieve that. There is no entitlement save that to an opportunity to do that. Thank you.

JUDGE WOODRUFF: Thank you. All right. I believe that's all the parties for opening. Go ahead.

COMMISSIONER CLAYTON: Judge, I'd like to ask a question of a couple of the attorneys who made openings here.

Ms. Langeneckert, you brought up a concept of having some sort of generic docket, I assume on an annual or biannual basis, where the Commission would set out some parameters for what it considered the most relevant factors in establishing a return on equity, I think is what you suggested.

MS. LANGENECKERT: Roughly, yes.

COMMISSIONER CLAYTON: Can you come up so the audience can hear? I'm sorry. I want to make sure everyone can hear.

Are you aware of any states that -- or any other jurisdictions that perform that type of analysis, either through rulemaking or through generic docket, that establish either some level of parameters for establishing ROEs?

MS. LANGENECKERT: Ms. LaConte yesterday testified to California having such a program, and I know that that's pretty much all over Canada is what they do. She obviously knows the particulars better than I working in other areas, and she will be back for off-system sales. She had to leave for private family reasons.

COMMISSIONER CLAYTON: Thank you. I wanted to ask Mr. Mills, I think you suggested something similar, at least setting out some basic guidelines of what the Commission expects through ROE analysis. Is that -- am

I --

MR. MILLS: Yeah. I think what Ms. LaConte had in mind is that the Commission for each utility would set an ROE that would last for several years rather than in each successive case relitigating the same questions. You would set sort of a base ROE and then make changes to that as changes to inputs changed over time.

What I'm suggesting is a little more broad in that I think that some of the parties really -- it used to be for years that the Commission would say the DCF is the best, the DCF is the best, and so the parties uniformly relied most heavily on the DCF and then supported that with a couple of different things like the CAPM perhaps or risk premium as a check.

We haven't had that kind of pronouncement from the Commission, I don't think, as clearly in recent years. I think it would be helpful not only for a future UE case but for Empire, for all the cases if the Commission were to say, for example, we -- we believe that the multi-stage DCF is superior to the original flavored DCF because of these reasons, and the parties in future cases would at least be able to address those reasons if not completely, you know, not spend time on something the Commission has found not to be as convincing as a different analysis.

That's sort of a different approach. I think it has the same kind of end result as what Ms. LaConte is suggesting.

COMMISSIONER CLAYTON: Well, if you accept that argument, if one accepts that argument, couldn't you continue that suggestion to deeper levels in the analysis, for example, maybe the Commission should set up parameters for proxy groups or set out parameters or guidelines for setting the risk-free rate so that that provision doesn't have to be litigated, each of the different provisions within the formula? Would you -- would you agree or disagree that the Commission should get down to that basic level to set out guidance?

MR. MILLS: No. I would agree with that, definitely. And obviously that -- you can't bind a future Commission, and the evidence in one case may show -- may tend to push you down a different path. But I think the more information we can get in each case about what was convincing and what was not convincing and down to the granularity that you're talking about, I think it will not only help us prepare for future cases, but it will help you get the kind of evidence that you want in future cases.

COMMISSIONER CLAYTON: Well, I have a feeling if we were to do something where we set out something in particular on guidelines, it is an interesting concept having the conversation here today, but I think the parties would argue, depending on what the result was, that they would each argue vigorously against what we previously pronounced, I think.

I mean, I don't see -- depending on how the results come out, each party would still litigate from their perspective, would they not?

MR. MILLS: Certainly.

COMMISSIONER CLAYTON: So would there be a way of reaching consensus among parties on certain levels of that analysis prior to reaching the result? Because it seems like -- let me just finish my comment and I'll stop here. But it seems like in my five years of being on the Commission, I mean, there are particular ranges that the utility comes in, there are particular ranges that Staff tends to come in, and there are particular ranges that intervenors tend to come in, regardless of the method, how they reached that result.

So I guess what I'm asking, is it possible to reach consensus at the start prior to reaching the result among parties to have a more efficient and productive process?

MR. MILLS: Bluntly, probably not. But I think -- I think certainly if the Commission wanted to take a more -- I mean, in terms of an individual rate case, I think that would be extremely difficult to do. If the Commission wanted to take a more generic approach and say for -- I mean, for example, to establish rules. Here we've got rules on how evidence is presented.

If the Commission wants to say, here are the rules on how you present return on equity testimony, these are the required parameters. Of course, you can't prevent parties from adding stuff to it, but if you say you have to present this type of analysis, you have to, you know, pick among these particular inputs, that may do something to head you down that path. But as you said, there's going to be additions to that.

My idea is simply that you wouldn't see over and over again something that, for example, you-all as a body may not find compelling. If -- for example, you've seen something new in this case, the ECAPM. If you don't like that, if you tell us that, maybe you won't see it again. We won't have to waste time in testimony responding to it, and you won't have to waste time in reports and orders discarding it again.

COMMISSIONER CLAYTON: Thank you.

CHAIRMAN DAVIS: Can I jump in here? Mr. Mills, yesterday we had, I believe, in opening statements from both Mr. Thompson and Mr. Coffman, who's not here, we had discussions about if you -- you know, obviously if utilities are concerned about cash flow, they can come in and ask for an interim rate increase. I mean, and it's been my understanding, and this is my impression, that you've been fairly much opposed to interim rate increases. Maybe that's not a fair characterization.

Would it be productive to have a roundtable on interim rate increases that, you know, if everybody agrees, like is apparent in this case from looking at the latest filed reconciliation, that most people agree that Ameren is entitled to at least $60 million, is there -- I mean, is there a way to bridge that gap in the future?

MR. MILLS: Well, there's a couple of ways you can bridge that gap. In terms of interim rate increases, my office has always taken the position, I think the Commission has generally adopted it, that an interim rate increase is granted in circumstances when it's necessary to protect the health and sometimes literally the survival of the utility company.

It's not something that is generally designed just to get a company some more money that it wants a little earlier. It's when a company is in serious financial distress. It's an extraordinary technique under those circumstances. And I think we would certainly hold to that view.

In terms of getting a utility company money earlier, I think the company could always -- I mean, I'm not going to talk about settlement negotiations, but I think the company could almost in any case say, okay, we're going to accept the number that's on the table and walk away, and then file another rate increase.

If there's a reconciliation that all the parties have signed off on that gives X number and then here's what it is, I don't think there would be much difficulty in the parties saying, yeah, we'll settle on that, and the company gets that money almost immediately.

MR. BYRNE: Your Honor, could I maybe address the issue that Commissioner Clayton has raised? I mean, I think there might be some benefit in considering generic proceedings, but our view is, you know, the Commission has in the cases where it's decided the litigation issue of return on equity, the Commission has provided some guidance in those decisions.

We're not working off a completely blank slate like Mr. Mills has suggested. And we've tried to mold our case to fit the standards that the Commission has used in previous cases. And so I think while it might be helpful to have such a generic proceeding, we've already got some guidance from the Commission.

JUDGE WOODRUFF: All right. I believe

we're ready for our next witness, then, which is Dr. Morin.

(EXHIBIT NOS. 3, 4 AND 5 WERE MARKED FOR IDENTIFICATION BY THE REPORTER.)

(Witness sworn.)

JUDGE WOODRUFF: You may inquire.

ROGER MORIN testified as follows:

DIRECT EXAMINATION BY MR. BYRNE:

Q. Good morning, Dr. Morin.

A. Good morning.

Q. Could you please state your name and address for the record.

A. Roger A. Morin, Georgia State University, College of Business, University Plaza, Atlanta, Georgia 30303.

Q. And Dr. Morin, what is your title?

A. My title is Emeritus Professor of Finance, and I'm also Distinguished Professor of Finance for Regulated Industry at the National Center for the Study of Regulated Industry at the Robinson College of Business, Georgia State University.

Q. And Dr. Morin, are you the same Dr. Morin who caused to be filed in this case direct, rebuttal and surrebuttal testimony that's been marked Exhibit 3, 4 and 5?

A. I am.

Q. And do you have any corrections to that prefiled testimony?

A. I have two corrections on the direct testimony.

Q. And what are those?

A. Page 35, line 9 and 10, delete the sentence which begins with I note. The second correction, which is typographical in nature, is on Schedule REM-E2-2. REM-E-2, at the bottom of the table insert average 0.86. Those are my only corrections.

Q. Okay. And as corrected, is the information presented in that prefiled testimony true and correct to the best of your knowledge and belief?

A. Yes, sir.

Q. And if I was to ask you the questions contained in that testimony here today when you're under oath, would your answers be the same?

A. They would.

MR. BYRNE: I would offer Exhibits 3, 4 and 5, and tender Dr. Morin for cross-examination.

JUDGE WOODRUFF: Exhibits 3, 4 and 5 have been offered into evidence. Are there any objections to their receipt?

MR. THOMPSON: No objection.

JUDGE WOODRUFF: Hearing none, they will be received into evidence.

(EXHIBIT NOS. 3, 4 AND 5 WERE RECEIVED INTO EVIDENCE.)

JUDGE WOODRUFF: And for cross-examination, we begin with, looks like MEG's the first one. Noranda?

MR. CONRAD: Yes, sir. Just a couple things.

CROSS-EXAMINATION BY MR. CONRAD:

Q. Good morning, Doctor.

A. Good morning, sir.

Q. I take it from your testimony that you have prepared a rate of return analysis for Union Electric; am I right?

A. Once before in 2002.

Q. But in this case you're submitting one, right?

A. Correct.

Q. Do you consider, sir, the presence of an FAC, and I'll define that term, then I'll probably shorthand it, fuel adjustment clause, to increase or reduce the riskiness of an electric public utility?

A. I believe the presence of an FAC clause does reduce risk to an electric utility, and approximately 90 percent of utilities in the United States have such a clause.

Q. Would you agree with me that -- and let me stop a second. You're obviously familiar with what we call rating agencies such as Standard & Poor's, Moody's, Fitch and so on, are you not, sir?

A. I'm very familiar with them.

Q. Would you agree with me that rating agencies such as those I mentioned are interested in whether an electric utility has a FAC or an FAC?

A. Very much so. The principal reason cited for the downgrade by Moody's for AmerenUE last May was the absence of such a clause.

Q. Dr. Morin, help me out here a little bit. I'm going to try to work with just short answers for you.

A. That was a short answer.

Q. Well, not as short as I would like, sir. I think I tried to get something that you could answer yes or no.

And would you agree with me that these rating agencies primarily function to give creditors or prospective creditors insight into the utility's financial condition?

A. Yes.

Q. In your recommendation, did you make an assumption that AmerenUE had a FAC in place or not?

A. My recommended return of 10.9 percent is predicated on the presence of such a clause, yes.
Q. What recommendation would you have made had there been no FAC assumption?
A. An extra 25 basis points based on bond yield differentials between utilities that have such a clause and the ones that do not. So that would be 11.15.
Q. So I take it from that that you would agree with me that the presence of an FAC is generally considered to present a less risky circumstance for creditors than if there was no FAC, all other things being equal?
A. Yes.
Q. What can you -- you mentioned 25 basis points, and you may have heard counsel Thompson earlier. Are you able to translate that quickly into what that 25 basis points would be worth to customers or ratepayers of Ameren?
A. Since each basis point is worth approximately half a million dollars, you multiply 25 by half a million.
Q. Now, we spoke a moment or two about rating agencies. Do you know what an accumulation period is in an FAC?
A. No.

Q. So if I were to ask you what AmerenUE's proposed accumulation period in its FAC, you wouldn't know?
A. I would not have an opinion on that, no.
Q. Are you aware, sir, of any instance in which a rating agency has changed a rating based on the provisions of a utility's FAC regarding the number of accumulation periods?
A. Rating agencies take a blend of factors into account, not just a single factor when they upgrade or downgrade a utility, and the presence or absence of an FAC clause would simply increase the probability of an upgrade or of a downgrade in the absence of such a clause.
Q. Let me try the question again. Please listen carefully. Are you aware of any instance in which a rating agency changed a rating based on the provisions of a utility's FAC regarding the number of accumulation periods that utility had?
A. That specifically, no, I am not.
Q. If I were to ask you about the recovery period for Ameren's proposed FAC, would you be familiar with that concept?
A. No, I would not.
Q. And so I take it that you would similarly not be aware of any instance in which a rating agency

changed the rating of a utility's FAC as a result of the duration of the recovery period?

A. Rating agencies have an all or nothing attitude --

Q. Are you aware, sir? Are you aware of that? Are you aware of any instances in which that's changed?

A. I'm not aware of that specific reference.

Q. That's the question I asked. Thank you for your answer.

Assuming that Ameren's proposed FAC is approved, how long would you expect it to remain in effect?

A. A very long time.

Q. Would you expect the rating agencies to make the same assumption?

A. Yes.

Q. And you would believe -- agree with me that that would be a reasonable assumption?

A. Yes, it would be.

Q. Are you aware of any instance in which a rating agency changed a rating based on the provisions of a utility's FAC regarding the duration of the FAC?

A. No.

Q. Same question, if you're aware of any change if they considered whether an FAC had to be renewed

every two or three or some number of years?
A. No specific reference to that. Only the presence or absence of such a clause.
Q. Similarly, sir, are you aware of any instance in which a rating agency changed a rating based on the stated intensity or the timing of a prudence review of activities under the FAC?
A. No.
MR. CONRAD: Thank you, Dr. Morin.
THE WITNESS: Thank you, sir.
JUDGE WOODRUFF: MIEC?
CROSS-EXAMINATION BY MS. VUYLSTEKE:
Q. Good morning, Dr. Morin.
A. Good morning. How are you?
Q. Fine. How are you? My name is Diana Vuylsteke, and I represent the Missouri Industrial Energy Consumers.
A. Pleasure to meet you, I think.
Q. You too. I want to start by referring to page 59 of your direct testimony.
A. I have it.
Q. And there you discuss alternative DCF methodologies to use as a check on the results of your constant growth DCF models; is that correct?
A. Yes.

Q. And referring to that testimony, line 7 through 9, you state that while a constant growth DCF model has a long history, analysts, practitioners, academics and regulators, including the FERC, have come to recognize that it is not applicable in all situations; is that correct?

A. That is correct.

Q. Would you agree that the FERC doesn't normally consider a non-constant-growth DCF analysis but does so only when the circumstances in specific cases justify the consideration of that alternative DCF model?

A. The use or non-use of the two-stage DCF model by FERC is predicated on a case-by-case basis. So the answer is yes.

Q. And do you know how often the FERC considers the multi-stage-growth DCF analysis?

A. It usually does for pipelines, but not typically for electrics.

Q. Dr. Morin, are you aware that in Ameren Illinois's most recent Illinois rate case involving the ICC, that the ICC relied on a non-constant-growth version of the DCF study to support a return on equity for American Illinois utilities in an Order issued just a couple of months ago?

A. I am aware.

Q. And referring to page 60 and the top of page 61 of your direct testimony.
A. I have it.
Q. You note that the real GDP growth from 1929 through 2006 was approximately 3.5 percent; is that correct?
A. Correct.
Q. But do you cite a reference for the support of that factual finding?
A. Yes. Ibbotson, now Morning Star Valuation Yearbook 2008 in their discussion of the two-stage DCF model use a growth rate of 6.1 percent in the DCF model.
Q. In his surrebuttal, MIEC witness Mike Gorman quoted Morning Star's finding that over the period 1926 through 2007 Morning Star found that the historical actual real GDP growth has been around 3.4 percent. Do you disagree with Mr. Gorman's testimony that this is Morning Star's finding on the historic real GDP estimate?
A. I do not. And if you add this to expected inflation, you get something close to 6 percent.
Q. Also in Mr. Gorman's direct testimony, he relied on long-term consensus forecasts by economists for five and ten-year GDP growth?
A. Yes, he did.
Q. That indicated a real nominal GDP growth in

the range of 4.8 percent to 5 percent?
A. That's correct. The problem here is that the DCF model requires a perpetual growth rate, not a five to ten-year growth rate. And you're on safer ground if you're going to use this approach, which I support, to use a very, very long-term growth of the U.S. economy rather than just a projection for the next five years.
Q. Do you know whether -- I'm sorry to interrupt. Do you know whether or not consensus economists are projecting real GDP growth over the next five and ten years to be around 3 percent?
A. They probably do, although I suspect they will revise their forecasts given the ongoing financial crisis and economic forecast. That forecast is likely to drop.
Q. Dr. Morin, do you believe that consensus professional security analysts and economists' projections influence investors in forming their investment decisions?
A. Yes. The academic literature supports the notion that stock prices are greatly influenced by recommendations of outside equity analysts, and that stock prices do contain and reflect such information.
Q. Do you know a consensus analyst's forecast of GDP growth that's longer than Blue Chip's?
A. I do not, but I do know the historical

growth rate from the 1920s until now, 6 percent.
Q. Dr. Morin, do you believe that forward-looking expectations may not exactly mirror historical results?
A. I agree with that.
Q. I'd like to refer you now to your rebuttal testimony, page 39.
A. I have it.
Q. Okay. You characterize there Mr. Gorman's DCF study -- I should refer you to lines 11 through 13, and there you characterize Mr. Gorman's DCF study by saying that Mr. Gorman's DCF analysis is results-oriented, self-serving and inconsistent with Mr. Gorman's prior testimony. You state, his rejection of the results from the traditional DCF model has the effect of substantially reducing his recommended return on equity; is that correct?
A. That's correct, and that's shown on page 41 in that table.
Q. I apologize. I'm sorry about that. Do you believe it is self-serving, results-oriented and manipulative for the Federal Energy Regulatory Commission to periodically rely on a non-constant-growth version of the DCF study?
A. No. I was only concerned with the lack of

consistency from testimony to testimony, and my only point here is that if he does reinstate his constant growth DCF model, his midpoint becomes 10.8 percent, which is awfully close to my 10.9.

Q. You talk about consistency, but you testified earlier that the FERC decides whether or not to use that on a case-by-case basis. There are times when the FERC uses it and times when the FERC does not?

A. That's fine for FERC. I'm talking about Mr. Gorman here.

Q. So the inconsistency in itself, you still maintain it's self-serving?

A. It's an inconsistency, put it that way. When somebody uses a certain technique for 90 percent of cases and all of a sudden there's a change, there has to be pretty good reason for it.

Q. That's the FERC. And then do you also believe it was results-oriented, self-serving and inconsistent for the ICC to rely on the non-constant-growth DCF study to support the authorized ROE awarded a few months ago?

A. I believe it was inconsistent with his past testimonies.

Q. I'm talking about the Commission itself in their decision, was that self-serving of the Commission to use that method?

A. I don't know.

Q. Okay. Dr. Morin, have you found that your constant growth DCF analysis did not correctly measure a utility's cost of equity in prior cases?

A. I've always used the DCF method for the past 30 years. I've always used a mix or a blend of DCF, CAPM and risk premium. And there are times when the DCF results are very low and the CAPMs are very high, and conversely right now the DCF results if we were to do it today, all of us here, all the witnesses using very low stock prices, we would get very, very high DCF estimates.

On the other hand, the CAPM has a tendency to moderate these excesses by producing lower numbers. That's why I've always used an average of all the techniques as a moderating process.

Q. Okay. Do you recall in a prior case where you did not include it or decided not to include it in supporting your recommended ROE?

A. I do not recall that. I do not recall ever doing a case where I did not use DCF. I just don't recall that.

Q. Isn't it the case that in testimony in which you -- that you filed in the Delaware Public Service Commission on behalf of Delmarva Power & Light Company, you found that the results of a constant growth DCF study understated the utility's cost of common equity in that proceeding?

A. In all proceedings I always point out that the DCF model typically understates the investor required rate of return because the regulator, the commissions, apply the rate of return to a book value that is typically less than the market value. So there's a chronic inability of the DCF model to correctly specify investor returns. That's just one of the features.

Q. In the Delmarva case, recalling back to that case again, you found that because you understood the DCF model results to understate the cost of capital to utilities because the market to book ratio at that time was greater than 1.0, you made that finding; is that correct?

A. I made the statement, but I did not make an explicit adjustment for it.

Q. Are utilities' market to book ratios still greater than 1.0?

A. They are slowly converging towards one with the stock market debacle these days, but they're still above 1 on average, approximately 1.4.

Q. Dr. Morin, isn't it true that in past testimony you have recommended that the current betas for electric utilities be set aside and a beta derived from a different means be used to develop your CAPM return estimate to support your recommendation in an electric utility rate proceeding?

A. No. That's incorrect. I've always used the ValueLine betas in the last 20 to 30 years, and at some point I did mention that historical betas understate the rising risks of the utility industry. Whereas today, at least prior to the crisis, I would have believed the opposite, where historical betas may overstate a utility's risk. That was probably true prior to the financial crisis.

Right now I think betas understate the risks because investors are in the process of repricing risk essentially.

Q. Okay. Dr. Morin, did you testify on behalf of Mid-American Energy Company before the Illinois Commerce Commission in May 2001?

A. Yes.

Q. Okay. I'm going to go ahead and give you a copy of the --

A. I have it.

Q. I'm sorry. Your counsel asked for a copy, so I'm pulling that. Okay. In that testimony, you relied on a discounted cash flow analysis, capital asset pricing study and a risk premium study to support your recommendation; is that correct?

A. That's correct, as I always do.

Q. And concerning your CAPM analysis in that case, is it accurate that in that testimony you did not rely on the published betas of electric utilities for your CAPM study and instead relied only on the betas for a group of natural gas companies?

A. That is correct, because the -- in 2001-2002 the electric utility industry was experiencing a profound period of transition to a deregulated, more competitive environment, and I thought that the gas distribution utilities would be a better proxy for electric distribution utilities.

Q. And the electric utility betas were lower than the gas utility betas?

A. At the time they were, and today they're about the same.

Q. And that reduced your CAPM return estimate?

A. Correct.

Q. And one of the reasons you cited for your decision to do it that way was that you thought historical electric utility betas are downward biased; is that correct?

A. That's correct, at the time.

Q. And that is not what you did in this case?

A. That's true, because the utility industry has been in a much more stable period in the last five years than was the case in 2001-2002.

Q. Dr. Morin, in your CAPM study in the Mid-American case, you relied on the gas utility group because you believed it to be more risk comparable than the electric utility group and that the electric utility betas were downwardly biased; is that correct?

A. That is correct.

Q. By relying on a beta that was higher than the published betas for electric companies, were your findings and recommendations in the Mid-American case self-serving or inconsistent with other testimony and designed to increase your return on equity estimate?

A. No. They were consistent with what was going on in the industry at the time.

Q. The second issue in this case you have with Mr. Gorman's DCF study is his choice of long-term GDP growth estimates?

A. Yeah. We're in agreement with a lot of things, but one of the disagreements is the GDP long-term growth forecast I think is slightly understated.

Q. Are you aware that Mr. Gorman relied on a consensus economic economist's projected five and ten-year nominal GDP growth as published in the Blue Chip Economic Forecast?

A. Yes.

Q. Do you have reason to believe that the Blue Chip Economic Forecast is not a reliable source of consensus economists' projections and represents a publication that is perceived by the marketplace as reputable?

A. I do not have any problems with that. The problem I do have is using it as a proxy for the very long-term growth component of the DCF model.

Q. And relying on consensus economists' projections is entirely consistent with your recommendation to place reliance on consensus analyst growth rate projections for the DCF model, is it not?

A. Yes, because that's all we have.

Q. Now, referring to your empirical CAPM study, I have a few questions about that. First, are you aware of any published academic research that has relied on ValueLine adjusted betas to support the empirical CAPM?

A. Yes, my own studies, my book, The New Regulatory Finance in 2006, chapter 9 and 10, has a whole bunch of studies that I've conducted and used ValueLine adjusted betas.

Q. Have you ever published a report subject to

peer review on that study?
A. No. Just a lot of textbooks that I've been subject to extensive peer review, I can assure you.
Q. Is that the only study?
A. Well, there's three or four studies in that book.
Q. But they're all done by you?
A. Or my staff, correct.
Q. Okay. And that is the only study that relies on adjusted betas? That's the only one?
A. That's true, because adjusted betas or ValueLine betas were not around prior to the 1980s. So prior to that, all the empirical studies in the literature were conducted using what we call raw or unadjusted betas, before ValueLine betas became systematically available.
Q. So it's your or your staff's study that you published in a book, not peer reviewed, and not published or studied by anyone else?
A. Well, it was peer reviewed by several prominent scholars before final publication of those textbooks.
Q. Now, you've appeared in rate proceedings opposite Mr. Gorman before; is that correct?
A. Yes, I have, several times. Mr. Gorman and I have fenced on a few issues. I mean, I like Mr. Gorman

and I respect his work, and we've had slight disagreements on flotation costs.

Q. Okay. And you appeared in the Delmarva Power & Light proceeding that I referred to earlier?

A. Yes.

Q. And that was where you first encountered Mr. Gorman's argument that an empirical CAPM employed with adjusted betas is inappropriate. Do you recall that?

A. Yeah, I recall that argument, and I, of course, replied to that argument in my surrebuttal saying that the empirical literature finance provides very strong support for the validity of the empirical version of the CAPM. That's why it's used by the New York Public Service Commission in its generic proceeding, which the Commission has shown interest in generic proceedings. It's used as a routine model in their generic determination of an ROE.

Q. Okay. Now I'd like to refer to pages -- to page 28 of your surrebuttal testimony.

A. I have it.

Q. Okay. You state there that you were astonished by Mr. Gorman's statement that the ECAPM is not based on sound economic principles and is not supported by the academic community; is that correct?

A. That's correct. And the next sentence tells you why.

Q. Well, is that exactly what Mr. Gorman's testimony was, actually?

A. Well, obviously he's not a supporter of the empirical CAPM, and I was a little bit surprised because that's one of the most widely known findings in the literature of finance and it's cited in most textbooks on corporate finance.

Q. But your characterization of Mr. Gorman's rebuttal testimony, would you -- is that really a correct characterization of what he actually said in his rebuttal testimony?

A. Well, he does not support or endorse the validity of the CAPM, and that was my response to that.

Q. Do you mind if I come up and show you a copy of Mr. Gorman's --

A. Sure.

Q. Dr. Morin, could you read lines 20 through 22 of that testimony?

A. Line 20, I am not aware of any research that was subjected to peer review that supports Dr. Morin's proposed use of an adjusted beta in an ECAPM study.

Q. Isn't it Mr. Gorman's argument that it is inconsistent with academic literature to use adjusted betas in an ECAPM as you have done in this proceeding because the academic literature supports the ECAPM with unadjusted betas?

A. Well, I just referred you to my own published work in the textbooks that uses ValueLine adjusted betas that supports the validity of empirical CAPM.

Q. But his argument is it is inconsistent with the academic literature in general to use adjusted betas in an ECAPM. That is his testimony.

A. So be it.

MS. VUYLSTEKE: Okay. I don't have any other questions. Thank you.

THE WITNESS: Thank you very much.

JUDGE WOODRUFF: For the State.

CROSS-EXAMINATION BY MR. IVESON:

Q. Good morning, Mr. Morin.

A. Good morning, sir.

Q. Just a couple of questions to clarify. In your surrebuttal testimony, you use the term large capitalization company. How would you define that term?

A. A billion dollars and up. The market cap is the number of shares times the share price, and it's the measure of size of companies.

Q. So anything over a billion dollars would be a large capitalization company?

A. Roughly speaking, yes.
MR. IVESON: May I approach? Mark this as 502.
(EXHIBIT NO. 502 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)
BY MR. IVESON:
Q. My question on this is very simple. Can you identify what that is?
A. Yes. It's a collection of interest rates on various instruments published by the Federal Reserve from November 10th -- on November 10th.
Q. Looking at the upper left-hand corner, it bears a release date of November 17th, 2008; isn't that correct?
A. Yes, sir.
Q. And it is from the Federal Reserve website; isn't that correct?
A. Yes. It's a source of data that I use quite often myself.
Q. And that shows the interest rates for the week of November 10th; is that correct?
A. Yes.
Q. And it also shows the interest rates for the week ending November 7th?
A. Yes.

Q. And it shows the October interest rate; is that correct?
A. Yes.
MR. IVESON: I have nothing further, your Honor.
JUDGE WOODRUFF: Did you wish to offer this exhibit?
MR. IVESON: Yes, please.
JUDGE WOODRUFF: Exhibit 502 has been offered. Any objections to its receipt?
MR. BYRNE: Your Honor, what number is it again?
JUDGE WOODRUFF: 502. Hearing no objections, it will be received into evidence.
(EXHIBIT NO. 502 WAS RECEIVED INTO EVIDENCE.)
JUDGE WOODRUFF: Public Counsel?
MR. MILLS: Just very briefly.
CROSS-EXAMINATION BY MR. MILLS:
Q. Dr. Morin, I'd like to return to the topic of rating agencies and fuel adjustment clauses. Is it your understanding that rating agencies essentially view fuel adjustment clauses as either present or not present?
A. Yes.
Q. They don't get into the details as a yes/no

question?

A. Typically not.

MR. MILLS: Thank you. That's all I have.

JUDGE WOODRUFF: For Staff?

MR. THOMPSON: Thank you, Judge.

CROSS-EXAMINATION BY MR. THOMPSON:

Q. Good morning, Dr. Morin.

A. Good morning, sir. How are you?

Q. I'm fine. Thank you. My name is Kevin Thompson. I'm the General Counsel of the Commission. I'm here representing the Commission Staff.

A. I know who you are.

Q. Thank you. Now, this chart shows the different recommendations that have been proposed in this case. Have you read the testimony of the other ROE witnesses?

A. Yes, extensively, but there is one glaring correction to your chart.

Q. Please?

A. I did not recommend a 11.4 percent ROE. I merely stated that it would not be unreasonable for the Commission to increase the ROE in view of the ongoing financial crisis, but I am not recommending 11.4 percent.

Q. Okay.

A. I am recommending 10.9 with a clause, 11.15

without a clause.

Q. I appreciate that correction. We lawyers are very concrete, and so of course I read your suggestion of an increased ROE to account for the financial crisis and applied it very concretely.

Let's say the Commission does not grant a fuel adjustment clause to AmerenUE. In that case, would you agree with me your recommended return on equity is 11.15?

A. I would.

Q. Okay. And what kind of adjustment would you propose that the Commission make to that figure in view of the current financial situation?

A. I do not have a recommendation at this point in time. I have looked at the data. If I were to update my testimony, obviously long-term government interest rates are down from the day that I prepared my testimony. This would lower the CAPM results and the risk premium results.

On the other hand, the spectacular decrease in stock prices would increase the DCF estimates, and the net effect would be a draw basically between those two opposing forces. So -- and I'm hesitant to amend my recommendation based on the financial crisis, hoping deep within my heart that this is a fairly temporary phenomenon and not a structural phenomena.

And that's why I was reluctant to upgrade my recommendation despite the fact that utilities are now borrowing money at 9 percent, 9.5 percent, which would suggest a much higher ROE if you apply a reasonable risk premium, but I did not do that. I guess as, I'm getting older I'm getting a little bit more conservative, and I think this financial crisis, I'm hoping it's not going to last that long.

Q. So in summary, then, to understand your surrebuttal testimony accurately, you're not advising the Commission to add another 25 basis points to whatever return on equity it comes up with?

A. I am not.

Q. Okay. Thank you, sir. I wanted to get that clear. Now, let me ask you this. Do you consider what you do to be an art or a science?

A. I consider it to be a scientific art.

Q. A scientific art?

A. Yeah. It's judgment that's informed judgment, not just judgment. Informed judgment that rests on very solid economic foundation, on very solid empirical testing, very solid empirical evidence. One of my mentors when I was at the Wharton School always said, of course there's judgment involved in applying financial models, but judgment is really only about 100 basis points thick.

Q. Okay. So you would agree with me that in analyzing the same company at the same time, that you and other financial experts might very well differ in the recommended return on equities that you come up with?

A. I can certainly understand why there are some minor differences. Mr. Gorman and I are pretty close. I'm at 10.9. If he incorporates his standard DCF he's at 10.8 midpoint. To me, that's a legitimate difference of opinion probably attributable to flotation costs. But when you're getting 50, 100 basis points away from that, I'm very suspicious. I smell a rat basically.

Q. What rat do you smell?

A. I smell that there's something wrong with the implementation of the methodologies or the assumptions are not based on informed judgment or the models are inappropriate.

Q. Are you referring to Mr. Hill's recommendation?

A. In part, yes.

Q. Now, you know Mr. Hill, don't you?

A. Yes, of course. I like Mr. Hill. I've known him in many, many different cases.

Q. Do you respect his work?

A. I respect his work, but I don't agree with

his models and his assumptions, but I respect him.
Q. And he doesn't agree with yours either, does he?
A. No, he doesn't, but I have -- I have a lot of evidence on my side in this proceeding, you know. The average authorized return is 10.7. I'm at 10.9 without a flotation, without a fuel clause. So I'm pretty good company here with my 10.9.
Q. Okay.
A. The Commission's authorized 10.8 in a recent case for a company that has a fuel clause. I feel pretty good about my recommendation.
Q. Now, I hate to pick up a line that Mr. Conrad has used, but nonetheless, if I could get you to keep your answers shorter. Thank you, sir.
Now, nonetheless, you agree Mr. Hill is a widely recognized financial analyst expert?
A. Yes.
Q. Okay. And is there anything about any of the recommendations that are in front of this Commission that would make you say that any of them are ridiculous?
A. Well, I think the 9.5 percent is outside any kind of reasonable limits of probability.
Q. Okay. You don't like that one a lot?
A. It's not that I don't like the number. I

just don't like what it is predicated upon.
Q. So you disagree with the assumptions that Mr. Hill used?
A. I disagree with the growth rate assumptions that he has made --
Q. Okay.
A. -- in the DCF model.
Q. Very good. Now, you used, I think, two proxy groups; isn't that correct?
A. Yes. A sample of investment grade, dividend-paying, vertically integrated electric utilities, and a proxy group for the industry proxied by Moody's group or index of electric utilities.
Q. And you would agree with me, would you not, that the other financial experts have criticized your Moody's group?
A. Yes. Some have said that there's some companies that are riskier and it shouldn't be comparable to AmerenUE, and my reply to that is that it has the same beta on average, so it's pretty comparable in risk.
Q. So as long as the beta is similar, then you feel the risk is comparable?
A. Yes. That's one measure of risk.
Q. Okay.
A. Has a prominent role in financial theory.

Q. What about business risk? What if some of these companies were much more diversified in the source of their revenue?

A. That could be the case. That would lower their beta and they would be even less risky if that was the case.

Q. What if some of them were much smaller in terms of capitalization?

A. Then they would be even riskier if that was the case, but usually Moody's Group does not include small cap companies. I don't think that's an issue.

Q. Now, the methods that you used, are they all well-recognized and well-known methods used in financial analysis?

A. Yes. DCF, risk premium, CAPM and an empirical version of the CAPM are fairly standard techniques.

Q. And are those the same methods that Ms. LaConte used?

A. The first three, yes, but she did not rely on an historical risk premium analysis.

Q. But with that difference, I mean, do you have any quarrel with the methods that she employed?

A. Not the methods. Just the assumptions behind the methods.

Q. The inputs?
A. The inputs.
Q. And, in fact, the difference in all these recommendations is explained by differences in inputs, are they not?
A. Yes, correct.
Q. And you employ professional judgment and experience when you select the inputs you use, do you not?
A. I rely on judgment, but supported by empirical evidence and supported by financial literature.
Q. And that's the sort of evidence that all financial analysts rely on, is it not?
A. I'm not sure that's correct. That's what I do. I don't know about the others.
Q. Okay.
A. I'm an academic. I'm a financial scholar basically, and I'm a little bit more, I think, in tune with the financial literature than some other people would be because that's the world in which I live.
Q. Now, that's supposed to be the formula for the discounted cash flow?
A. It is.
Q. Okay. And now, when you use that formula, what -- in that form, what is it you're trying to find?
A. You're trying to find the investors'

required rate of return for a given company.

Q. Okay. Now, who are the investors in the case of AmerenUE?

A. You mean who they are individually? Or I suspect that most of the stock is held by financial institutions, mutual funds, pension funds, bank trusts and some individuals.

Q. What if I were to tell you that AmerenUE, in fact, is a wholly-owned subsidiary of Ameren Corporation, would that change your answer?

A. No. I was referring to the Ameren shareholders because AmerenUE is not -- is not publicly traded.

Q. But this Commission is not setting a return on equity for Ameren Corporation, is it?

A. No, it's not.

Q. Okay. So isn't it a fiction when we talk about investor expectations with a company who has no publicly traded stock?

A. No. We're looking at proxy companies, and we're -- indeed we do have expectation data from investors. That's why we use proxy groups.

Q. With respect to Ameren Corporation?

A. Correct.

Q. But not AmerenUE?

A. These are -- the proxies that I use are proxies for AmerenUE.

Q. Okay. So this would be the appropriate result if, in fact, AmerenUE did have publicly traded shares; is that what you're saying?

A. Correct.

Q. Okay. But, in fact, it does not, does it?

A. It does not. It's an operating subsidiary of Ameren.

Q. So how does it raise capital, if you know?

A. Through its parent company Ameren that issues stock and it raises its own debt capital. Of course it has its own bond rating and must compete with everybody else for debt money.

Q. Okay. So it issues its own debt capital, bonds; is that correct?

A. Correct.

Q. So really we're concerned more with the expectation of bond investors than stock investors; isn't that right?

A. No. We're trying to figure out the cost of equity here, and the cost of equity is predicated on investor expectation as to future growth and risks.

Q. Now, you have systematically added in flotation costs in each of your results; isn't that correct?

A. That's correct, because that's a legitimate cost of doing business.

Q. Do you know if AmerenUE incurred any flotation costs during the test year?

A. It probably did not, but that's irrelevant because by analogy, even if a company is not building a new plant, it continues to recapture the past investments through depreciation charges. It's the same thing for flotation costs. All the past issues of common stock are recovered through an ROE adjustment over a period of time.

Q. So in other words, as an academic, you're saying this is how it ought to be done?

A. Well, that's how I think it should be done. That's how most textbooks say it should be done. Some commissions prefer to expense flotation costs as they are incurred, like in Nevada, for example. Some commissions advocate the kind of adjustment that I support, as in Minnesota and other jurisdictions.

Q. Would you be surprised if I told you that this Commission traditionally expenses flotation costs?

A. If it has expensed all flotation costs associated with past issues, then my ROE adjustment should not be there. It would be double counting.

Q. Now, looking at this equation, the D

represents dividend yield; is that correct?

A. The D over P represents the expected dividend expected a year from now divided by the share price.

Q. But in getting that D, do you exercise professional judgment?

A. That's pretty -- really not a bone of contention. Most people use the current dividend and simply inflate it by one year of growth. That's the conventional wisdom on the DCF.

Q. What about the P figure, do you exercise professional judgment in selecting that figure?

A. Financial theory would suggest using the current spot price because that's the price that's -- reflects all knowable information currently.

In practice, some people average over 30 days or two weeks, and I don't have a problem with that. I tend to use spot prices because I'm using large groups of companies, and any vagaries in individual security will sort of cancel one another out. But the quick answer to your question is, yes, there is some judgment involved.

Q. Certainly if one analyst averages over a period of time and you use a spot price, that's a very different sort of choice, isn't it?

A. It could be. Depends on the behavior of stock prices. If I were to use spot prices today, I would have a very, very high DCF result on your chart. If you divide by P and P's a very low number, you're going to get a very high dividend yield.

Q. What about G, the growth rate, do you exercise professional judgment in selecting a growth rate?

A. Yes, you do. You have a choice of using history as a guide. You can use analyst forecast, which is what I do and what Mr. Gorman does.

Q. Would you agree with me that, in fact, it is in the area of growth rate that there is the most disagreement between the experts in this case?

A. Yes, I would.

Q. And, in fact, the use of a multi-stage or two-stage or three-stage analysis equation is to show different growth rates?

A. I don't have a problem at all with the two-stage growth model at all. The only difficulty is to come up with the inputs for the second stage. But you're right, the multi-stage model recognizes the possibility of various stages of growth in the future as envisioned by investors.

Q. Okay. Now, this one's supposed to show the equation for the risk premium?

A. Correct.

Q. Now, again, when you work this equation, you are attempting to figure out the return that an investor would require?

A. Correct, on common stock over and above the risk-free rate.

Q. Okay. And do you exercise professional judgment when you select the risk-free rate?

A. Some, although that's not very contentious. I think most analysts and most academics, most scholars would use in the context of a rate case the yield on 20 or 30-year bonds as a proxy.

Q. Did all the analysts in this case use the same risk-free rate?

A. Pretty well, yes.

Q. All right.

A. Same proxy.

Q. What about the risk premium, is there -- is there professional judgment in selecting the risk premium figure?

A. Yes, there is. Typically one does it by looking at history. One looks at the return on utility stocks versus the return on treasury bonds and looks at the historical spread between the two, and the judgment comes into play as to your choice of period. You go back 30 years or 40 years or 20 years, that's when the judgment intervenes.

Q. So if you have two analysts each working a risk premium for the same company, you're very likely to get two different results?

A. Yes. One is right and one is wrong.

Q. Okay. It will be your result that's right and everyone else is wrong?

A. No. I'm not saying that. I'm saying my judgment is based on using very long time periods because when you're using historical data, you want to maximize the possibility that expectations are realized over long time periods and they are over long periods or else investors never invest any money. If you're using short periods, you run into a danger that these realized returns might not be necessarily reflective of expected returns. So you've got to use long periods.

Q. Okay. Here we have the CAPM, although as you can see I've reduced a pair of terms to the MRP term. Again, do you exercise professional judgment in selecting a risk-free rate to use in the CAPM?

A. Same answer as before.

Q. What about beta?

A. No, not really. Most people use ValueLine betas. In all my 230 cases I've been in, most analysts, most experts use ValueLine betas.

Q. So that just comes out of a book?
A. Well, it comes out of the ValueLine database.
Q. And did you and the other analysts in this case all use the same beta figures in your CAPMs?
A. Same source, ValueLine. The only difference is because of the timing, my betas are based on last February and the betas have come down since then, and that's the reason for the difference.
Q. Okay.
A. But we use the same source.
Q. Now, with respect to the market risk premium, do you use professional judgment in calculating that figure?
A. That's where the -- the challenge that comes into play here. There is a whole cottage industry around the exact nature of the market risk premium, is it 5 percent, is it 6, is 7, is it 8 percent. There's a huge literature on that topic. And some people use history as a guide. Some people use prospective risk premiums. I tend to use a blend of the two. So yes, there is judgment, considerable judgment involved in determining the market risk premium.
Q. What method does your textbook espouse?
A. It espouses a combination of what I do

here.

Q. Just like you did here?

A. Yeah, a combination of long, long, long-term realized market risk premium and also a prospective risk premium using the DCF model to an aggregate market index.

Q. But there are other textbooks that do it differently, aren't there?

A. There are other textbooks? Not really. There are other -- there's vast literature on the exact nature of the risk premium, yes, huge literature on that.

Q. So there's other analysts who would do it differently than you do it?

A. There's other authors, other academics who have put forth the view that the market risk premium has shrunk over the last few years and that the historical market risk premium does not adequately capture the current market risk premium, but I think what's happened in the capital markets in the last three months would dissuade anyone from the idea that the market risk premium has shrunk.

MR. THOMPSON: Okay. I think that's all I have. Thank you.

THE WITNESS: Thank you, sir.

JUDGE WOODRUFF: Come up for questions from the Bench, then. Commissioner Murray?

COMMISSIONER MURRAY: Thank you.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good morning, Doctor.

A. Good morning.

Q. I want to explore a few different areas with you, if you don't mind. You talked in your testimony about the effect of market to book ratio on the DCF analysis, and you indicated that if a company is trading close to its market to book, if the market to book ratio is close to unity, that results in one thing, but if the market to book ratio is higher than 100, that would result in the DCF analysis overstating?

A. Understating.

Q. Understating. Okay. I have it reversed. Today, I believe that the market to book ratio for Ameren is currently under 100; is that correct?

A. That's correct, and therefore, if you were to apply a DCF model to Ameren per se, that would overstate the DCF estimate for Ameren.

Q. Do you know by how much?

A. No. Very little. The idea that underlies all this, the best way to describe it is with a very, very simple example. If you have a stock that's trading for a hundred bucks and the investor wants 10 percent, that means the company has to generate $10 of earnings, but if the Commission or any Commission turns around and applies that 10 percent to a book value of $50, there's only $5 in the pot. So the investor requirement will not be met. And it works in the reverse direction in the market to book is less than one.

Q. You went through that pretty clearly in your testimony. So it wouldn't make an adjustment, the fact that the market to book ratio has changed and it seems to be dropping almost daily?

A. Right.

Q. Like the rest of the market. That would not change your overall analysis in this case?

A. That would simply eliminate or reduce the understatement of the DCF model. It's not as powerful an argument as it was because market to book ratios are a conversion to one, and the DCF model is fine when stocks are trading around market to book equal to one.

Q. Now, I want to ask you about flotation costs. You've made a statement earlier that if the flotation costs have been expensed, then that would -- your adjustment would not be necessary. Is that what you stated?

A. That's absolutely correct. I have assumed somewhere around 20 to 25 basis points in all the DCF analyses. This was predicated on the assumption that expenses, that the flotation costs incurred by Ameren and its predecessors were not expensed. If they were expensed, then I would be double counting and that adjustment has no place.

Q. So how would that affect your overall recommendation?

A. It would lower it by approximately 20 basis points, if, in fact, the Commission has expensed flotation costs in the past.

Q. So are you saying that your 10.9 with an FAC would be lowered by --

A. It would be 10.7, to the extent that all flotation costs have been recovered. The policy of expensing is fine, except that it needlessly burdens current generations with the full costs of capital that's going to last for a very, very, very long time. So there's a sort of an intergenerational transfer of wealth that takes place, and that's why I believe some commissions are reluctant to expense flotation costs, not to penalize or overburden the current generation of ratepayers with costs of capital that's going to last for many generations. So that's a policy issue that you have to make.

Q. Isn't it becoming more common to use the

10-year treasury as a benchmark for risk-free versus the 30-year?

A. No. I believe most analysts use 20 years or 30 years in my experience. The 10-year is benchmark on television and on CNBC and so forth, but to implement the CAPM, you need to marry or match the maturities of stock, which is infinity, with the bonds that you're using, and the 20 to 30-year is a better match, a better fit between the maturity of stock, which is infinite, and the model. So you want to use the longer maturity on the bond to have apples with apples. I would say 20 to 30 years is fine.

Q. How does a company determine how and when to pay out dividends?

A. Wow, that's quite a question.

Q. That may take a couple of hours, I guess.

A. No, I'll give you a short answer. Most utilities have a target payout ratio, which nowadays is around 60 percent, and they will simply line up dividends with the behavior of earnings basically. So if earnings are growing, let's say, 6 percent, they will try to make the dividend stream grow also at 6 percent to maintain that target dividend payout policy.

Q. Okay.

A. And that depends on the clientele, and people that buy utility stocks are typically people that depend on current income, so they gravitate towards dividend paying stocks, or as more speculative investors, investors of higher tax brackets will gravitate to companies that have returns for capital gains that don't pay dividends. It depends on taxation, clientele effects and so forth.

Q. There is a theory that dividends are double taxed, right?

A. And also dividends are double taxed, and who knows what's going to happen with the next administration on that.

Q. And if a company's return on equity is not sufficient to attract investors, then the company might increase the yield, the dividend payout, is that --

A. No.

Q. If possible?

A. If a company is granted too low a rate of return, it will have difficulty accessing the equity market, and the only place to get equity is to pay less dividends and have more retained earnings. And that will lower the equity ratio, increase the risk of the company, and the debt spiral will begin and ensue.

Q. But don't most utilities try to maintain their dividend payout at a fairly consistent level?

A. Yes, they do, around 60 percent, and they will do everything they can to stay that way, and they will issue bonds or issue stock to maintain that dividend payout ratio. Now, right now we don't know. I don't think anybody can issue stock right now or debt for that matter, but yes, the answer is yes.

Q. In your testimony anywhere did you -- I didn't find it with a quick search for it, but did you have anything, any documents from Regulatory Research Associates Electric Utility Market Data?

A. Yes. In my rebuttal, one of the criticisms that I direct is the returns that are recommended by Staff are quite inconsistent with the mainstream allowed and authorized rates of returns, and that's on page -- I'm quite familiar with the ROE data, if you go to, on the rebuttal testimony on page 6.

Q. All right. Then you just were citing the allowed ROE of the various utilities?

A. Yes. This is the currently authorized ROEs for these companies, not necessarily recent orders, but by sheer coincidence recent orders average about 10.5 percent, 10.4 percent. And if you remove the T&D so-called wires utilities from the ROE data, you get an average authorized return for vertically integrated electric of about 10.6 on average, and most of those companies have fuel clauses. So both the authorized rate of return and recently allowed rates of returns coincide here.

Q. Okay. I am looking at a publication by -- this is SNL Energy Financial Focus Utility Market Comment, week ending November 14, 2008, and included in that is a chart from Regulatory Research Associates Electric Utility Market Data. I won't ask you too much because I know you don't have a copy in front of you, but I think I can ask you some general questions related to Ameren on -- as of the week of 11/14/2008, the Regulatory Research Associates data shows average ROE of 9.5.

A. For Ameren?

Q. Uh-huh, for Ameren Corporation. And it shows yield percentage dividend yield percentage 7.54. Would you disagree with --

A. I'm not sure about that data because my understanding is that this Commission's recent decision is 10.8 percent.

Q. Isn't that -- isn't what would be shown on the Regulatory Research Associates data what their actual --

A. Oh, the realized return?

Q. Uh-huh.

A. Oh, I'm sorry.

Q. Realized?

A. Yes, that's correct. The realized rate of return is much lower than the allowed rate of return because of this regulatory lag issue that was discussed several times.

Q. I thought the 9.5 percent was fairly consistent with what we had in testimony here.

A. That is the realized return, not the allowed return, because of regulatory lag.

Q. And it also shows the current dividend yield at 7.54 percent. Do you know if that's accurate?

A. I think it's lower than that. It's probably around 5 percent right now.

Q. That's what I thought was in testimony that the dividend yield was lower than that. But does the dividend yield vary significantly from month to month or --

A. It has not deviated markedly from about 4, 4.5 percent until recently with the stock price going way down, the dividend yields go way up.

Q. Yields?

A. Yields have been increased very substantially in the last three weeks.

Q. And this also has a column for payout percentage. It shows Ameren at 86 percent. Do you know what that payout percentage represents?

MR. MILLS: Judge, I'm reluctant to object to a Commissioner's questions, but we're having a lot of questions here about a document that's not in the record that none of us have seen, that apparently one Commissioner is reading from a computer screen and asking this witness questions about, and the witness doesn't even have it.

So I think it's going to be difficult for us to respond to this information that's going into the record because we don't know what document this is, where it came from, whether it's reliable or not, or what kind of reliance is being placed upon it. So I'm going to have to object to these questions.

JUDGE WOODRUFF: Commissioner, can you identify more fully what that document is?

COMMISSIONER MURRAY: Yes, and I'm sorry. I realize that does pose a problem, but I'm trying to ask general questions to find out if it can be confirmed whether or not these numbers represent reality.

MR. BYRNE: Your Honor, could I suggest something? We've been going for about two hours, and maybe we could take a break and we could actually get the document.

COMMISSIONER MURRAY: That would be fine, except I have written on it.

JUDGE WOODRUFF: You actually have a document there, you're not reading off the computer screen?

COMMISSIONER MURRAY: Yes.

JUDGE WOODRUFF: We are due for a break. Let's take a break and come back at let's say 10:35.

(A BREAK WAS TAKEN.)

(EXHIBIT NO. 1000 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

JUDGE WOODRUFF: During the break, Commissioner Murray passed out copies of the document that she'd been reading off of. We're going to mark that as Exhibit 1000. And I don't know if -- we'll decide whether it will actually be admitted into evidence, but for now it's just marked. Commissioner Murray, you can continue with your questions.

COMMISSIONER MURRAY: Thank you, Judge. I'm not questioning from this to prove the truth of the document. I'm just trying to understand for my own edification somehow how some of these things are figured and whether these numbers actually are confirmed by the present circumstances according to this witness.

BY COMMISSIONER MURRAY:

Q. First of all, Dr. Morin, would you identify that document, please, that you were handed?

A. SNL Energy, which incidentally used to be Regulatory Research & Associates, Financial Focus Utility Market Comment, week ending November 14, 2008.

Q. So SNL Energy is the same as Regulatory Research Associates?

A. Yes. SNL Energy recently purchased Regulatory Research & Associates. It's now one and the same.

Q. If you'd turn to the chart that begins on page 3 of the document, and what is that titled?

A. I'm looking at Table 1.

Q. Yes.

A. RRA Electric Utility Market Data.

Q. As of what date?

A. 11/14/08.

Q. Would you look at the column under average ROE?

A. Yes, I have it.

Q. And ignore the fact, if you will, that there was some highlighting in there, a couple of circles I had made that I couldn't get erased. I just want you to look at the various average ROEs, and these are realized ROEs; is that correct?

A. That's correct. This is the net income divided by common equity over the most recent 12-month period. So these are realized historical book return on equity, not necessarily what was allowed.

Q. And you say that Ameren chose this 9.5; is that correct?

A. That's correct.

Q. Now, there are a few that are in that range or lower; is that correct?

A. Well, the average at the bottom of the table is 12.7, and some are lower, some are higher.

Q. So in terms of those that are lower, there's -- well, let's look at Nisource for example, No. 18, it shows an average ROE of 6.9?

A. Correct.

Q. So that would represent the realized ROE for Nisource?

A. Correct.

Q. And it also shows a dividend yield for each of the companies that are listed; is that correct?

A. That's correct. That's simply the annualized dividend divided by the stock price shown in the first column.

Q. The annualized dividend?

A. Correct.

Q. And for Ameren it shows 7.54?

A. That's correct. So if you wanted to do a very simple DCF, you would simply add the growth rate to that 7.54 and you would get a DCF estimate.

Q. Okay. So depending on how you determine the growth rate, that would give you your result?

A. Correct, for Ameren.

Q. And there's a Moody's, S&P, Moody's slash S&P ratings column; is that correct?

A. Yeah. Next to last columns are the bond ratings of these parent companies.

Q. Is there any conclusion you can draw from the ways that the companies are rated in terms of their realized ROE, or is there any correlation there at all?

A. I'm looking at the low rated company, the B double A 3s, along that column, and I'm finding Pepco 7.4, Pinnacle West, 7.6, TECO, 9.6, WestStar 8.7. There seems to be a correlation here between the quality of the bonds and the ROE performance. The lower rated companies don't seem to be doing as well in that particular time period as the higher rated companies.

Q. But then you see First Energy?

A. That's correct, yes. Some are higher.

Q. Showing a B double A 3, and its average ROE was 14.1, correct? So is there -- is there ordinarily any correlation between the realized ROE and the credit ratings?

A. There would be correlation between the bond ratings and the average ROE over several years. I would be a little bit reluctant to take simply one result from one 12-month period and infer anything about correlation and bond rating. Most of the time these studies are done between expected return and bond rating. For example, DCF estimates are correlated with bond ratings, but I wouldn't pay too much homage to a one-year realized ROE and its correlation with bond rating.

Q. And really I'm using this chart here not as something that I think would be necessarily a time period that ought to be represented -- representative, but more just to see if these factors are interrelated somehow. Can you tell me if the -- we've got an average ROE of 12.7 and an average dividend yield of 5. Is there a correlation between those averages?

A. No, not really, because the growth rate has to be paired with a dividend yield to get the investor rate of return. So if I were to add the dividend yield to the growth rate, that possibly is correlated with the ROE. In other words, high growth companies could be low dividend yield companies, and conversely very low growth companies can have a higher dividend yield component. It's the sum of the two that would be correlated with the profitability measures and the bond rating.

Q. Do you think that Ameren, take a five-year period, for example, has been -- had results that are about average for the utility industry?

A. My opinion on this is that if you were to do a five-year average, it would be systematically below average because you are in a historical test year jurisdiction, and there's a regulatory lag that's inherent in the regulatory process that causes the utility to have a very difficult time of earning its authorized rate of return because it's always playing catchup, so to speak. Its rates are set on historical costs that are essentially obsolete by the time the rates are in effect. So an inflationary period particularly you're always playing catchup. In a deflationary period, the reverse would be true. You would overearn.

Q. I just want to ask you about risk premium. Is the risk premium a number that stays fairly constant or, in other words, the risk premium that you apply to the current bond yield, is it constant within a range for utilities or --

A. If you look at my direct on page 47, there's a graph.

Q. And I am there. I see a little variation between --

A. That shows at least regulators have on average over the last ten years allowed a risk premium of approximately 5 and a half, 5.6 percent, and it's been pretty stable for the last five years or so. Excuse me. Last ten years. Now, by coincidence the historical realized risk premium is also 5.6 percent, as I discussed earlier on page 44.

So it would appear from this both historical experience and from the decisions of regulators that they have allowed a risk premium of about 5.6 percent on average. When interest rates are very low, they tend to allow a larger risk premium, and when interest rates are very high, the risk premium shrinks.

Q. But generally not more than that range that you've shown?

A. Correct, somewhere between 5 and 6 percent.

Q. And do you think today's market situation would result in -- in that changing?

A. It's difficult to talk about today's markets. Utilities are borrowing money right now at 9, above 9 percent. Even single A companies, triple B companies like AmerenUE is borrowing money -- would be borrowing money if it could at around 9 and a half percent. All the recent bond issues that I've seen in the last three weeks, has been quite a few, are above 9 percent.

So if you are applying an historical risk premium over single As, you would find allowed rates of returns above 12, which is quite consistent with the RAA data that when bond yields are 9 percent, the average allowed rate of return is above 12. I'm not suggesting you do that, but that would be what the current crisis would suggest.

Q. And are you aware of Ms. LaConte's suggestion that the Commission have some kind of a generic proceeding in which we simplify the -- each individual rate case? Are you familiar with what she indicated?

A. Yeah. I'm quite familiar with generic proceedings, and I support Ms. LaConte's suggestion to streamline, to simplify, to make the process more expedient, not to have to read and listen to 500 pages of ROE testimony. And fortunately I've been involved in most of the landmark generic proceedings in the United States and Canada. I was very much involved as one of the witnesses in the California proceeding, and I believe probably the best generic ROE system in the country today is in, of all places, in the state of Mississippi where they have a range of ROE that's allowed by the Commission, and the range is indexed to company performance.

In California, what happens is every three years the major utilities have a hearing along with all the intervenors and they all present evidence, and the Commission, the California Commission decides on an ROE based on that evidence. And let's just say it's 10.75, for example. And then for the next three years, the ROE allowed remains at 10.75 as long as bond yields don't change by more than plus or minus 100 basis points.

If there is a change in the A rated utility bond yield more than plus or minus 100 basis points, there's an automatic adjustment in the ROE so you don't have to have a rate case. So I can certainly envisage a system like that here over a three or five-year period.

Another example that I was very much involved in is the New York generic proceeding for electric utilities, and to this day, 14 years now, the New York Commission relies on this generic financing case, and what they do, they say we will give two-thirds weight to the DCF and one-third weight of the CAPM, and for the CAPM they average the plain vanilla CAPM and the empirical CAPM and they specify exactly the inputs for the DCF. It's a two-stage model using dividend forecasts using six-month stock price. Everything is pretty well determined.
You can almost just take a spreadsheet and out comes out the ROE basically, and that's another way of doing it.

Q. How do you think that's been successful?

A. It's been successful in California. It's been successful in Mississippi. The problem with the New York one, it has not been recalibrated for 15 years or so, and things -- times have changed in terms of the sample of companies they use and the availability of certain data and so forth. So my feeling is, I think it's expedient, it reduces administrative costs, and I think it also provides an incentive for utilities to get the upper end of the range if they can.

And I'm a strong supporter of generic regimes. The entire country of Canada and all the ten provinces are all on this form of ratemaking where they use the CAPM to set an ROE, and then the ROE changes once a year in line with the changes in interest rates. So, for example, if interest rates go up by 1 percent, they're allowed to increase their ROE by 75 percent of that, .75 basis points.

Conversely, if interest rates go down, they would reduce the ROE by 75 basis points. And most of the provinces in Canada, I think all of them are on this indexed ROE formula, and they recalibrate it in most provinces every three years. In the case of National Energy Board, it's every five years.

Another thing that's interesting, in Alberta, which was mentioned by Ms. LaConte yesterday, is they determine an ROE for all the utilities in, let's say in Missouri, for example, and they make risk distinctions using the equity ratio. So in Alberta they will say, well, utility X, you're a little bit more riskier than average, we will impute a higher common equity ratio. And the other utility Y, well, we think you're less risky than the average Missouri utility, we'll impute a lower equity ratio. So they adjust for risk using equity ratios. That's another interesting feature.

So I would encourage the Commission to sort of contemplate such a possibility and perhaps having some brainstorming sessions. And one of the things that I do a lot in the United States and Canada and in Europe is brainstorming sessions with Commissioners about things like PBR, performance based ratemaking, outside the context of a rate case of course, and I think it's a worthwhile idea to pursue and for the intervenors as well.

Q. And you mentioned Mississippi in your opinion as having the best system; is that correct?

A. Yeah. They have a benchmark ROE every year, and there's a formula, it's almost like a robot, like a mechanical formula that's an average of DCF, CAPM and risk premium and they come up with a benchmark. If the company's earned rate of return is within the range of that benchmark, no rate increase, no rate decrease. If the company is earning more than the band, the band set by the ROE benchmark, there's automatic rate decrease. If the company earns below the band, there's automatic rate increase.

What's interesting about the band, the ROE range that's allowed, it's indexed to management performance. So if management performance is stellar, for example, the band increases by 50 basis points. If management performance is very, very poor, the band decreases by 50 or 100 basis points, and performance is determined according to load availability, comparisons of rates with the southeastern average in the case of Mississippi, load factor. There's four or five benchmarks that they use.

I have a whole chapter in my latest book called New Regulatory Finance which is devoted to essentially the Mississippi plan.

Q. Was that determined through a generic --

A. Yes, it was.

Q. -- record proceeding?

A. In 1984, the company, the intervenors, the consumers council, the industrial intervenors all got together and hammered out this. It's called a PEP, P-E-P plan, performance evaluation plan, and everybody signed on to this thing and it's been in operation since 1984.

Q. Thank you. I appreciate that information. One minute.

COMMISSIONER MURRAY: That's all the questions. Thank you.

THE WITNESS: Thank you.

JUDGE WOODRUFF: Commissioner Gunn?

COMMISSIONER GUNN: I don't have a whole lot of questions for you. I do have a couple.

QUESTIONS BY COMMISSIONER GUNN:

Q. When you were doing your analysis about -- with the fuel adjustment clause, did you have a particular assumption about what the pass through ratio would be? Did you assume 100 percent?

A. I assumed it was a one to one mainstream type of fuel clause, one on one.

Q. And if there was -- if it was a 50/50 pass through, would that change the analysis?

A. It probably would. I think the credit rating agencies would be a little bit more alarmed if the fuel clause contained a lot of sharing mechanisms that were outside of the mainstream, but most fuel cost adjustment regimes are one on one, one to one pass through.

Q. Let's talk about those rating agencies for a second. When you -- when you took your groups and looked at the bond rating, did you do any inquiry as to the appropriateness of the bond rating? Did you assume that Moody's and Standard & Poor's and Fitch's rating was absolutely correct?

A. Yes.

Q. This is a little bit of a pet peeve of mine, because -- do you know what the rating for Lehman Brothers was the day before it filed bankruptcy?

A. Yeah. It was investment grade.

Q. It was A2?

A. A2, yes.

Q. A2.

A. I understand your concern.

Q. S&P had it at A1 one week before its collapse, and Fitch's has it as an A, and then on the day of the collapse, on the day they announced bankruptcy, it was only then that they downgraded. So I actually think there's a huge weakness in the underlying assumptions that the Moody's and Standard & Poor's ratings are appropriate. There seems to me to be a fundamental flaw if they do apparently no analysis to determine the health of the company up until the point that they collapse.

I don't know why we are relying on it or why Wall Street is relying on it or banks are relying on it to decide whether capital -- what the cost of capital is and whether it's appropriate to lend money to companies.

A. I share your concern, particularly for unregulated companies, but I think for utilities it's less of a concern because they are regulated, they are monitored, they're under surveillance by the board, by the Commission here.

Q. But the -- if we take a look at the last time that Ameren was -- and I don't fault the company for this, it's not their fault, but the last time they were downgraded was because of the absence of a fuel adjustment clause. There weren't -- there wasn't a change in leadership. There wasn't a change in direction. There wasn't a huge change in the costs. It was essentially that they didn't receive, you know, as big of an increase as they wanted here, but also that they didn't get a fuel adjustment clause.

Now, I don't believe that they did an inquiry as to whether a fuel adjustment clause was appropriate. They just looked at other utilities and said, well, they all have fuel adjustment clauses, so obviously that makes you more risky than some of the -- these other utilities. Would you agree with that assumption?

A. I would agree with that assumption, but the only role that bond rating plays in my testimony and most of the other witnesses is that we want our sample companies to be investment grade.

Q. And I understand --

A. That's the only role that it plays.

Q. I understand that completely, and again, like I said, this isn't a problem with your testimony. It's not a problem with the company. There is -- we need to take a look at what these -- at the relationship between what the reasoning is behind these bond rating companies. I think for too long we've taken them at face value, and there is now demonstrable evidence that they may not know what they're talking about. So I'll get off my soapbox here in a second.

A. I share your concerns with the corporate sector, less with the utility sector, but I kind of share your concern.

Q. Thanks. Now you talked about -- and I just want to clarify something. You said that because of the regulatory lag with the historic test year in a deflationary economy, that that would actually potentially cause the company to overearn?

A. Correct.

Q. Whereas in an inflationary economy, --

A. Under-earn.

Q. -- they would be under-earning?
A. Correct.
Q. There have been articles out fairly recently, I think as early as yesterday, for example, one in the Washington Post, that there is some concern that we may be entering with the collapse of the economy and the collapse of prices, especially fuel prices and things like that, that we could be entering a deflationary stage, and so I'll ask you to put on your forecasting hat a little bit. Does that change your analysis? Let's assume not a -- let's assume that we enter into at least a stable or slightly deflationary economy for the short term, for the next year. Does that change your -- would what change your analysis and how so?
A. No, it would not change my analysis, because we know what the costs are for commodity for the next 12 months for steel, for metal, for labor, for maintenance, for copper and for aluminum, we know pretty well. I don't think we can expect a huge deflationary avalanche, if you wish, for the next 12 months. I don't think so. But if there was a chronic deflation, the utility, the historic test year would gain rather than lose. It's a two-edged sword.
Q. That would be something we would deal with --

A. Next rate case.

Q. -- in the next rate case?

A. Yeah. Absolutely.

Q. Because of the regulatory lag, we would --

A. But I would encourage examining a forward test year.

Q. I think that's -- except for one more thing. The counsel and you testified that one of the reasons why you discounted Mr. Gorman's testimony was because he uses a model 90 percent of the time and doesn't use it in this case?

A. Correct.

Q. And you call it inconsistent?

A. Correct.

Q. It's not really inconsistent, though, is it? I mean, when you use a model 90 percent of the time, it assumes that there are certain cases in which you do not use the model. If it had been 100 percent of the time, it would have been inconsistent.

A. Well, I --

Q. The fact that you don't use it every time is consistent, so it's not really inconsistent?

A. Well, to me it is, but the only comments I have on that is that if, if the standard DCF result had been incorporated and is rave results, the midpoint would have been 10.8 percent, which is what the Commission ordered them to do in the last case.

Q. Do you do exactly the same analysis in every case?

A. Pretty well, yes.

Q. Well, pretty well or in every case?

A. I would say in every case in the last several years I do the same thing.

Q. Has it evolved from years prior?

A. Yeah, but when I change methodology, it's huge. It's a major, major landmark event in my consulting life where I explain it very well why I did. And it's nothing wrong with somebody changing methodology, but it's just a little bit inconsistent. If I was a commissioner, I would love to see consistency from case to case unless there was a darn good reason to change.

Q. Well, we might be able to ask Mr. Gorman to explain that.

A. Excuse me?

Q. We might be able to ask Mr. Gorman to explain.

A. Absolutely. I'm sure he has a good explanation, too.

Q. Then we might be okay.

COMMISSIONER GUNN: That's all the

questions I have, Judge. Thank you.
JUDGE WOODRUFF: Commissioner Jarrett?
QUESTIONS BY COMMISSIONER JARRETT:
Q. Good morning, sir.
A. Good morning, sir.
Q. I have just a couple of quick questions. I have just a couple of quick questions. You remember the chart that Mr. Thompson put up with -- basically it was a table of all the recommended ROEs from the various witnesses in this case? Do you recall that?
A. I do.
Q. And I know you had some corrections on your part, but at least a couple of the recommendations were in the 10.2 range. Do you recall that?
A. Yes.
Q. And Ameren's, in their last rate case I believe this Commission approved a 10.2 ROE?
A. Correct.
Q. And would it be fair to characterize, then, those folks that are around 10.2 as that, you know, sort of a status quo, things are the same, so give them the same ROE? Would that be a fair characterization?
A. You could say that. I mean, nothing ever is the same.
Q. Right.

A. We're certainly in a different environment now than we were in those days.

Q. And that was my next question. Can you give me some examples of what is different in the environment today that we need to consider that the previous Commission that decided that case might not have had to consider?

A. Two or three come to mind. One of them is the alarming rising costs that are experienced by utilities for materials, for labor, for commodities, fuel and so forth.

The second one would be this company and many other utilities having a gigantic construction program ahead of them. AmerenUE is contemplating investing around $3 billion in the next several years, and their rate base is $6 billion. So they're going to be increasing their rate base by 50 percent, and half of that will have to be financed by debt, the other half by equity approximately. So it's imperative that they maintain access to capital markets at the lowest cost possible.

The third factor that's different is the company's bonds were downgraded by Moody's last May for many reasons, but the main one being a lack of a fuel clause. And as we speak today, Fitch has put the company's bond under a negative outlook, pretty well for the same reasons. So those are the three factors that dictate to me that a more accommodating or generous ROE would be in the cards.

The fourth factor would be that what the Commissions have done around the country for vertically integrated utilities is award on average about 10.6, close to 10.7 percent ROE, which is pretty close to what I recommend and -- and given the lack of a fuel clause, one would think it would be even higher. So the 10.8 percent that you granted Empire District I think was fair and reasonable. So those are the three things that come to mind right now.

Q. And are you -- are you aware of any cases where, like, the rating agencies, S&Ps, Moody's, have downgraded because they felt that a company was granted an inadequate ROE by a Commission?

A. Yes. The spectacular example of that was Con Edison about two, three months ago. The awarded ROE was one of the lowest in the country. This was a T&D, ConEdison, a T&D wireless utility, was 9.1 percent and the headline, the heading of the document published by Moody's and S&P was Con Ed granted the lowest ROE in the country, and this was the direct cause of the downgrade. So that's a rather dramatic example.

Q. Right.

A. And it's very rare for bond rating agencies to speak that way, to talk about ROE and highlight, you know.

Q. And I believe in your testimony, your direct testimony you talk a little bit about the fact that lower ROEs make it harder to raise common equity?

A. Well, absolutely. If investors have a choice between utility X, utility Y, and one has a 10.7 for an ROE, the other has 10.2, you would think you would gravitate towards the one with the 10.75.

Q. Right.

A. And I've learned through the years that more is less. If you have a good, solid, fair, supportive ROE, it translates into lesser cost later, into a higher bond rating, single A as opposed to triple B, for example, and it's easier for the company to raise money. And if it costs the company 25 basis points less than it would otherwise, for example, for every $100 million that this company would borrow, it would cost 5 million more for the ratepayers on a 20-year bond issue if you're A rather than triple B. And this company's going to raise at least a billion dollars in debt, so we're talking about $100 million savings here if the company's rated single A as opposed to triple B. So in that sense, I say more is less, you know.

Q. Thank you. And just another quick question or a couple quick questions. I believe Ms. Vuylsteke asked you a question about Illinois Commerce Commission case, Mid-America I think was the name?
A. Yes.
Q. Are you familiar with that?
A. Yes.
Q. Can you give me some more details about that case? What it was about?
A. I think that there were two Mid-American cases I was involved in. One was for a very specific generation plant investment, and the other one was for distribution activities,
Q. Do you remember which case was the one where she was talking about?
A. I think it was the distribution case she was talking, the natural gas companies as proxies for distribution.
Q. Right. And is Mid-America primarily a gas?
A. No. They're primarily --
Q. Primarily electric?
A. More electric than gas. And, of course, they're been bought out by Warren Buffet.
Q. Do you remember what the ROE --
A. No.

Q. -- in that case was awarded?
A. No. I could check that during the break. It was 2001 or 2002.
Q. It was a 2001 case?
A. I'll check for you.
COMMISSIONER JARRETT: Thank you. I have no further questions.
JUDGE WOODRUFF: Chairman Davis?
QUESTIONS BY CHAIRMAN DAVIS:
Q. Good morning, Dr. Morin.
A. Good morning, sir.
Q. Do you recall what the ROE awarded to the various Ameren subsidiaries was in the recent Illinois rate cases?
A. No, I do not.
Q. Obviously we've had a lot of talk about DCF. Do you have an opinion as to whether the quarterly DCF should be employed or not?
A. Yes. I typically rely on the annual DCF model, even though dividends are paid quarterly, and the reason for that is a very subtle one. If you're on a forward test year and you use the quarterly DCF model, you're being overgenerous to the utility. And the best way to explain that is with an example that if you put $1,000 in the bank and next year it accrues to let's say

$1,100 because you've made 10 percent, the Commission would apply an ROE on 1,100 rather than a 1,000 in the case of a forward-looking rate base. So in the case of forward-looking and forward test year jurisdictions I tend to use the annual model.

In the case of a historical jurisdiction, as is the case in Missouri, I would probably use a quarterly DCF model. I did not in this case because I guess I'm becoming a little bit more conservative over time, and I just felt conservative was indicated at this point in time. But the quick answer to your question is yes, particularly in a historical test year.

Q. Traditionally, I mean, even if you had employed a quarterly DCF model, you're looking at --

A. 20 basis points more on the DCF estimates.

Q. You think -- you think it's higher, 20 is that --

A. Definitely, yes. There's a whole chapter in my book that compares the two models for various growth rates, various stock prices, various dividend, and instead of 10 percent, it would be 10.2 percent, or instead of 10.5, it will be 10.7. It's kind of like if you're going to the bank and you get, you know, 10 percent on your money compounded annually, and the bank across the street is compounded quarterly, the 10 percent will be become

10.2 percent at the bank that compounds quarterly.

Q. And I was thinking it would be more along the lines of five basis points.

A. I think that was a wrong impression. Definitely is 20 basis points. Chapter 14 in my book. It's called Quarterly DCF Model.

Q. I own the book.

A. Well, if you have insomnia, it will definitely cure you, especially the chapter on quarterly timing. It's 20 basis points, but I did not use this.

Q. Right. Okay. Is there anything else that you want to add that you think is important that we should know?

A. Yeah. We're going through a very difficult time right now, so I would err on the side of conservatism rather than -- and meaning the side on a supportive or reasonable ROE right now because this company is looking at a huge, huge capital budget that's fairly nondiscretionary.

And I think it's important to restore the company's capital attractability and solidify its bond rating, and we don't want to see a downgrade from Fitch, and I think a reasonable supportive rate order would contribute a lot to the company's financial health and then ratepayers.

But I think a lot of my concerns have been discussed here with the lines of the questions that you've pursued, and I think you should examine the possibility of a generic ROE in the situation to avoid all this.

Q. Do you really think that a generic ROE proceeding would end it?

A. Yes. I think it would solve it.

Q. End what now?

A. It would end -- well, you'd have to suffer once every five years or once every three years listening to all the experts and so forth, and then decide once and for all on the ROE benchmark, and then you'd have peace of mind for expediency and less costs for three years to five years. And I'm assuming that everybody would sign off on this and would be happy with the benchmark, but it would be hell to pay for that generic proceeding. You'd have to listen to the same kind of stuff we're doing today.

Q. In questioning from I believe it was the Attorney General's Office, I believe you characterized any company with more than a billion dollar market cap as a large cap; is that correct?

A. Correct. The Ibbotson/Morning Star Valuation Yearbook uses that as a cutoff point to define small caps and large caps, and I think that's a useful cutoff point.

Q. Where would a mid cap fall?

A. Mid cap, 500 million to a billion. These are arbitrary, you know.

Q. Right, because it's my understanding that -- that others use different -- different thresholds that, you know, under a billion would be a small cap, under 300 million would be a micro cap.

A. Micro cap.

Q. 1 to 10 billion would be a mid cap, anything over 10 billion would be a large cap?

A. My cutoff is 1 billion, but I don't have a problem with your cutoff. The S&P 500 is about what you suggest, 10 billion cutoff. It was. I don't know if it is anymore.

Q. All right. And obviously in preparing your testimony in this case, you reviewed Ameren's fuel adjustment proposal?

A. Yes.

Q. Okay. And so you felt comfortable making the 10.9 percent ROE recommendation with a 95 percent pass through?

A. No. My 10.9 percent is predicated on the adoption of the fuel clause.

Q. Right. It's predicated on adoption of the fuel clause, but it's a 95 percent pass through fuel clause?

A. I don't have a problem with that.

Q. Okay.

A. You couldn't split hairs any more, whether it was 80 or 90 or 95 or 100. It would be very hard to quantify that into basis points.

Q. Okay.

A. Bond rating agencies tend to think all or nothing basically.

Q. Okay.

A. Although they do favor sort of mainstream one on one or close to one on one pass throughs.

Q. Okay. So is it fair for me to have gotten the impression earlier, though, that it's your opinion that 50 percent didn't cut it?

A. You're quite right. You read through my mind. I don't think it would cut it with the rating agencies. They would be much more concerned 50/50 than they would be one on one. That would produce some volatility in the earnings stream, more risk and so forth.

CHAIRMAN DAVIS: Okay. No further questions, Judge.

THE WITNESS: Thank you, Chairman.

JUDGE WOODRUFF: All right. We'll come back, then, for recross based on questions from the Bench beginning with MEG. Noranda?

MR. CONRAD: Just a couple. Well, maybe more than a couple, but not a great many more. What are we referring to this as (indicating)?

JUDGE WOODRUFF: That's Exhibit 1000.

MR. CONRAD: The sponsor of it was?

JUDGE WOODRUFF: Pardon me?

MR. CONRAD: The sponsor was?

JUDGE WOODRUFF: Commissioner Murray. She's not offered it into evidence. She --

MR. CONRAD: So it has not been --

JUDGE WOODRUFF: It has not been offered into evidence.

MR. CONRAD: It's just been marked, although she has obviously marked it herself.

JUDGE WOODRUFF: Yes.

RECROSS-EXAMINATION BY MR. CONRAD:

Q. Well, let me just ask the witness a couple then in this nature. Do you have before you, sir, what has been marked for identification at this point Exhibit 1000?

A. Yes.

Q. Did you prepare that?

A. No.

Q. Was it prepared under your direction or your supervision?

A. No. We're talking about the SNL exhibit?

Q. Talking about what's been marked for identification as Exhibit 1000.

A. No, I did not prepare that. It was prepared by SNL Energy.

Q. Did you prepare the copy?

A. No. It was submitted to me by the Bench.

Q. On the second -- I guess it's actually the second physical page of that document, there is a chart. Do you see that chart, sir?

A. Yes.

Q. And I think particular attention was given by someone apparently to line 3, and particular attention I think was drawn to the average ROE column. Do you see that?

A. Yes.

Q. Now, is that a number that is related to the 12 months earning numbers?

A. Yes. It's the realized ROE over the 12 months earnings.

Q. Would you agree with me that you can get to earnings by increasing revenues and leaving expenses alone?

A. Well, everything else remaining constant, if you increase revenues and you hold cost constant, it will increase earnings by definition. Not necessarily earnings per share.

Q. Would you agree with me that -- well, we're going to assume all other things are equal, that there hasn't been any issuance of stock, right? You'll indulge me in that assumption, won't you?

A. Sure. Yes.

Q. Would the same thing be true if you were to freeze revenues and reduce expenses?

A. The same would be true, everything else being constant.

Q. If you were to assume with me that the expenses for Ameren Corporation identified there as line 3 were to go down by 300 to $400 million, what effect would that have on the average ROE?

A. Well, clearly if you reduce your expenses, everything else remaining constant, you would increase your net income and that would increase the realized ROE.

Q. Do you have any idea to what number that would rise?

A. No.

Q. Would it also affect the yield on a dividend?

A. Not necessarily. It certainly would affect the stock price, therefore the dividend yield indirectly.

Q. But your testimony is that that kind of a change would affect the ROE by raising it, correct?

A. Yes.

Q. But you have no opinion at this point as to how much?

A. Correct.

Q. Commissioner Gunn asked you a question that elicited from you a response that you knew what prices for steel and other commodities were. Do you recall that?

A. Yes, I do.

Q. What is the price for steel today?

A. I don't know what it is per ton, but my statement was based on my last week's experience at a hearing in Minnesota on behalf of Minnesota Power, Elite, essentially Elite, and there were major reports of cutbacks and reductions in shifts in taconite and steel industries in that state, which are responsible for 60 percent of the company's revenue. So this is where that statement came from.

Q. So your answer is you don't know?

A. I don't know the exact price. All I know is that it has come down.

Q. You also mentioned aluminum. Do you know what the price for aluminum is today?

A. No, I do not.
Q. Do you know what the price for aluminum was four months ago?
A. No, I do not, but I suspect it's down.
Q. Do you know what the London Metal Exchange price for aluminum is?
A. No.
Q. Do you know where London is located, sir?
A. London, Ontario or London, England?
Q. Let's try England. Is England on the same world that you are, sir?
MR. BYRNE: I'm going to object to the annoying and argumentative nature of the questions from Mr. Conrad.
MR. CONRAD: It's a world price. Is it the same world?
MR. BYRNE: I'd like a ruling on my objection.
JUDGE WOODRUFF: I will caution counsel to avoid argumentive questions. You can go ahead.
BY MR. CONRAD:
Q. Do you know what the price of aluminum is?
A. I do not.
Q. So if I were to -- if -- you have no idea whatsoever about what changes have occurred in the price

of aluminum in the last four months, do you?

A. Other than they have declined precipitously, I do not know the exact price, nor did I need to know those in preparing my testimony.

Q. So you've testified that the cost of steel and the cost of aluminum have both declined, and in the case of aluminum you used the term precipitously?

A. The prices have come down, yes.

Q. What does precipitously mean?

A. Dramatically.

Q. What does dramatically mean?

A. Precipitously.

Q. You're going to have to help me out more than that. Can you put it in percentage terms?

A. 15, 20 percent.

Q. Or greater?

A. Or greater.

Q. So if it was greater than that, that would be really dramatic or really precipitous, wouldn't it?

A. Yes, it would.

Q. And what does the electric utility use aluminum for?

A. You'd have to ask the company engineers about that.

Q. You have no idea?

A. No.

MR. CONRAD: I think that's all. Thank you.

JUDGE WOODRUFF: And for MIEC?

RECROSS-EXAMINATION BY MS. VUYLSTEKE:

Q. Dr. Morin, you testified in response to some questions from Commissioner Murray on the generic proceedings on ROE issues to explore options or standards that would be valuable for the Commission and for intervenors; is that correct?

A. Yes, ma'am.

Q. And there was also some discussion earlier, if you were here for that, responding to a question on the possibility of some generic dockets regarding interim rate increases to improve utility cash flow?

A. Yes, I remember that.

Q. In general, why are such investigations valuable in your view?

A. To expedite and streamline the regulatory process and to reduce costs, both direct and indirect, to ensure certainty in the process, and that would be of interest to ratepayers, industrial and residential and commercial.

Q. Would a docket on possible financing options for a nuclear power plant also be useful for similar reasons?

A. Yes, it would, definitely.

MS. VUYLSTEKE: Thank you.

JUDGE WOODRUFF: For the State?

MR. IVESON: Thank you.

RECROSS-EXAMINATION BY MR. IVESON:

Q. Dr. Morin, just a -- try to get some clarification. I believe it was in response to a question from Commissioner Jarrett, you gave some testimony regarding hypothetical savings if the rate of return were at a level you suggested, savings on costs of borrowing?

A. Uh-huh.

Q. I believe you said if the investment grade would go up to A, there would be a 25 basis points savings; is that correct?

A. Yeah. If the company is upgraded from triple B to single A, let us say there's a spread of 25 basis point, which is .25 percent, for every $100 million that the company raises over 20 years, it would increase costs to ratepayers by 10 million, or for every billion dollars, it would increase costs by 100 million, if the spreads were -- excuse me, if the spreads were 50 percent. I misspoke. If the spreads were 25 percent, it would cost the ratepayers an additional $50 million every time they raise a billion. So it's in that sense that I say more is less.

Q. So let's assume it was a 50 basis point spread that would save 100 million over the 20-year life of the bonds.

A. Correct.

Q. That would be for a billion dollars worth of borrowing?

A. Correct.

Q. I think you testified earlier that the company was looking at spending approximately $3 billion?

A. That's correct.

Q. So we're talking 300 million over 20 years?

A. Exactly right.

Q. For each basis point on the return on equity recommendation, there is a $500,000 increase; is that correct?

A. Correct.

Q. So given the 70 basis point spread between the recommendation, that's approximately $35 million?

A. Correct.

Q. That's approximately $35 million every year, correct?

A. Correct.

Q. So over the 20-year life of this, the ratepayers would be paying $700 million; is that correct?

A. Well, if you've got to increase the ROE, this will reduce the risk to the company, and the cost of equity will decline over time also.
Q. Just answer, the ratepayers would be paying $700 million more over the 20-year period if your rate of return recommendation is adopted, correct?
A. Assuming no rate case, no future -- yes.
Q. Assuming all else stays equal?
A. Correct.
Q. So the ratepayers would be paying $700 million to save 300 million dollars, correct?
A. That's correct, but --
Q. Thank you.
A. But you're neglecting the fact that if the company becomes less risky, the cost of equity will decline in the next rate case.
Q. Assuming there is another rate case?
A. That's a fairly good assumption, though, they would be.
Q. I've got a $400 million spread, I might not file that rate case. Thank you.
JUDGE WOODRUFF: Public Counsel?
RECROSS-EXAMINATION BY MR. MILLS:
Q. Just briefly. You had some questions from the Bench about generic proceedings and I believe your

recommendation was that that -- or your general suggestion was that that is a fairly good process; is that true?

A. Yes, sir.

Q. Do you believe that the outcome of such a process would be better overall if all parties are able to participate on a financially equal basis?

A. Yes.

Q. Thank you.

A. That was the case in Mississippi.

Q. And how did that come about that all parties were able to participate equally?

A. Well, there was a lot of nudging from the Commission. There was a lot of political pressure. There was a lot of good will on the part of all parties to streamline the process and reduce cost.

MR. MILLS: Thank you. No further questions.

JUDGE WOODRUFF: For Staff?

RECROSS-EXAMINATION BY MR. THOMPSON:

Q. Dr. Morin, with respect to the generic proceeding you were discussing, you're not offering an opinion as to whether Missouri law allows that, are you?

A. Not at all, no.

MR. THOMPSON: And Judge, at this time I'd like to offer Exhibit 1000 we've been discussing.

JUDGE WOODRUFF: All right. Exhibit 1000 has been offered. Are there any objections to its receipt?

MR. CONRAD: Yeah. It's hearsay and no foundation.

JUDGE WOODRUFF: Any response to that?

MR. THOMPSON: None whatsoever.

JUDGE WOODRUFF: I'll sustain that objection and Exhibit 1000 will not be received.

BY MR. THOMPSON:

Q. Now, Dr. Morin, we were talking about -- you were asked some questions about a chart, I think on page 47 of your direct.

A. I have it.

Q. Okay. And do you still have Exhibit 502 up there that the State of Missouri handed you?

A. (Indicating.)

Q. Yeah. I wonder if you could find the 30-year treasury rate on there?

A. Yeah, 4.21.

Q. 4.21. Now, if you add that to the 5.6 from the chart on page 47 of your direct, what number do you get?

A. 9.8 less flotation costs. That's assuming, of course, constancy of the risk premium and if you neglect all the other tests.

Q. Okay. Are you done?

A. Yes.

Q. Thank you. Now, with respect to the numbers that Commissioner Murray was asking you about on Exhibit 1000 that has not been received into evidence, take a look at those allowed return on equity figures, earned return. I'm sorry.

A. They're not allowed returns.

Q. Thank you.

A. They're average. They're realized returns.

Q. Realized returns. Okay. What is a realized return?

A. Historical return, what the company did over the last 12 months.

Q. So do you know if those figures have been adjusted in any way for ratemaking purposes?

A. Probably not, because these are parent company consolidated figures.

Q. Okay.

JUDGE WOODRUFF: Mr. Thompson, you need to use the microphone.

MR. THOMPSON: Sorry, Judge. I have no further questions. Thank you.

THE WITNESS: Thank you.

JUDGE WOODRUFF: All right. Any redirect?

MR. BYRNE: Yes, your Honor.

REDIRECT EXAMINATION BY MR. BYRNE:

Q. Good morning, Dr. Morin.

A. Good morning.

Q. First thing I'd like to ask you about is Commissioner Gunn asked you some questions about some problems with rating agencies, and I think it dealt with the whole problem with Lehman Brothers and how they didn't foresee the bankruptcy. And I guess my question to you is this: In spite of whatever flaws they might have, don't the -- do the rating agencies determine access to capital and the cost of capital for corporations?

A. That is, in fact, correct. Most institutional investors require a bond rating, most of the time investment grade bond rating before they even contemplate purchase of any bond or any securities.

Q. Do investors of all types rely on Moody's and Standard & Poor's and Fitch's?

A. Yes, they do, particularly institutional investors, and a lot of them have in-house rules about the minimum grade requirement before they invest money. For some it's investment grade. For some insurance companies it's minimum A rating, so there's a huge importance attached to bond ratings before investing money on the part of financial institutions.

Q. And Commissioner Gunn also asked you some questions about the possibility of entering a deflationary period. Do you remember that?

A. Yes.

Q. When was the last time the United States was in a sustained deflationary period?

A. Decades and decades and decades ago.

Q. Was it in, I mean, at least in the Great Depression?

A. 1930s I was going to say.

Q. And since then have we pretty steadily had inflation?

A. Correct.

Q. There's a lot of questions about the impact of the credit crisis, and Mr. Iveson asked you about -- marked an exhibit about interest rates.

MR. BYRNE: I'd like to mark an exhibit, if I could.

JUDGE WOODRUFF: This will be No. 59.

(EXHIBIT NO. 59 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. BYRNE:

Q. And while I'm passing it out, Dr. Morin, can you tell me what that is?

A. Yes. It's simply a chart that compiles the bond yields on Moody's seasoned B double A bonds.

Q. And what does it show on the yield on B double A bonds currently?

A. It shows there's a very -- I'm not sure I should use the word precipitous, but certainly a very quantum increase in the cost of debt for B double A corporations close to 10 percent.

Q. And is that -- is that the largest increase for a number of years, the highest level for a number of years for B double A bonds?

A. Yes. The last time you saw that was in early 1990s.

MR. BYRNE: I'd also like to mark another exhibit.

JUDGE WOODRUFF: This will be No. 60.

(EXHIBIT NO. 60 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. BYRNE:

Q. And could you identify this for me, please?

A. Yes. This is the standard RRA, which is now SNL, compilation of allowed rates of returns. And this is the most recent edition dated October 2008, and it reports all the allowed rates of returns up until September 2008.

Q. Okay. And in the first sentence on the first page, what does it say the average electric return on equity is?

A. For the first nine months of 2008, the average of electric equity return authorizations by state commissions was 10.51 percent, 29 determinations, versus the 10.36 for calendar year 2007. And I do note that none of these determinations were conducted after the financial crisis began in early October.

Q. And I believe you testified in response to a question that the average from September -- for the 12 months ended September 30th, 2008, what was your average?

A. For vertically integrated utilities was 10.6 percent.

Q. And is this -- this document the source of your data for that?

A. RRA is the source of the data, yes.

Q. Okay. And Commissioner Davis asked you a question about what was the authorized return for the Illinois -- Ameren Illinois utilities, and I think you said you didn't know. But take a look at -- take a look at page 4 near the bottom, and I believe that may answer Commissioner Davis' question.

A. 10.65.

Q. Okay. 10.65 percent?

A. Correct.

Q. In response to some questions earlier, you talked about Mr. Gorman changing his analysis, his DCF analysis a little bit. Can you explain a little bit more about that?

A. Well, Mr. Gorman did the standard DCF analysis on his proxy group, and he also did a two-stage DCF analysis on the proxy group, and at the end of the day he basically rejected the single stage, plain vanilla DCF model that most commissions use and most witnesses use, and this had the effect of reducing his midpoint quite a bit. And I simply noted that if you reinstate the results of the DCF model, the standard DCF model, the midpoint becomes 10.8 percent in his results.

Q. And how often in your experience has Mr. Gorman used that normal standard DCF?

A. For a long time, and most of the time in the past he's used the standard DCF model.

Q. Does the Federal Energy Regulatory Commission use the standard DCF model in establishing returns on equity for electric utilities?

A. For electric?

MR. CONRAD: Objection, leading.

JUDGE WOODRUFF: Sustained.

BY MR. BYRNE:

Q. I'll rephrase the question. What DCF model does the Federal Energy Regulatory Commission use to establish returns on equity for electric utilities?
A. For electric utilities, it's the plain vanilla constant growth single period DCF model. For pipelines, however, they use the two-stage DCF model.
Q. And how about state commissions. You've testified before a number of state commissions; is that correct?
A. Yes, almost 50, and the majority rely on the standard DCF model.
Q. Okay.
A. Not all of them.
Q. Okay. The vast majority or just the majority?
A. The vast majority.
MR. BYRNE: Okay. I'd like to mark another exhibit if I could.
JUDGE WOODRUFF: Be 61.
(EXHIBIT NO. 61 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)
BY MR. BYRNE:
Q. Could you identify this, if you would, Dr. Morin?
A. This is a document published by Standard &

Poor's entitled Assessing U.S. Utility Regulatory Environment, dated November 2008.

Q. And I'd like you to take a look, there's been some discussion about how rating agencies view fuel adjustment clauses. Do you remember that --

A. Yes.

Q. -- line of questioning?

A. I do.

Q. I'd like you to turn to the third page and read for me the last, I guess the second to the last paragraph, or maybe it's the last full paragraph on that page.

A. I'm on page 3 at the bottom of the page, second to the last paragraph, and I read, the most prominent factor in this part of the analysis is the application of separate tariff provisions for major expenses such as fuel and purchased power. The timely adjustment of rates in response to changing commodity prices and other expenses that are largely out of the control of utility management is a key component in credit enhancing regulatory jurisdictions. We analyze the quality of special tariff mechanisms to determine their effectiveness in producing cash flow stability they are designed to achieve. The frequency of rate adjustments, the ability to quickly react to unusual market volatility and the control of opportunities to engage in hindsight, the allowances of cost could effect the analysis almost as much as whether the tariff provisions exist at all. The record of disallowances plays a major part in regulatory assessment.

Q. Okay. And do you recall, Mr. Mills I think asked you a question -- Mr. Mills asked you a question about is a fuel adjustment clause a yes or no proposition for credit rating agencies. Do you remember that line of questions?

A. Yes, I do.

Q. Would this paragraph suggest that the terms of the FAC are important to credit rating agencies?

A. Yeah. I think they would be concerned with a marked deviation from the conventional practice of one to one. They would look at the terms of the adjustment clause.

Q. And when you say one to one, what do you mean?

A. I mean one on one pass through of all fuel costs as opposed to 90/10 or 50/50.

MR. BYRNE: Okay. I'd like to mark another exhibit.

JUDGE WOODRUFF: This will be 62.

(EXHIBIT NO. 62 WAS MARKED FOR

IDENTIFICATION BY THE REPORTER.)

Q. Dr. Morin, could I ask you to identify that document?

A. It's a document published by Fitch Ratings entitled EEI 2008 Wrapup - Cost of Capital Rising.

Q. Does it have a date on it?

A. It is dated November 17, 2008. So it's quite timely.

Q. And I'd ask you to look at page 5.

A. I have it.

Q. And I'd ask you to read the first paragraph under regulatory considerations if you could.

A. Jurisdictional regulatory practices promise to be a key element in determining the ultimate impact on issue of creditworthiness given the sharp increase in the cost of capital as a result of the ongoing financial crisis. Utilities in states that have authorized reasonable returns on equity and adopted balanced regulatory mechanisms, including forward test years and automatic fuel and other tariff adjustment mechanisms, are more likely to come through the spirit of stress without undue deterioration to the current creditworthiness.

Q. I want to ask you about, if you know, when -- you mentioned that FERC does the standard constant growth DCF for electric utilities. Do you know how FERC calculates the growth rate under their constant growth DCF model?

A. Yes. They use analyst forecasts published in IBES and also ValueLine. So they use earnings growth forecasts just like I do.

Q. Okay. Dr. Morin, Mr. Thompson asked you, I think, a long time ago when he was cross-examining you if the differences in methods amongst all the experts are attributable to differences in inputs. Do you remember that question?

A. Yes, I do.

Q. And I guess my question is about Mr. Gorman. Are the differences that you have with Mr. Gorman based primarily on the inputs of his models?

A. No. We agree a lot on most of the inputs and most of the models. My major bone to pick was simply the rejection of one of the historical tests that's occupied a very prominent place in regulatory proceedings in the past.

Q. You had some questions about flotation costs, and I think that you said if they had -- if flotation costs had been expensed in the past, then -- and that was the method they were recovered in rates, then your adjustment wasn't appropriate, is that a fair --

A. That's correct.

Q. -- summary of what you said?
A. That's a fair summary.
Q. And I guess my question is, if AmerenUE didn't have a rate case for 20 years and it was issuing stock during that period, would you -- would it have been able to recover those costs as an expense in rates?
A. No. In the absence of a rate case, they would not be able to recover those costs.
Q. Talked a little about the -- in discussing generic ROE proceedings, you mentioned the California model. Do you know what the generic ROE for large electric utilities is in California?
A. Well, it's different for each of the three major utilities, PG&E and Edison and San Diego Gas and Electric. Its 11.10, 11.25 and 11.35 for each of the electric utilities. And, of course, that was done some years ago. It would probably be different today.
Q. I want to ask you about -- to look at two of the exhibits I gave you. One is the -- one is the exhibit that shows the BAA bond yield, and --
A. I have it.
Q. And I think -- I think you said that the last time bond yields were this high was back in the -- when did you say it was?
A. Early 1990s; 1991, 1992.

Q. And I'd like you to take a look at the regulatory focus exhibit from RRA, and look on page 2 of that document, and let me ask you, what are the authorized ROEs in 1991 and '92?

A. For electrics, they're 12.55 and 12.09.

Q. And is there a relationship between the bond yields in your mind and the authorized ROEs during that period?

A. Yeah. There is a -- not a one to one relationship. There's certainly a positive relationship. When interest rates go up, bond yields go up, the cost of borrowing goes up and so does the cost of equity because equity is clearly a riskier instrument than bonds are.

Q. I mean, is it a simple -- I'm not an expert, but is it as simple as you have to pay someone more to own stock than to own a bond?

A. That's -- to put it very simply, to induce an investor to buy stock, you've got to give that investor more than he can get on the bonds. How much more is the risk premium.

Q. Okay. You discussed a little bit what the Empire case and what -- and the Commissioners' view of Mr. Gorman's testimony in that case, and I think one of the things you said was they averaged in his constant growth analysis; is that correct?

A. Correct.

Q. And would -- an additional thing in the Empire case was they made a 25 basis point adjustment to Mr. Gorman's recommended return on equity because of the difference in the credit ratings of his sample group versus Empire's; is that correct?

MR. MILLS: Objection, leading.

JUDGE WOODRUFF: I'll overrule it. It was leading, but to move things along, I'll allow him to do it.

MR. BYRNE: Thank you.

BY MR. BYRNE:

Q. Is that correct?

A. That's correct.

Q. Okay. And would it be appropriate in your mind if there's the same kind of difference in credit rating to make the same kind of adjustment in this case?

A. Yes.

Q. And would that be a reasonable amount of adjustment in this case, in your opinion?

A. Yes, especially right now with the corporate spreads exploding upwards, yes, it would be a conservative adjustment.

Q. And I think you testified in response to Chairman Davis a little while ago that -- that an adjustment to reflect the difference between quarterly and annual dividend payments, you didn't make it in yours; is that correct?

A. That's correct, I did not use a quarterly DCF.

Q. But you suggested if it could be made or if it was going to be made, it could be about 20 basis points; is that correct?

A. Correct.

Q. And do you know how much the adjustment was in the Empire case?

A. I believe it was five basis points.

MR. BYRNE: I don't think I have any other questions. Thank you, Dr. Gorman -- I mean Dr. Morin. I'm jumping ahead.

THE WITNESS: Just getting ready for this afternoon, I guess.

JUDGE WOODRUFF: All right. Well, thank you.

MR. BYRNE: I would like to offer Exhibits 58, 59, 60 and 61, I believe.

JUDGE WOODRUFF: It's 59 through 62.

MR. BYRNE: 59 through 62.

JUDGE WOODRUFF: All right. Exhibits 59, 60, 61 and 62 have been offered. Any objections to their receipt?

MR. MILLS: Yes, I have objections.

JUDGE WOODRUFF: What's your objection?

MR. MILLS: Well, first of all, just as a general practice, the notion of dumping this much material that none of the parties have seen through discovery, through direct testimony, in on redirect is somewhat suspect.

I mean, the fact that the company had 20 copies of each of these dozen page documents ready to go and already reviewed and put into the record essentially prevents other parties from looking at these exhibits, having a chance to analyze them, having their experts a chance to analyze them and determine whether or not they're relevant, whether or not they're reliable.

Some of this stuff, for example -- you've asked for objections on all of them at once, but in particular on Exhibit -- and I believe it is 60, which is the October 3rd, 2008, not only was this available well before Mr. -- Dr. Morin produced his surrebuttal testimony, he in fact testified that he relied upon it in his surrebuttal testimony.

If that's the case, it should have been made a part of his surrebuttal testimony, and the parties could have examined it and could have conducted cross-examination about it, rather than waiting until redirect when the parties are prohibited from asking any questions of this witness about any of these exhibits.

So I object particularly to Exhibit 60 on that basis, that it is unfair surprise and it is not directly related in its entirety to questions that were raised by the parties or the Bench, and to all of these exhibits on the basis that they have been introduced on purpose apparently at such a point in the proceeding that the parties are prohibited from conducting cross-examination upon them.

JUDGE WOODRUFF: Response?

MR. CONRAD: Well, let me add to that so he can respond once to all of us. I would also endorse Public Counsel's objection, but add to it that all of these are at this point hearsay. There's been inadequate foundation provided on any of them.

MS. VUYLSTEKE: I would also like to add that if the Commission does decide to allow Ameren the leeway and to let all of these documents into the record, that we are close to lunch break, and I think that in fairness, at least allow the parties an opportunity over the lunch break to review these documents to ensure that they don't have additional questions on them.

JUDGE WOODRUFF: Now your response.

MR. BYRNE: Anybody else? Okay. First of all, on the hearsay issue, these are the very kinds of documents that are relied on by all of the experts in presenting their testimony in this case. You know, the Commission rules allow an expert to rely on this type of testimony. These reports from Standard & Poor's and RRA have been standard things that people have relied on all the time and other experts are relying on in this case. There's an exception to the hearsay rule that allows experts to rely on these kinds of things and it applies here.

Second, with regard to unfair surprise or bringing these things late into the process, you know, it's true I did anticipate that I might get the chance to offer these, but the chance arose, it was -- the door was opened up by cross-examination and by Commissioners' questions.

Most of the documents are brand new, you know. Some of them are dated November 17th. Most of them I didn't have. The one exception is, in fact, the RRA information which we had in October. But to claim unfair surprise, this Commission has relied on RRA data and the most current RRA data it can get its hands on in case after case after case. There's no question that the Commission was going to look at RRA data in this case, and so there's no unfair surprise, so anyway, that's my response.

MR. CONRAD: I have a response to that.

JUDGE WOODRUFF: Go right ahead.

MR. CONRAD: With respect to items 59, 61 and 62, counsel defeats his own argument because he points out that while experts may rely upon them, this expert did not. He made the copies and he provided them. That's insufficient foundation under even his own interpretation.

As to 60, this expert may or may not have relied on this, but in any event, it was not attached, and so the parties were deprived of an opportunity to cross with respect to it. My objection, your Honor, stands.

JUDGE WOODRUFF: Anything else anyone wants to add? Well, I'm going to overrule the objections and allow the documents into evidence. 59, 60, 61 and 62 are received into evidence.

(EXHIBIT NO. 59, 60, 61 and 62 WERE RECEIVED INTO EVIDENCE.)

JUDGE WOODRUFF: All right. Dr. Morin, you can step down.

THE WITNESS: Thank you, your Honor.

JUDGE WOODRUFF: I believe --

MS. VUYLSTEKE: I have some additional cross. Are you going to allow recross?

JUDGE WOODRUFF: We usually don't, but --

THE WITNESS: I have a plane to catch.

MS. VUYLSTEKE: Your Honor, given the fact that we've had a bunch of exhibits put into the record that we barely had ten minutes to read, I would appreciate the chance to ask a few questions.

JUDGE WOODRUFF: All right. I'll allow it.

MR. MILLS: And if we are to do that, your Honor, I would appreciate the opportunity to at least have a break to be able to review some of this material that was just handed to us moments ago before.

JUDGE WOODRUFF: What is your plane schedule, Dr. Morin?

THE WITNESS: Five o'clock, St. Louis.

JUDGE WOODRUFF: We should be all right. We will he continue with Dr. Morin then after our lunch break. We'll take a break now and we'll come back at one o'clock.

(A BREAK WAS TAKEN.)

JUDGE WOODRUFF: Let's come to order. We're back from lunch, and we're going to do a special recross on the documents that were admitted into evidence during the redirect examination of Dr. Morin. So we'll begin with, I believe Noranda would be the first on the list that wanted to recross.

RECROSS-EXAMINATION BY MR. CONRAD:

Q. Okay. You have before you what's been marked as Exhibit 61?

A. Yes.

Q. When was the first time you saw this document?

A. First time I saw 61 was today.

Q. Did you prepare this document?

A. No, I did not. Standard & Poor's prepared it.

Q. Do you work for Standard & Poor's?

A. No, I do not.

Q. Was it prepared under your direction or supervision?

A. No.

Q. Tell me what the circumstances were when you received this document for the first time.

A. I saw it for the first time this morning.

Q. When this morning?

A. Eight o'clock.

Q. That was before it was handed to you after you took the stand?

A. I read this document for the first time this morning around eight o'clock.

Q. That was before you took the stand?

A. Yes.
Q. Did you make -- you didn't make this copy, did you?
A. No, I did not.
Q. You have before you 62?
A. Yes.
Q. Did you -- when was the first time you saw this document?
A. About the same time.
Q. Same time being?
A. I saw this this morning around eight o'clock when I came in.
Q. Did you prepare this document?
A. It was prepared by Fitch.
Q. Do you work for Fitch?
A. No, I do not.
Q. Was it prepared under your direction or supervision?
A. No, it was not.
Q. Did you make the copy?
A. No, I did not.
Q. By whom was it handed to you?
A. By counsel.
Q. Let's look at 60.
A. I have it.

Q. And when would -- when did you see this document for the first time?
A. I've been familiar with this one for quite a long time, I would say almost since its publication. It's something that I scrutinize on a regular basis. So I would say approximately a month ago.
Q. Was that before your surrebuttal was prepared?
A. After.
Q. Your surrebuttal was prepared and submitted when?
A. It was prepared in early November, I believe.
Q. And this is dated when, sir?
A. October 3rd.
Q. And do I recall correctly that October comes before November?
A. Yeah, it does.
Q. So when did you see this for the first time?
A. Roughly in mid October. I can't tell you exactly.
Q. Which was before your surrebuttal, correct?
A. Probably, yes. Probably.
Q. Well, now, that's a different answer than I

got a minute ago.

A. I just don't remember.

Q. Is that your final answer?

A. I don't remember when I read them. I read millions of documents. I don't remember the exact date on each one of them.

Q. You read millions?

A. Pardon me?

Q. Millions?

A. Hundreds.

Q. A couple of decimal points difference there, isn't there, sir? Well, now, let's see. You read millions or hundreds of millions?

MR. BYRNE: I'm going to object to the continuing argumentative nature of Mr. Conrad's examination.

MR. CONRAD: I'm inquiring about --

JUDGE WOODRUFF: I'm going to overrule the objection.

BY MR. CONRAD:

Q. The man says he reads millions of documents and he says hundreds. Is it hundreds or hundreds of millions?

A. It's an expression meaning a myriad.

Q. Do you have 59 before you?

A. Yes.
Q. When did you first see this document?
A. This morning, eight o'clock.
Q. Did you prepare this document?
A. I did not.
Q. Did you participate in its preparation or supervision?
A. I did not.
Q. By whom were you given this document?
A. Counsel.
MR. CONRAD: Your Honor, I appreciate the fact that you've made a ruling, but I think I'm going to ask that that be reconsidered with respect to 59, 61 and 62 for the complete absence of a foundation, which the witness has now acknowledged. And as to 60, he now again acknowledges that it was available to him at the time that his surrebuttal was prepared but he did not choose to attach it.
Now, you know, to me that makes really two separate bases. 59, 60 -- excuse me. 59, 61, 62 are wholly irrelevant, lacking completely in any foundation from this witness.
JUDGE WOODRUFF: Do you have a response?
MR. BYRNE: Yes, I do. You know, Mr. Conrad's questions make the point that he didn't

prepare these documents. Of course he did not. Experts in dealing with ROE and lots of other issues before the Commission are entitled to rely on hearsay, things that would otherwise be hearsay, things like ratings agency reports, things like RRA data, which have been consistently relied on by the Commission in setting ROE, consistently presented by witnesses in proceedings before the Commission.

That's not a legitimate grounds to exclude those from evidence, and you've already ruled that they're in evidence, and so I think that ruling should stand.

MR. CONRAD: And your Honor, once again, and now confirmed by the witness, he did not rely on these documents. He saw them for the first time at eight o'clock this morning. He did not rely on them in preparation of his testimony in this proceeding.

MR. BYRNE: He presented --

MR. CONRAD: Again, there's no foundation.

MR. BYRNE: He presented testimony on redirect, yes, he did rely on them. So that's one way of presenting testimony is on redirect examination.

MR. CONRAD: That's bootstrap. That's circular.

MR. BYRNE: Your Honor, these are the kind of documents that are in this case now that are relied on all the time in cases.

JUDGE WOODRUFF: I agree with you on the aspect that these are not hearsay -- well, they are hearsay, but they can be relied on by expert witnesses. I'm not concerned about that. The second argument is more problematic in that it's questionable whether he relied on this in his testimony since it did not come up until redirect.

MR. BYRNE: Well, he certainly relied on RRA data in his testimony. That's been from the beginning, and this is the latest incarnation of the RRA reports, so he did rely on RRA. No one can -- no one can say that they're surprised by this data.

JUDGE WOODRUFF: I don't know that anybody's surprised by the data. The question is, are these documents something he relied on? Let me ask the witness, in preparing your testimony, did you rely on these documents?

THE WITNESS: No, I did not. Only the RRA documents.

JUDGE WOODRUFF: Which were attached to your previous testimony?

THE WITNESS: Yes, I relied on the previous edition of the RRA.

MR. BYRNE: But your honor, that's not the standard. It's not the standard if he relied on the testimony. Obviously if he saw it this morning, he did not rely on it in putting together his prefiled testimony this morning. What happened here is on cross-examination various parties went into areas where he had new information that was in addition to the information that was in his prefiled testimony, and it's entirely appropriate for him to respond to questions on redirect with new information on areas where people open the door to it. That's entirely proper. It's not tied to what he put in his prefiled testimony.

MR. CONRAD: We're talking about exhibits.

MR. BYRNE: It's responses to my questions on redirect. They opened the door. He knew -- he had some more information that he learned since his testimony was filed.

JUDGE WOODRUFF: We could go back and forth on this for a couple hours, and I know we don't want to do that. I'm going to reconfirm my previous rulings. The documents are in evidence. All right. Mr. Conrad, do you have anything else?

MR. CONRAD: No, sir, I do not.

JUDGE WOODRUFF: All right. For MIEC?

FURTHER RECROSS-EXAMINATION BY MS. VUYLSTEKE:

Q. Dr. Morin, I want to refer to Exhibit 59.

That document shows corporate bond yields, not utility bond yields, correct?
A. That's correct.
Q. And doesn't Moody's track utility bond yields separately from corporate bond yields?
A. They do, and they're typically slightly, slightly less.
Q. Has the FERC -- here's another area of questions. Has the FERC used the multi-stage growth DCF model?
A. Yes, it has, typically in pipeline cases.
Q. Then I'm moving to a third topic. Have they used it in electric cases?
A. I don't recall that they did. My recollection is that they typically rely on the single-stage DCF model for electric cases, but there could be exceptions to that.
Q. Okay. And then the third area of questioning is regarding FAC. Have you studied the FAC situation of utilities around the country?
A. Not in detail, no, but I am familiar with the utilities that have such a clause and the ones that do not have such a clause.
Q. Okay.
A. I think one of my data responses I looked

at almost 100 utilities, and I think 88 of them had such a clause.
Q. When did you review FACs of utilities around the country? What time frame?
A. When I received the Data Request.
Q. Let me ask you, in your review of FACs around the country, to the extent you reviewed them, can you tell me how capacity costs are generally treated?
A. No, I could not. I don't have that much detail, no.
Q. Can you tell me how off-system sales margins are treated?
A. No.
Q. Can you tell me how generation unit outages are reviewed for prudence and whether they are?
A. No, I could not.
Q. Can you talk -- can you discuss whether fuel costs are reviewed for prudence in most FAC clauses?
A. No, I could not.
Q. How does Ameren's proposed FAC compare to the mainstream FAC for these factors if you can even say that?
A. The sharing 95/5 usually compares to a one for one in most regimes.
Q. But with respect to all of these other

factors, you can't really compare?

A. Correct, I cannot.

MS. VUYLSTEKE: I don't have any other questions. Thank you.

JUDGE WOODRUFF: Public Counsel?

MR. MILLS: Judge, despite my best efforts over the lunch hour, I had e-mails to review, other cases to review, I was not able to prepare any coherent cross-examination based on these documents I just received.

JUDGE WOODRUFF: Staff want in on this?

MR. THOMPSON: No, thank you, Judge.

JUDGE WOODRUFF: I'll offer an opportunity for redirect if you want.

MR. BYRNE: No, thank you, Judge.

JUDGE WOODRUFF: Then you can step down, and I advise you to run for it, and you are excused, sir.

THE WITNESS: Thank you, your Honor.

JUDGE WOODRUFF: All right. The next item, witness then would be Mr. Hill for Staff. As Mr. Hill's taking the stand, I wanted to ask the parties, I notice that he is on -- both on return on equity and on capital structure. Is he going to be tendered for cross on both or are you going to bring him back for capital structure?

MR. THOMPSON: I would prefer to tender him for both.

JUDGE WOODRUFF: Does anyone have any objection to that?

MR. THOMPSON: Just so he only has to make one trip up. He has a plane to catch.

MR. BYRNE: We're fine with that, Judge.

JUDGE WOODRUFF: Okay. Mr. Hill, if you'd please raise your right hand.

(Witness sworn.)

JUDGE WOODRUFF: Thank you.

MR. THOMPSON: May I inquire, Judge?

JUDGE WOODRUFF: You may inquire.

STEPHEN HILL testified as follows:

DIRECT EXAMINATION BY MR. THOMPSON:

Q. State your name, please.

A. Stephen Hill.

Q. How are you employed?

A. I'm self-employed as a financial consultant.

Q. And who -- on whose behalf are you here today?

A. The Staff.

Q. Are you the same Stephen Hill that caused to be prepared and filed certain pieces of prefiled testimony?

A. Yes.

Q. They've been marked, I believe, as Exhibit No. 203, direct testimony of Stephen G. Hill, Exhibit 204, rebuttal testimony of Stephen G. Hill, and Exhibit 205HC and NP, surrebuttal testimony of Stephen G. Hill. Are those the pieces of testimony?

A. Yes, they are.

Q. And did you prepare those yourself?

A. Yes, I did.

Q. And if I was to ask you the same questions today under oath, would your answers be the same?

A. Yes, with a couple of typographical changes.

Q. What are those typographical changes?

A. In my direct testimony, which is Exhibit 204, is that right?

Q. No. Your direct is 203.

A. Okay. Thank you. Exhibit 203, page 21, line 14, the word Reuters should be the initials IBES. And on page 36 of the same exhibit, the sentence appearing on line 6 and 7 beginning with the word using and ending with percentage 9.19 should be struck. It's unnecessary.

The only other typo that I found rereading this was in my surrebuttal testimony, which would be 205, I believe, Exhibit 205, would be on page 27, line 22. At the end of the line 22 beside the word a, insert the word smaller. Those are the only typographical changes that I have.

Q. With those changes, is your testimony true and correct, as far as you know?

A. Yes.

MR. THOMPSON: I would offer Exhibits 203, 204 and 205.

JUDGE WOODRUFF: All right. 203, 204, 205HC and NP have been offered into evidence. Are there any objections to their receipt?

(No response.)

JUDGE WOODRUFF: Hearing no objections they will be received into evidence.

(EXHIBIT NOS. 203, 204, 205NP AND 205HC WERE MARKED FOR IDENTIFICATION AND RECEIVED INTO EVIDENCE.)

MR. THOMPSON: Thank you, Judge I'll tender the witness for cross.

JUDGE WOODRUFF: Thank you. For cross-examination, we begin with Public Counsel.

MR. MILLS: No questions.

JUDGE WOODRUFF: For the State?

MR. IVESON: No questions, your Honor.

JUDGE WOODRUFF: For Noranda?

MR. CONRAD: Just very briefly.

CROSS-EXAMINATION BY MR. CONRAD:

Q. Is it Mr. or Dr. Hill?

A. It's Mr.

Q. Okay. Did your recommendation assume the existence of an FAC or not?

A. No, sir, it did not.

Q. What recommendation would you have made if there had been an FAC in place?

A. I didn't make a specific recommendation. It was my understanding that the Staff was not in favor of that recommendation, so I didn't investigate that. I found that a cost of capital raising 9 percent to 9.75 was reasonable in this market. The midpoint of that is 9.375.

And with a fuel adjustment clause, because of AmerenUE's common equity ratio of almost 51 percent, which is significantly higher than average, higher than the average for any of the sample groups that were studied in the case, mine, Dr. Morin's, Mr. Gorman's, there should be a downward adjustment for financial risk. So I didn't really come up with a number per se, but it would be between 9 and 9.375 with a fuel adjustment clause.

Q. Okay. Forgive me, sir. I kind of got lost in your answer there, but what would -- what would be the -- try to use your terminology, the number of basis points that you might assign to the presence or the absence of an FAC?

A. I think Dr. Morin and I are in agreement on that issue. I think it's about 25 basis points, and 25 basis points, just for the Commission's information, multiplied times 51 percent equity ratio at 5.8 billion rate base is about 7 and a half million dollars a year, bottom line. That's the impact. That doesn't include taxes. Taxes would be another 35, 40 percent on top of that. But the after tax impact of 25 basis points is about 7 and a half million a year.

Q. Mr. Hill, okay. So I -- I'm taking it that you're in general agreement with Dr. Morin's testimony this morning about how to translate that 25 basis point differential into dollars for ratepayers?

A. Yes, except I think that his number and the number provided by Staff counsel is a pre-tax number, and the number I just gave you is an after-tax, so simply a profit number, bottom line number. But with that caveat, then the answer is yes.

Q. All right. And you'd agree with me that ratepayers' dollars that they pay are pre-tax dollars?

A. That's correct.

Q. In your experience, you're familiar with rating agencies that we've talked about a little bit this morning?

A. I'm familiar with what? I'm sorry.

Q. The rating agencies?

A. Yes.

Q. Are you aware of any instance in which a rating agency changed a rating based on the provisions, structure of a utility's FAC regarding the number of accumulation periods it had?

A. No, I'm not. I know that, for example, for Puget Energy in the state of Washington, which has a 95/5 setup, rating agencies have discussed it saying that there is some responsibility still remaining with the utility, but I'm not aware that that would -- had caused them to make a ratings change on that issue alone.

Q. Same question if you can kind of connect this up just to save time. Any change in rating that you're aware of as a result of duration of the recovery period?

A. No. I've not seen that discussed in a bond rating report.

Q. And the same basic question with respect to the duration of the FAC?

A. You mean what -- how long a life the FAC might have?

Q. Right. Whether you'd seen anything of a

change in rating?
A. No, I have not.
Q. And have you seen any instances of a changed rating based on the stated or expected intensity or timing of a prudence review?
A. Can you repeat that question?
Q. Okay. Let me try to simplify rather than try to repeat it. In your review of rating agencies as they in turn have reviewed utilities' FAC programs, has a discussion ever bubbled to the top regarding prudence reviews, how effective they are, how ineffective they are, how intense they might be? Has that topic even hit the --
A. Not related to fuel adjustment clauses. Prudence usually comes into play in large capital additions like generation or a very large transmission project.
Q. So in -- would it be safe to kind of sum that up, then, that your -- your understanding of how the rating agencies review FAC, fuel adjustment clauses, is kind of yes/no, you get a dot on the map, you don't get a dot on the map?
A. I think that's right generally. In that -- one of the documents that was handed out in Dr. Morin's redirect, Standard & Poor's makes clear that automatic recovery of fuel adjust -- fuel costs is a consideration

that they take very seriously, but they don't pars out pieces of it, and it's rarely -- that sort of thing's rarely discussed in my experience.

Q. Thank you, Mr. Hill. I appreciate your use of the term parsing out. That's what I was looking for a while back, and I couldn't think of it. Thank you.

MR. CONRAD: Thank you, your Honor.

JUDGE WOODRUFF: All right. Then for MIEC?

MS. VUYLSTEKE: No questions.

JUDGE WOODRUFF: MEG?

MS. LANGENECKERT: No questions.

JUDGE WOODRUFF: Brings us down to Ameren.

MR. BYRNE: I have a few.

JUDGE WOODRUFF: All right.

MR. BYRNE: I'd like to mark an exhibit if I could.

JUDGE WOODRUFF: All right. That's No. 63.

(EXHIBIT NO. 63 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

CROSS-EXAMINATION BY MR. BYRNE:

Q. Mr. Hill, I marked Exhibit 63, which I believe is your deposition that I took; is that correct?

A. That's the first part of it, yes.

Q. And I guess there are exhibits from that deposition you may recall, the areas you've testified

since 2000 and your billing records?
A. Right.
Q. Keep that with you because I'll be referring to it.
A. All right.
Q. I'd like to start by asking you some -- a few questions about your background. It's my understanding based on taking your deposition that you generally present rate of return and return on equity testimony from the consumer advocate standpoint; is that correct?
A. Out of the 250 cases that I've done, the majority of them, I'd say 75, 80 percent have been for consumer advocates, that's correct.
Q. And I -- as I understand it, when you first -- you graduated from college in 1973; is that correct?
A. Graduate school.
Q. Graduate school. Tulane; is that right?
A. Tulane, that's right.
Q. And then for a period of time you were playing music; is that correct?
A. That's correct.
Q. And you had a -- from like '73 to '82 you generally played music; is that right?

A. Off and on. I worked for two years for the West Virginia Air Pollution Control Commission, the State of West Virginia, as a chemical engineer.
Q. But that didn't have anything to do with rate of return or return on equity testimony; is that right?
A. No. It had something to do with financial analysis, but not rate of return specifically.
Q. And then as I understand it, your career involved in rate of return or return on equity analysis started in 1982; is that correct?
A. That's correct, yes.
Q. And in 1982 you got a job for the West Virginia Consumer Advocate's Office; is that correct?
A. The Consumer Advocate Division of the Public Service commission. It's not a separate office. It's a part of the Public Service Commission.
Q. But it's my understanding that that part of the Public Service Commission serves the same sort of function as Office of Public Counsel does in Missouri; is that right?
A. That's correct.
Q. And you continued to work for the Consumer Advocate's Office through the 1980s; is that correct?
A. Yes.

Q. And then in the late 1980s you decided to start a part-time consulting business; is that right?

A. That's right.

Q. And while you were doing part-time consulting, at first at least, or while it was part-time, you still worked as -- for the West Virginia Consumer Advocate's Office?

A. Right. As I explained in deposition, the West Virginia Civil Service allows a state employee to work part-time. You can declare three-quarter time or half time and work two months -- two weeks a month and then do whatever else you want the other two weeks.

Q. Okay. And looking at your deposition on page 11, line 24, you talked a little about when you started your consulting business, and I think it says on line -- page 11, line 22, you began to meet people around the country that had a need for cost of capital witness because there are not too many folks that do it on the consumer side; is that correct?

A. That's right.

Q. And I think you said, and maybe you just said it again, 75 or 80 percent?

A. I think that's a reasonable percentage.

Q. That's -- those are public advocate type parties that you represented in cases that you've testified in?

A. That's correct.

Q. And you have represented the Office of Public Counsel in this state; is that correct?

A. That's right.

Q. Do you know how many times? Do you remember?

A. Three. That's a question I'm not quite sure. Two or three.

Q. And in your deposition, you also said that you did represent just one utility in your career; is that correct?

A. That's right, just recently here in this state.

Q. And what utility was that?

A. Trigen Energy.

Q. And that was a fairly recent case, was it not?

A. Yes, it was.

Q. And again, my understanding from our deposition is that the reason Trigen told you that they were hiring you is they were looking for a consumer advocate type of witness to present their case; is that correct?

A. No, that's not correct.

Q. Okay. Well, take a look at your deposition, page 21, line 6, is what I was specifically getting that from. I think it's line 6. Hang on. I guess we could go back to get some context, you could see a couple more questions before that, but we were talking about your representation of Trigen, and UtiliTech had hired you or talked to you about being hired by Trigen, and then you say, let's see, and it was Steve Carver was the lead agent in the case and contacted me and said this utility wants to use, quote/unquote, consumer advocate type witnesses to present their case.
A. That's correct. What you asked me was not correct.
Q. Maybe I didn't ask it right. But what you said in your deposition's correct?
A. Yes.
Q. Okay. I'm sorry for the confusion. Have you ever taught at a university, Mr. Hill?
A. I have not.
Q. Have you ever published a textbook on utility finance?
A. I have not.
Q. And I think on your resume you attached -- well, it was attached to your direct testimony, I think you had three articles that were published; is that true?

A. Yes.
Q. Are there any other articles that you've published?
A. No.
Q. And you have your own business, right? Is that true?
A. Yes.
Q. Is it Hill Associates?
A. That's correct.
Q. And it's a home-based business; is that correct?
A. That's right.
Q. And you don't have any employees; is that correct?
A. That's right.
MR. BYRNE: Okay. I'd like to mark another exhibit if I could.
JUDGE WOODRUFF: This will be 64.
(EXHIBIT NO. 64 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)
BY MR. BYRNE:
Q. And it's a data request we asked Staff and Staff's response. It relates to a question Chairman Davis had asked during opening statements, but it says, you know, we asked the question, please identify the Staff

members who were involved in the decision to hire Mr. Hill. And basically the response says you were initially contacted by Ron Bible, and then ultimately the decision was made by Robert Schallenberg and Ron Bible. Is that -- that's what it says, right?

A. Yes, that is what it says.

Q. And is that true?

A. Well, I would accept Staff's representation that it's true. The part of this, what response that I wrote was the first paragraph. I mean, the only contact I had was by Ron Bible. I don't know what happened behind the scenes. The second paragraph was added by the Staff to let you know fully what happened, quote, behind the scenes, unquote.

Q. Okay. Now, my understanding is that you are recommending a 9.5 percent return on equity for AmerenUE in this case; is that right?

A. That's correct.

Q. Okay. And there was a little discussion before I think with Mr. Conrad, but let me see if I can get it straight. If we're allowed to have a fuel adjustment clause, you believe the return on equity should be even lower than 9.5 percent?

A. Yes. 9.5 goes along with the Staff's recommendation that the company not be allowed an FAC at this time.

Q. And, you know, I don't have a reference in your deposition, but my recollection is that your midpoint was 9.37 percent; is that correct?

A. That's correct.

Q. And my further recollection is you said that if we were given a fuel adjustment clause, it would be below -- your recommended rate of return would be below -- return on equity would be below 9.37 percent; is that correct?

A. Yes. That's because the companies that I looked at were generally similar in risk according to bond ratings, and AmerenUE has a much higher common equity ratio than those companies on average. So they would have less financial risk, and their ROE should therefore be below the average for the group.

Q. And I think you also said, although I don't have a citation to this, so if you don't remember, I can't -- I can't hold you to it, but I think you said that you would look at the possibility of splitting the difference between 9 and a quarter and 9 percent, but you weren't sure if that would be what it would end up being?

A. Well, I -- it is my recollection of the deposition, you wanted, like the counsel here, want a specific number for what happens with an FAC, and I didn't do that analysis, so I couldn't give you a specific number. So I said it would be between 9 and 9 and a quarter, but that was just, you know, kind of a shoot from the hip response.

Q. Sure. I understand.

A. I don't have that number.

Q. Got it. Okay. And my understanding is your belief is that the rate of return that you're recommending in this case for AmerenUE is consistent with your belief about what the cost of equity has been for electric utilities in general over the last four or five years; is that true?

A. In general, the cost of equity I believe has been below 10 percent for that period of time. I believe that was the context of our discussion in deposition.

Q. Look on page 25 of your deposition. I think that's where it is. Page 25, line 17.

A. Yes.

Q. And I think you say, well, over the past four or five years the cost of equity has been pretty solidly between 8.75 and 9.75. Does that make sense to you? Did I read it right, and do you agree with it?

A. You read what I said correctly, and yes, I agree with it.

Q. Okay. I'd like to take a brief look at the analyses that you did. My understanding is that you did four analyses and -- is that right?

A. Right.

Q. And one of them is the discounted cash flow analysis; is that correct?

A. Yes.

Q. And is that a single stage DCF that you did?

A. Yes.

Q. Okay. And is that -- as I understand it from your testimony, the DCF analysis is what you primarily rely on, and you do the other three analyses as corroborative analyses? I think that's out of your direct testimony. Is that correct?

A. Well, we went over this in some detail in the deposition, and I think the DCF is probably the most accurate cost of equity analysis, and I disagree with Dr. Morin about the accuracy of the DCF when market to book ratio is different than one. I think that's incorrect. But I'll say that I think the DCF is the most accurate, but I don't -- and I have never used it by itself to estimate the cost of capital.

Q. Was it --

A. I've always used the methodologies that I use now to temper the DCF result, and I believe I told you in deposition that if, for example, my DCF result was 9 and the average of the other three results was 9.75, I'm certainly not going to recommend 9 percent. I'm going to have to adjust upward the DCF result. I mean, that's why I do more than one analysis.

Q. Do you have your direct testimony there?

A. Yes, I do.

Q. Because that's where I'm kind of getting this. If you look at page 43, line 3, you do call the other ones corroborative analyses, and maybe that's at least part of what they do; is that fair to say?

A. Yes, but it's -- I think you'd be wrong to conclude from that that the DCF is sort of the be all end all of my analysis.

Q. Okay. And we've talked -- what's the formula for the DCF?

A. It's K, cost of equity capital, equals D, the dividends, expected dividends, over P, the price, plus G, the growth rate, long-term sustainable growth rate.

Q. And my understanding is the growth rate, the growth rate you put into that formula is a pretty important component, is it not?

A. It's everything in the DCF.

Q. So -- and my understanding is the growth rate impacts the return on equity that ends up being the product of the formula one for one. In other words, if your growth rate goes up ten basis points or down ten basis points, then your ROE will go up or down ten basis points; is that correct?

A. Yes.

Q. Okay. And let me ask you how you developed your growth rate for your DCF analysis.

A. All right. I discuss this in some detail beginning at page 18, going all the way through page 22 of my direct testimony, and at that part of my direct testimony, I explain that my growth rate analysis is founded on sustainable growth, which is what the originator of the DCF, professor Myron Gordon, indicated would the most reliable indication of long-term steady state sustainable growth, and that is a B times R, or retention rate times expected return on equity growth rate. I'm sure the Commission's seen that sort of thing before, so I'm not going to go into detail to explain it.

But I look at several companies. I look at the sustainable growth rate over the past five years, the trends in that growth rate. Also look at projected growth rates for the next two years and for three to five years in the future. I look at projected sustainable growth rates. I looked at projected earnings growth rates from

ValueLine and also from IBES. I looked at projected dividend growth rates and projected book value growth rates.

So I look at those growth rates, and for each company -- for Ameren I discussed it in the pages I mentioned, 18 through 23 of my direct testimony. For each of the other companies in my Appendix C, I discuss the growth rate analysis for each one. And through that analysis of those growth rates, the trends in those growth rates, and I reach an estimate of the long-term sustainable growth for each company.

Then I look at the external portion of the growth, which is a portion of long-term sustainable growth that investors realize through the sale of stock. If a company is issuing stock or expected to issue stock continually and the stock price is above book value, then investors will receive a benefit from that. As a difference between market price and book value enures to their benefit, that will add to their expected growth rate.

So I add that in where it's appropriate or subtract it where it's not appropriate. And then that's my long-term sustainable growth rate. I check those growth rates against published growth rates available in the industry for those companies. And through that analysis I reach an estimate for a long-term growth for the DCF for each of the companies.

Q. Okay. And we talked a little bit about this in your deposition. My understanding is you look at all that different data, but at the end of the day the growth rate that you pick is a judgment on your part; is that correct?

A. That is true. And as I said in deposition, and as the witnesses made very clear so far, the aspect of judgment in cost of equity estimation is inescapable. If you make the professional judgment that five-year earnings projections from sale side analysts are the only information that investors look at, that's a -- that's a big assumption, and that's a big factor in judgment with regard to the earnings of the DCF. In fact --

Q. Well, I think you've answered my question, Mr. Hill, which was really just yes, it's a judgment, but I should be more like Mr. Conrad and --

MR. THOMPSON: No, don't.

BY MR. BYRNE:

Q. Anyway, this really is a yes or no question. I think I know what the answer is based on what you just said, but there's no mathematical formula that ties any particular thing you looked at to the growth rate you select; is that correct?

A. No matter how you do the DCF or any cost of equity mes -- methodology --

Q. I thought it was a yes or no.

A. -- methodology, judgment is an inescapable fact.

Q. Okay. And my understanding is -- I'm really sure this is a yes or no question. My understanding is that your growth rate that you selected was 5.04 percent, yes or no?

A. Yes.

Q. Okay. Did you -- Mr. Hill, did you consider the recommendations of Commission Staff in other recent electric cases when you arrived at your growth rate?

A. No, I did not.

MR. BYRNE: Okay. I'd like to mark an exhibit.

JUDGE WOODRUFF: This will be No. 65.

(EXHIBIT NO. 65 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. BYRNE:

Q. Mr. Hill, what's been marked as Exhibit 65 is a set of Data Request responses that we got from the Staff, and there's several of them there. I only want to look at a couple. In particular, look at No. 31, and it says, please confirm that the growth rates Mr. Barnes -- well, maybe I should back up.

Mr. Barnes in the previous Data Request was the Staff witness in Empire District Electric Company's most recent rate case, Case No. ER-2008-0093, and that's confirmed in, I think in Data Request 29. His range of return on equities is in Data Request 30, and then Data Request 31 talks about his growth rate.

And it says, please confirm that the growth rates Mr. Barnes used for his discounted cash flow analysis in Case No. ER-2008-0093 were 5.55 percent to 6.63 percent. Do you see that?

A. Yes, I see it.

Q. And the answer, and I won't read the whole question, but the answer is, yes, those were the growth rates. And -- and so my understanding of how this DCF analysis works is if you're proposing a growth rate of 5.04 percent in this case and Mr. Barnes is proposing a growth rate range of 5.55 percent to 6.63 percent, that's a pretty significant difference. More specifically, at the low end of his range he is 51 basis points higher than your growth estimate is that true, yes or no?

A. The numbers --

Q. Yes or no, is that true?

A. The numbers confirm --

MR. THOMPSON: I'm going to object, your Honor. The witness' answer, No. 1, is whatever it is. He can't demand a yes or no answer. No. 2, this is absolutely irrelevant. He said he did not rely on what Staff offered in any previous case. Mr. Barnes has not offered evidence or testimony in this case, and I object. It's irrelevant.

JUDGE WOODRUFF: What is the relevance?

MR. BYRNE: I think the consistency of Staff's position from case to case -- well, first of all, Mr. Thompson himself has relied on previous cases. I think the consistency or inconsistency of Staff's position from case to case is very relevant.

MR. THOMPSON: All I did was refer to adders --

MR. BYRNE: It undermines the credibility of his testimony --

MR. THOMPSON: -- that have been offered in other cases.

MR. BYRNE: -- if he's inconsistent with what the Staff has done in other case decided three months ago.

MR. THOMPSON: I stick with my objection, your Honor. This is absolutely irrelevant.

JUDGE WOODRUFF: I believe I'm going to

sustain the objection. I don't believe it is relevant.

BY MR. BYRNE:

Q. Well, that will shorten my cross-examination. I'd like to talk to you about one of your corroborative analyses, and that is the modified earnings price ratio. Is that one of your corroborative analyses?

A. Yes, it is.

Q. Okay. And my understanding, based on your deposition, this was an analysis -- well, the origin of this was a slightly different analysis called the earnings price ratio that was used in the 1960s; is that correct?

A. Not exactly.

Q. Well, look at page 35 of your deposition.

A. I don't believe that's the page you want, is it?

Q. No, that isn't the page I'm looking for. Okay. Well, let me skip that part, then.

The -- my understanding is it is a -- the earnings price ratio is something that was used previously at FERC; is that correct?

A. No. The -- the earnings price ratio is an equity cost estimation methodology that's mentioned in finance textbooks, that's mentioned in Dr. Morin's textbook, all three editions of it. During the 1980s during the FERC's generic cost of capital rulemaking process, which lasted for many years, the -- one of the checks that FERC used was to see that the equity return they came up with using the DCF was bracketed above or below by the earnings price ratio and by the expected ROEs depending on what the market book ratio was because those parameters will flipflop depending on the market to book ratio, but they orbit around the cost of equity. So FERC used those methods to check their DCF. I began to use those methodologies and average them for the same purpose.

Q. I think you answered my question. I was asking about when FERC used it. Are you done with explaining when FERC used it?

A. I don't think there's any difference.

Q. Between when FERC used it and when you used it?

A. Yes. I think the --

Q. I'm only asking about FERC.

A. The genesis of procedure is the same.

Q. And then isn't it true that FERC stopped using that method in 1992?

A. The FERC stopped the generic DCF because -- and this goes to one of the Commissioners' questions about generic ROE.

Q. I'm sorry. I think that's a yes or no question. Did they stop using it in 1992, yes or no?

MR. THOMPSON: I object, your Honor. The witness needs to be allowed to answer.

JUDGE WOODRUFF: Overruled. You can control your witness.

BY MR. BYRNE:

Q. Did they stop using it in 1992? Let me refer you to --

A. The generic DCF, is that your question?

Q. Yes. The earnings --

A. Yes, is the answer to that.

Q. I'm sorry. The -- I'll tell you what, let's look at your deposition. That will make this easier. Page 39, please, is where you're talking about the earnings price ratio, I believe; is that correct? Are you talking about the earnings price ratio on page 39 of your deposition?

A. Yes.

Q. Okay.

A. Page 39 you said?

Q. Page 39.

A. Yes. I'm there, yes.

Q. And on line 12 I asked you the question, FERC doesn't use it now, do they? And you say, no. They stopped the generic in 1992.

A. Well, I understood your question to be did they stop using generic rate of return.
Q. Okay. Well, I'm sorry. Let me ask it again. Are they using the earnings price ratio now?
A. I don't know. I couldn't quote you chapter and verse what FERC is doing now.
Q. All right. That's fine. Can you name a state that has relied on a modified earnings price ratio to set a return on equity in the last 20 years? Can you name a state?
A. As a primary methodology?
Q. Yes.
A. No.
Q. Okay. Another one of your corroborative analyses is the market to book analysis; is that correct?
A. Market to book ratio analysis, yes.
Q. Market to book ratio analysis. Okay. Isn't it true that the market to book ratio analysis is just an algebraic rearrangement of the DCF, yes or no?
A. I say that in my direct testimony.
Q. Isn't it true that you really can't consider it to be an independent methodology, yes or no?
A. I also say that in my direct testimony.
Q. Okay.
A. DCF is the most widely used method.

Q. Are you aware of any state commission that bases its cost of equity result on the market to book ratio? Can you --

A. No.

Q. -- name a state?

MR. BYRNE: Okay. That's all the questions I have. Thank you, Mr. Hill.

THE WITNESS: Yes, sir.

JUDGE WOODRUFF: Did you wish to offer the exhibits that you marked?

MR. BYRNE: I would like to offer all of the exhibits that I had marked. I guess it's 6 --

JUDGE WOODRUFF: 63, 64 and 65.

MR. BYRNE: 63, 64 and 65.

JUDGE WOODRUFF: Are there any objections to 63, 64, 65?

MR. MILLS: Yes.

MR. CONRAD: Yes.

MR. IVESON: Yes.

MR. THOMPSON: Absolutely.

MR. MILLS: Could we perhaps take them one at a time because I have different objections to different exhibits?

JUDGE WOODRUFF: Yes. Certainly. Mr. Mills, go ahead.

MR. MILLS: With respect to 63, I object to simply dumping the deposition into the record. You know, a deposition is a discovery tool that may be used for some discovery, and there may be some relevant information in there, in fact, but counsel for AmerenUE has touched on some. But it's chocked full of irrelevant information, and there's no reason to dump it in wholesale when Mr. Hill is here and any relevant questions can be asked of him right now.

For example, we have a whole bunch of bills from years ago from Mr. Hill. I believe at least that portion is irrelevant. I quickly skimmed through the deposition. There's a lot of questions in here that are irrelevant. I object to the admission of the deposition as a whole document on the ground of relevancy.

JUDGE WOODRUFF: I'll hear everything, all the objections.

MR. MILLS: You want me to go on?

MR. CONRAD: I also have on 63 --

JUDGE WOODRUFF: Let's go ahead and do them exhibit by exhibit. Go ahead.

MR. CONRAD: However you prefer. I think to some extent Mr. Mills and I are saying the same thing. There has been a proclivity, I think, to want to take depositions and just dump the whole of them in. They are out of court statements that are offered to prove the truth of what they say, which is by my definition hearsay, and there are exceptions to the hearsay rule, one of which is a prior inconsistent statement.

So if there was evidence that in one or more of these questions that the witness testified at the time of the deposition inconsistently with how he is testifying here, that portion of the deposition, the question and answer can properly be admitted. But its purpose there is not to prove the truth of what it says, but rather to prove that the witness speaks inconsistently about the same topic.

Beyond that, the objection remains hearsay. And the witness is here. You don't have an unavailable deponent or any of those issues that might fit under other exceptions. So in that regard, Mr. Mills and I share that same objection.

JUDGE WOODRUFF: Staff also objects to 63?

MR. THOMPSON: I have no objection to 63.

MS. VUYLSTEKE: I just wanted to add in support of the objection to 63 that this Commission has indicated a preference in the past, and I think you have, Judge Woodruff, to the testimony of live witnesses. I think when the witness is available and is on the stand, then that should be the evidence, and the deposition should be used only to impeach or in the event that a witness is unavailable.

JUDGE WOODRUFF: Any response as to 63?

MR. BYRNE: Yes, I do. Your Honor, the Rules of Civil Procedure, which apply in this instance because the Commission's rules adopt the Rules of Civil Procedure, have a very broad standard for the use of depositions, and in particular it says, depositions may be used in court for any purpose. They're not merely used to impeach a witness, which is what a lot of the other parties are saying. They can be used -- they can be read into the record in court. They can be -- they can be submitted to the court as an admission of a party opponent, which is what they are.

This Commission has a pretty long history in dealing with depositions. I can remember -- the first time I remember depositions being used in a Commission case was in 1987, and I was working for the Staff and we had a complaint against Union Electric Company. But they've been used consistently in lots of cases at the Commission and they've been allowed to be entered into evidence as exhibits.

Several years ago the Commission had a roundtable on trying to make proceedings more efficient, and one of the -- one of the recommendations that was spoken about by Commissioners and by others is, you know, shorten the hearing times by taking depositions of party opponents. We've tried to do that in this case. We haven't had that much time, but we've taken six or seven depositions.

Now, we can ask every question in the deposition in this hearing room and the hearings will last much longer. But I think the better practice is to do what the Commission has consistently done for 20 years and allow depositions to be offered into evidence.

MR. CONRAD: Your Honor, Mr. Byrne is incorrect in his citation of the rule, and I have it right here on my screen. It's 57.07(a), use of depositions. Any part of a deposition that is admissible under the rules of evidence applied as though the deponent were testifying in court -- that reads out the business about an unavailable deponent -- may be used against any party who was present or represented at the taking of the deposition or who had proper notice therefore.

Then and only then do you have the statement depositions may be used in court for any purpose. This has been wildly misinterpreted and great emphasis placed on that last thing, because as your Honor will recall, the old controversy used to be, well, if it is admissible for one purpose, i.e., impeachment, is it thereafter admissible for all purposes? Can it be considered?

And the answer that the Supreme Court here says in that one sentence is, yes, if it is properly admissible under the rules of evidence applied as though the deponent were testifying in court, then it can be used for any purpose, but that does not repeal the law of evidence, and that's my point.

There is a way to do what Mr. Byrne is saying, and it is simply to ask the question of the witness, and if the witness testifies inconsistently, you go through a process where you ask him, did you answer, and if he acknowledges that that was his testimony, then it comes in as a prior inconsistent statement, and under 57.07(a), then it can be used once it's properly admissible, that portion.

MR. BYRNE: Your Honor, there's no question that under 57.07(a) this Commission has the discretion to let these exhibits be entered in the way I've proposed, and that's what this Commission has consistently done for 20 years, and the reason they've consistently done that is the Commission doesn't want everyone to read question, answer, question, answer, and then impeach. I guess I could do that. I could hand Mr. --

JUDGE WOODRUFF: Well, you've already done that in your testimony --

MR. CONRAD: And we have no objection, your Honor, to the portions that he used if he wants to identify those and make the assertion that they're inconsistent. If they're not inconsistent, they're cumulative and they could be objected to on that basis, but they're certainly not harmful.

MR. BYRNE: The deposition is 123 pages long. I can go through and read each question and ask him to answer it. There's no doubt I could do that. But instead of doing that, I prefer to offer this as an exhibit and just treat it the way the Commission has treated depositions for years.

MS. VUYLSTEKE: Judge Woodruff, I just wanted to add regarding the issue of the Commission's discretion and the efficiency of the hearings, et cetera, I would just cite the Commission back to a decision that you made just a couple of years ago on this very subject of admitting deposition testimony where the live witness is available, that the problem with doing that is a variety of parties and the Commission itself are deprived of asking the witness the questions that they might have asked.

If Mr. Byrne has specific questions that he wants to ask, he asked them in a deposition, they're not asked to the witness live, then that deprives all the parties in the room of asking questions, and it also results in a more incomplete record. So there is an important reason to only allow the live testimony unless it's being used for specific purposes like impeachment.

MR. THOMPSON: Your Honor, if I may answer that?

MR. BYRNE: We gave notice. We gave notice to every party of each one of these depositions. The Commission suggested that we use depositions. We went to the trouble to take depositions to shorten cross-examination, and now we're offering the deposition and all these parties are saying we can't do it. That's not reasonable.

MR. MILLS: If I may add one more thing, Judge. As you're well aware, the standards for objecting to questions at depositions are very different from those at a hearing, and so regardless of whether parties are there or not there, generally objections are not raised to irrelevant questions unless they're wildly irrelevant and so far off the mark as to be a waste of time, but generally if you're there or if you're not there, you don't raise an objection to relevance.

So if Mr. Byrne were to go through and ask some of these questions today, I would object to them because this is a different setting than discovery. This is an evidentiary hearing, and the standards for relevance and whether or not you object to questions are very different.

JUDGE WOODRUFF: All right. I'm ready to make the ruling. I'm going to sustain the objection. You're correct that this has been a practice before the Commission for many years to allow the dumping of depositions into the record, as people have described, and I think that's a good description for it. I don't think it's necessary, and I don't think it's good practice, and 63 will not be admitted. Let's move on to 64.

MR. MILLS: I also have objections to Exhibit 64, and this is on -- the basis essentially is foundation, but also somewhat for hearsay. Mr. Hill testified that he doesn't have any knowledge of most of the information contained in the answer to Exhibit 60 -- to the DR that is Exhibit 64. He said he prepared one sentence on this page and has no knowledge of the others. So there's no foundation for its admission. Furthermore, and I don't think I mentioned this, but I don't believe it's relevant.

MR. THOMPSON: That would be Staff's objection, Judge, relevancy.

MR. MILLS: There is no issue in this case as far as I'm concerned on which the question of which Staff member hired this witness has any bearing. So it neither has any proper foundation as to its authenticity or its accuracy. It's hearsay and it's irrelevant.

JUDGE WOODRUFF: What's the relevance?

MR. BYRNE: The relevance is -- I guess the relevance is Commissioner Davis, Chairman Davis asked this question, and this is the answer to the question Chairman Davis asked, that was the relevance in my view.

MR. MILLS: This is ostensibly the answer to that, but we have no way to authenticate that with this witness, which gets us back to the foundation question.

MR. BYRNE: The answer to a Data Request is in the admission of the party opponent. Data Requests and answers are regularly admitted in these cases. Hopefully -- I mean, I can't admit depositions. Can I now not admit Data Requests that I got from --

MR. THOMPSON: They have to be relevant in order to be admissible.

JUDGE WOODRUFF: They do need to be relevant, but I'll allow more leeway on Data Request responses, and I'm going to let this one in.

(EXHIBIT NO. 64 WAS RECEIVED INTO EVIDENCE.)

MR. THOMPSON: I also object to Exhibit 65, your Honor.

JUDGE WOODRUFF: And 65 was?

MR. THOMPSON: It's a series of other Data Requests having to do with Staff's growth rate and ROE recommendations.

JUDGE WOODRUFF: And I stopped the questioning on that. That's irrelevant.

MR. BYRNE: Staff's inconsistency on the position of growth rates is not irrelevant.

JUDGE WOODRUFF: I ruled the testimony was irrelevant, so I'll rule the document is irrelevant also. 65 is not admitted.

CHAIRMAN DAVIS: Judge, can I inquire?

JUDGE WOODRUFF: Certainly.

CHAIRMAN DAVIS: If that testimony was admitted in another proceeding, we can take judicial notice of that testimony, can we not?

JUDGE WOODRUFF: Of the testimony from the --

CHAIRMAN DAVIS: If Matthew Barnes testified in the Empire District, we can take judicial notice of that, can we not?

JUDGE WOODRUFF: I believe so.

CHAIRMAN DAVIS: Okay. Thank you.

MR. BYRNE: Your Honor, I would then ask

that you take judicial notice of Mr. Barnes' testimony in the last Kansas City Power & Light Company case, which is Case No. ER-2008-0093 and the --

JUDGE WOODRUFF: That's Empire.

MR. BYRNE: The last Empire case and the last Kansas City Power & Light company case, which I can't find the -- ER-2007-0291. Mr. Barnes was a witness in both cases.

MR. THOMPSON: And Staff objects on the grounds of relevancy, your Honor.

MR. CONRAD: And I don't know that I have an objection, but I think the rules provide that we're to have copies.

JUDGE WOODRUFF: Can you provide copies?

MR. BYRNE: I can certainly provide copies.

JUDGE WOODRUFF: All right. When you provide the copies, I believe the Commission can take judicial -- or administrative notice of those -- of that testimony. If you want to provide copies, you certainly can, bring -- when you bring it up, when you produce the documents, I'll rule on it at that time.

MR. CONRAD: Judge, on further reflection, I'm not sure if this is an objection or not, but I'll make it such so you can deal with it in that context. Official notice, administrative notice in this case I believe properly extends to the existence of and content of orders that are issued by the administrative agency. In other words, you can take administrative notice that something has already been done. You can also take administrative notice of, you know, things like water freezes at 33 degrees Fahrenheit, things that are of common knowledge and so on.

I'm not sure, however, that given the lack of identity of parties, that it is entirely proper to take administrative notice of a witness' testimony in a prior proceeding that is in some -- I guess two cases, Empire District and Kansas City Power & Light, for the purpose of incorporating that into the record and for the purpose of basing a decision in this case upon the record in that case.

You in effect deny parties who are here the ability to cross-examine that witness if their witness -- that witness were here presently. And as we all know, the test for competent evidence is that it is subject to cross-examination. I cannot cross-examine Mr. Barnes. I cannot -- I don't know where he's testified. I had -- I was involved in both those cases, but I had different clients in them. So there's -- there's a little bit of a tension there.

I appreciate the desire -- if the issue

simply were did Mr. Barnes file testimony in those proceedings, I think that's properly a subject of administrative notice, that the Commission can say yes, he did, it's here in the record. But as far as going then into the questions and answers and the substantive content of what that testimony was, it seems to me that's kind of an end around the process here.

MR. MILLS: Judge, if I may?

JUDGE WOODRUFF: Let me ask this question first. Are you actually offering his testimony or the decisions in those cases that reference his testimony?

MR. BYRNE: I'm offering his testimony. The Staff has taken completely inconsistent positions on growth rate in the last two cases. I can't imagine why I can't offer that as evidence. They've taken completely inconsistent positions with the position they're taking in this case. I can't bring that to the Commission's attention? Is that what the ruling is here?

MR. CONRAD: Mr. Barnes is subject to subpoena, I guess. I presume, if counsel for the company made appropriate requests at the appropriate time he could be provided to come to the stand.

MR. BYRNE: They've admitted in a Data Request that they've taken inconsistent positions and I can't offer the Data Request into evidence? They've admitted it.

JUDGE WOODRUFF: That's my ruling.

MR. MILLS: If I may go back to the question of official notice, 536.070 sub 6 says that agencies shall take official notice of all matters which the courts take judicial notice. They may take -- says they may also take official notice of technical or scientific facts not judicially causable within their competence if they notify the parties during the hearing so and so forth of the facts that they propose to take such notice of and give the parties reasonable opportunity to contest such facts or otherwise show it would not be proper if the agency were to take notice of them, .

So I think the concept is that the agency can take notice of facts, for example the fact that Mr. Barnes filed testimony or the fact that Mr. Barnes recommended a growth rate of X, Y or Z, but I don't believe that it's proper to take judicial notice of an entire piece of testimony, perhaps of the facts therein when the parties are given proper notice of which facts therein that the Commission plans to take judicial notice of.

JUDGE WOODRUFF: And that brings us back to the document.

MR. BYRNE: I'll get the document and --

JUDGE WOODRUFF: Well, no. I meant the

document like Exhibit 65, which contains Staff's responses indicating what the growth rates were.

MR. MILLS: I don't know that we know that. This purports to be a document that shows Staff's DR and responses thereto, but no one has asked Mr. Hill whether or not he's prepared these responses.

MR. BYRNE: Those are admissions from a party opponent, your Honor.

JUDGE WOODRUFF: They are responses from Staff, and I assume Staff would agree that these are, in fact, your data request responses?

MR. THOMPSON: Absolutely.

MR. MILLS: If the Staff wants to stipulate to their authenticity, that's one thing, but barring that, there is no foundation.

MR. THOMPSON: I will stipulate to their authenticity. My objection is on the grounds of relevance, your Honor.

JUDGE WOODRUFF: Well, I'm going to reconsider my prior ruling and allow 65 into evidence --

MR. BYRNE: Thank you.

JUDGE WOODRUFF: -- to show those facts. All right. Let's move on then.

MR. MILLS: Judge, the entirety of Exhibit 65?

JUDGE WOODRUFF: Is there a limitation that the company would like to put on it?

MR. BYRNE: No, your Honor.

MR. MILLS: Some of these are talking about Empire's credit rating, and I thought we were admitting this for the purpose of Staff's position on growth rates.

MR. BYRNE: I would exclude the credit rating things.

JUDGE WOODRUFF: Can you tell me exactly which responses are involved?

MR. BYRNE: Sure. The first one, 29 tells who the witness was, so we need that. 29, 30 and 31 give me what I need on the Empire decision, and then -- and then -- well, really 32 also. 33 is a credit rating one, those -- that doesn't go to the point I was making. And 34 is a credit rating one. 35 is credit rating one. And then 37, 38, 39 and 40 are related to Kansas City Power & Light.

JUDGE WOODRUFF: So we're just -- we're dealing with 29, 30, 31 and 32 then?

MR. BYRNE: Yes, and the ones about Kansas City Power & Light, too.

MR. MILLS: 32 talks about dividend yield rather than growth rates. The questioning and the argument that Mr. Byrne had raised was the Staff's position on growth rate, nothing to do with the dividend yield.

MR. BYRNE: Okay. I agree with Mr. Mills.

MR. THOMPSON: Can I inquire, your Honor, as to the basis of your change of your ruling? Mr. Hill testified he did not rely on the testimony or position offered by Staff in any prior case in reaching his independent professional conclusions.

JUDGE WOODRUFF: I understand that.

MR. THOMPSON: Therefore, this information is absolutely irrelevant to any matter before this Commission for decision.

MR. BYRNE: It's a prior inconsistent position of Staff. It's very relevant.

JUDGE WOODRUFF: As indicated, I'll allow 29, 30 and 31.

MR. BYRNE: And then the same for Kansas City Power & Light would be 38, wait -- 37, 38 and 39, those are the equivalent ones in the Kansas City Power & Light decision.

JUDGE WOODRUFF: 37, 38 and 39?

MR. BYRNE: Yes.

JUDGE WOODRUFF: And 40 and 41 would be excluded?

MR. BYRNE: Yes.

JUDGE WOODRUFF: All right. That's the ruling.

(PORTIONS OF EXHIBIT NO. 65 WAS RECEIVED INTO EVIDENCE.)

JUDGE WOODRUFF: All right. And I believe after all that, we're ready to come up for questions from the Bench. Commissioner Murray?

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good afternoon.

A. Good afternoon.

Q. Just very briefly. Sorry, very briefly. Do you know how the Commission has treated flotation costs in the past?

A. I haven't studied the Commission decisions, but it's my understanding in talking with Staff that the Commission has not allowed flotation costs as an explicit adjustment to DCF.

Q. Has the Commission allowed those costs to be expensed?

A. That is my understanding as to the way the Commission's treated it in the past.

Q. All right. Do you have any problem with that?

A. Not a bit.

COMMISSIONER MURRAY: All right. I think

that's all I have. Thank you.

JUDGE WOODRUFF: Commissioner Clayton, do you have any questions for Mr. Hill?

COMMISSIONER CLAYTON: I have no questions. Thank you.

JUDGE WOODRUFF: Mr. Chairman?

QUESTIONS BY CHAIRMAN DAVIS:

Q. Good afternoon, Mr. Hill.

A. Good afternoon, sir.

Q. You just -- Commissioner Murray just asked you a question I want to follow up. You said the Staff told you that the Commission has denied flotation costs in the past?

A. I think I said the Staff said the Commission didn't allow flotation costs. That's the same thing, I guess.

Q. Okay.

A. In my discussions with Staff attorneys, that was the information I got.

Q. All right. Did they give you any other advice?

A. No, sir.

Q. No. Do you recall Mr. Conrad's questions where I believe he asked you about whether or not you analyzed the effect of a fuel adjustment clause on your

recommended ROE? Do you recall? Do you recall that?
A. Yes, sir.
Q. Do you recall that you said that you did not investigate that, that being a fuel adjustment charge, because Staff wasn't in favor of it?
A. They weren't in favor of recommending that the Commission implement a fuel adjustment clause. They didn't tell me one way or the other, anything to do about my cost of equity recommendation. That was my decision. I knew that Staff was not in favor of implementing an FAC, and so my equity cost estimate had to take that into account. Staff gave me no instruction of any kind at any time with regard to my equity cost estimate.
Q. Okay. Well, did they tell you anything else that they were or were not in favor of?
A. Having to do with this case? Of course I know that's what you meant. No. I discussed generally with Mr. Rackers when sitting around talking before deposition when I flew out here for deposition in St. Louis about generally the Staff's, you know, outline of what they thought their positions were going to be, where they were coming down on the issues, but nothing specific, nothing in great detail.
Q. Okay. So they did -- they did outline for you in advance what their positions were going to be?

A. No. I wouldn't say that here's where we were on X, Y or Z. They didn't do that. We talked about the progress of the case, where they were with developing their position and that sort of thing. And one of the questions that came up was, are you going to recommend adoption of a fuel adjustment clause? And the answer was clearly no, and so I had to take account of that in my recommended ROE.

Q. Okay. Hypothetically speaking, all other things being equal, if you're going to invest your money in a utility and you had to choose between two utilities, one with an ROE of 10.65 percent and one that paid 9.5 percent, which one would you choose?

A. If you're talking about a return, a guaranteed return based on stock price, then you'd have to choose the one with the higher return. But an allowed return of 10 percent in one case and 9 percent in another case is not going to determine what an investor makes than stock price. What will happen is the company that has the higher return, the stock price will be adjusted so that the investor receives his required return.

That's the whole premise of the DCF. So if you allow a company a 50 percent return, investors are going to be attracted to that company and the stock price will increase, but after arbitrage, the -- the return I receive on the market price, which is the way I have to get into it, is going to be the same as the company making 9 percent.

Q. All right. What if -- what if you're not the investor, what if you are the actual company itself and you have to choose between a jurisdiction making 10.65 percent and one paying 9.5 percent. If you have discretionary money, where would you invest it?

A. If after having fulfilled my public service obligation I had discretionary money to do something else with that was within the regulatory confines, I would invest it where I could make the most return on it. It's very clear.

Q. Okay. And once again, hypothetically speaking, if all other relevant factors are equal, including return on investments and return on equity, if you were going to invest money in an electric utility, would you choose an electric distribution utility that didn't have to deal with fuel costs or operating plants or one that does operate plants and incurs fuel costs?

A. All else equal was your preface?

Q. All else equal.

A. Then you take the lower risk company. However, the only caveat I have is there's only one -- only in Texas are there true pure wires companies that have no provider of last resort that I'm aware of, because Texas, as you know, sets it up so there's a generation company, a wires company and a retail electric provider. The wires company doesn't have any responsibility by commodity. They don't care if granny gets her electricity or not. It's not their problem.

Everywhere else that I'm aware in a deregulated environment where there are transmission companies, most of those of which I'm aware have provider of last resort responsibility, which means that they don't have the operating risk of somebody dropping the cigarette lighter in the turbine, which is pretty small really, but they do have the commodity risk, which is sizeable. If there's not power for all the grannies out there, then they've got to go find it somewhere and they've got to pay for it, and that's -- that's the main risk of generation that people are worried about.

So I have to be a little bit careful when we say a company is pure T&D and therefore is way less risky than an integrated company.

Q. What's the most recent completed rate case that you've participated in?

A. I would say it would be Puget, Puget Energy in Washington state. It was this summer. 10.2 was the recommended ROE.

Q. Okay. And you recommended 10.2?
A. No, sir, I did not.
Q. Okay. What did you recommend?
A. I couldn't give you an exact number. I can look it up. I've got my computer here. But I would say it would be in the 9.5, 9.25 range.
Q. So your recommendation, to the best of your knowledge, was 9.25 to 9.5, and the Washington Commission awarded 10.2?
A. Yes, sir.
Q. Okay. When's the last time you testified in front of the FERC?
A. That's been a while. I haven't testified before FERC in the 2000s. It's been the 1990s.
CHAIRMAN DAVIS: Okay. No further questions, Judge.
JUDGE WOODRUFF: Commissioner Jarrett, did you have any?
COMMISSIONER JARRETT: No questions.
JUDGE WOODRUFF: Then we'll go back to recross based on questions from the Bench, beginning with Public Counsel.
RECROSS-EXAMINATION BY MR. MILLS:
Q. Mr. Hill, the case in Washington state you just testified about, what was the utility?

A. Puget Energy.
Q. Is that a vertically integrated electric utility?
A. Yes, it is.
Q. About how many customers does it have?
A. Oh, I couldn't give you a number. It's a mid-sized electric utility. It's the largest one in Washington state.
Q. Roughly similar in size to AmerenUE?
A. I would say it would be similar. May be a little smaller.
MR. MILLS: That's all the questions I have.
JUDGE WOODRUFF: For the State?
MR. IVESON: I have nothing, your Honor.
JUDGE WOODRUFF: Noranda?
MR. CONRAD: Nothing further, your Honor. Thank you.
JUDGE WOODRUFF: MIEC?
MS. VUYLSTEKE: No questions.
JUDGE WOODRUFF: MEG?
MS. LANGENECKERT: No questions.
JUDGE WOODRUFF: Ameren?
MR. BYRNE: No questions.
JUDGE WOODRUFF: Any redirect?

MR. THOMPSON: Absolutely.

REDIRECT EXAMINATION BY MR. THOMPSON:

Q. Mr. Hill, before you came down here to testify today, did anybody tell you what result to reach in your analysis?

A. No, sir.

Q. In doing your analysis, did you pay any attention to anything Matt Barnes had said in any prior case before this Commission?

A. No, sir. My recommendation in this proceeding is based on current market data, my review of the financial literature in my expertise developed over the past 25 years, not on what somebody else thought last year.

Q. Is it your understanding that this Commission does not treat flotation costs as a component of return on equity?

A. That's my understanding.

MR. THOMPSON: Thank you.

JUDGE WOODRUFF: All right. Then Mr. Hill, you can step down.

THE WITNESS: Thank you, sir.

JUDGE WOODRUFF: And we're due for a break. We'll come back at 2:45 with Mr. Gorman.

(A BREAK WAS TAKEN.)

JUDGE WOODRUFF: Let's come to order, please. All right. We're back from break, and Mr. Gorman has taken the stand. If you'll please raise your right hand.

(Witness sworn.)

MR. MILLS: Judge, before we move on, can I ask a clarifying question? Where did we leave the question of official notice of testimony from Mr. Barnes? Is the Data Request responses that you did admit instead of that or in addition to that?

JUDGE WOODRUFF: That was intended to be instead of that.

MR. BYRNE: That was my understanding, too, Judge.

JUDGE WOODRUFF: All right. You may inquire.

MICHAEL GORMAN testified as follows:

DIRECT EXAMINATION BY MS. VUYLSTEKE:

Q. Could you state your name and business address for the record.

A. My name is Michael Gorman. My business address is 16690 Swingley Ridge Road, Chesterfield, Missouri.

Q. Are you the same Mike Gorman that caused the direct testimony of Michael Gorman and the rebuttal testimony of Michael Gorman, Exhibit 600 and 601, to be filed?

A. Yes.

Q. And if I were to ask you the questions contained in that testimony today, would your answers be the same under oath?

A. Yes.

MS. VUYLSTEKE: At this time I would like to request that Exhibits 600 and 601 be admitted into the record.

JUDGE WOODRUFF: Exhibit 600 and 601 have been offered. Are there any objections to their receipt?

(No response.)

JUDGE WOODRUFF: Hearing no objections, they will be received.

(EXHIBIT NOS. 600 AND 601 WERE MARKED FOR IDENTIFICATION AND RECEIVED INTO EVIDENCE.)

MS. VUYLSTEKE: And I will tender the witness for cross.

JUDGE WOODRUFF: For cross-examination, then, we begin with MEG.

CROSS-EXAMINATION BY MS. LANGENECKERT:

A. Good afternoon.

Q. Were you here yesterday when Ms. LaConte testified?

A. Yes.
Q. And did you hear some questions that were presented to her about the generic ROE that's been proposed in her testimony?
A. Yes.
Q. And did you hear a specific question that related to the ROEs that have been allowed in California?
A. Yes.
Q. And could you explain for us the difference between the California ROE and a Missouri ROE, why there would be any type of disparity?
A. Well, the risk characteristics of California utilities when I was in those cases, the last time was a few years ago, the California utilities exhibited a different risk profile than AmerenUE in particular and the other Missouri utilities that I've taken a look at. California has some unusual risk characteristics related to their attempt to go from a regulated environment to a deregulated environment and then to come back to some hybrid form of regulated environment. There's significant off-balance-sheet obligations for those utilities.
There's -- at the time I was looking at it, there wasn't clear legislative allowance for them to invest in new generating resources needed to serve retail

customers, and a lot of the mechanisms, rate mechanisms that ensured full recovery of costs were not clearly spelled out, at least a few years ago.

So at that time I would suggest that the risk for a California utility would not be a reasonable risk proxy for that of a Missouri utility, which has main -- stayed the course in terms of regulatory cost of service price setting for utilities, which has financially protected the utilities and preserved a much stronger and more attractive from an investor standpoint utility companies.

Consequently, I would think the cost of capital for utilities in Missouri would be lower than what the California Commission would find appropriate for California utilities.

Q. And then a lower ROE?

A. Right.

MS. LANGENECKERT: Thank you.

JUDGE WOODRUFF: For Noranda?

MR. CONRAD: Very quickly, Judge.

CROSS-EXAMINATION BY MR. CONRAD:

Q. Good afternoon, Mr. Gorman.

A. Good afternoon.

Q. Following up on one question about the California situation, are you aware of any utilities in

California or any holding companies in California that have gone bankrupt?

A. Yes.

Q. And that would be?

A. Civic Gas & Electric.

Q. And that's a holding company, isn't it, or was it subsidiary to, if you know?

A. I'm trying to recall back when it was in bankruptcy. It's a holding company now, but I have to review to see whether or not there was a structure like that at the time of the bankruptcy. I would have to review that.

Q. As far as you're aware, had any Missouri utilities gone into the bankruptcy court?

A. I'm not aware of any.

Q. Lo even Aquila?

A. They came very close.

Q. You have been here, I think, most of the day, I take it?

A. Yes.

Q. And you heard, I hope, the series of questions about the impact of FAC one way or the other that I've asked the other ROE folks. Did you make an assumption in your recommendation one way or the other on an FAC?

A. Well, I implicitly did. I made the assumption that AmerenUE's risk would not change after the rates determined in this proceeding would go into effect, and since AmerenUE currently does not have a fuel adjustment clause, then its risk after these rates go into effect would reflect no fuel adjustment clause in existence. I also observed in my testimony that if a fuel adjustment clause were implemented, that would reduce that risk and would justify a lower return on equity.

Q. Had you done anything in the way of quantifying what the -- in basis points what the value of the FAC might be?

A. I did not in this testimony, no.

Q. Do you disagree generally with -- with what you heard Mr. Hill and Dr. Morin state about that?

A. I do not. I have in other proceedings attempted to estimate a return on equity adjustment through the reduced operating risk associated with implementing a fuel adjustment mechanism, and I did it in a way that was very similar to what Dr. Morin's proposing to do here, and that is to look at the beyond yield spread between companies with more cost recovery assurance relative to other companies with -- with less cost recovery assurance.

I did it more broadly through looking at the yield spread between single A rated utilities and then E double A or triple B utilities. He refined that a little bit to identify companies with and without fuel adjustment clauses, but it's a similar methodology.

Q. But I take it you would agree -- and I think you testified to this a moment ago, but let me just be clear -- the presence of an FAC clause would in your view make an electric utility less risky than the same situation, same utility, all other things being equal but no FAC?

A. All other things equal, yes.

Q. Now, you follow the rating companies, I take it? I mean, you understand the rating company structure, what they do?

A. Yes.

Q. And is it -- is it fair that -- a fair characterization that a rating agency's primary function is to give creditors and prospective creditors insight into the utility's financial condition?

A. Yes.

Q. But that's limited to creditors, isn't it, not investors? I mean, stock investors, equity investors?

A. Well, their emphasis is on the credit standing of the utility, but that provides information on the overall investment risk for both bond holders and

equity holders.
Q. Sure. But their primary interest is from the creditors, right?
A. Yes.
Q. Are you aware of any instance in which a rating agency has changed the rating based on the provisions of a utility's FAC as regards the number of accumulation periods?
A. No.
Q. I think Mr. -- or Mr. Hill characterized that as parsing the clause. That was his term, and I thought it made some sense. It's kind -- in your view, it's kind of a yes, no, they have one, they don't; is that fair, from the rating agency' perspective?
A. No. I think the rating agencies are capable of understanding a fuel adjustment clause and understanding the -- the effect of that clause in allowing a utility to produce the cash flows necessary to support financial obligations. So I think they are -- are familiar with regulatory mechanisms and the implications those mechanisms have on a utility's cash flows.
Q. Are you aware of any instance in which a rating agency changed the rating of a utility's -- or their bonds or their credit rating as a result of the duration of the FAC recovery period?

A. No.
Q. How long would you expect an FAC to remain in effect for Ameren if one were approved?
A. Well, typically rate mechanisms are implemented at least in between rate cases, so I would think that if it -- it would at a minimum be in effect between now and the next rate case.
Q. Would you expect the rating agencies to make the same assumption?
A. Unless -- yes, unless there is reason to assume otherwise.
Q. Let me ask you about that duration question. Are you aware of any instance in which a rating agency changed a rating based on the provisions of a utility's FAC as regards the duration of the FAC or whether it had to be renewed?
A. I'm not familiar with -- with any change in rating or comments by a regular rating agency on that issue.
Q. Okay. So that would be a no?
A. Correct.
Q. Correct, it's a no?
A. It's a no.
Q. All right. Finally, are you aware of any instance in which a rating agency changed a rating for an

electric utility based on the perceived or stated intensity or timing of a prudence review for the utility and its FAC?

A. I have read comments in certain utilities' credit reviews where they comment on deferred fuel accounting mechanisms and proceedings which may take time to establish the prudency of major costs and whether or not they should be recovered from retail ratepayers.

Q. Would that be pertinent to the FAC or would that be the utility generally?

A. Certainly is to the utility generally. Yes, I mean, it's not -- not the structure of the FAC. It would be whether or not the actions of the utility were prudent or not.

MR. CONRAD: All right. Thank you, Mr. Gorman. And thank you, your Honor.

JUDGE WOODRUFF: Then Public Counsel?

MR. MILLS: No questions.

JUDGE WOODRUFF: Staff?

MR. THOMPSON: Thank you, your Honor.

CROSS-EXAMINATION BY MR. THOMPSON:

Q. Good afternoon, Mr. Gorman.

A. Good afternoon.

Q. We've seen you here before a few times, haven't we?

A. Yes.
Q. Now, your recommendation is 10.2; is that correct?
A. It is.
Q. And I believe you told Mr. Conrad you did not calculate how you would change that if, in fact, the Commission awarded a fuel adjustment clause to Ameren?
A. Correct.
Q. Now, Dr. Morin rated the fuel adjustment clause was worth 25 basis points. Would you agree or disagree with that?
A. I think that's a reasonable estimate.
Q. And were you here when Mr. Hill testified?
A. Yes.
Q. And he agreed with Dr. Morin's rating, did he not, 25 basis points?
A. With the 25 basis point adjustment, yes.
Q. Now, were you here yesterday when Ms. LaConte testified?
A. Yes.
Q. And she rated that as worth 20 basis points. Are you aware of that?
A. I believe that's correct, yes.
Q. And is that in the ballpark or too small?
A. I think it's in the ballpark.

Q. Okay. So it's not an exact science, is it?
A. That's correct.
Q. Okay. Now, you're aware that the Commission awarded AmerenUE 10.2 in its last rate case, are you not?
A. I am.
Q. And do you believe conditions have changed materially since that award was made?
A. Well, they certainly have in the last month.
Q. Let's leave the last month out of it for the time being. If the last month had not happened, would you believe that conditions had changed materially?
A. Not materially. I think if you look at my recommendation in the last case, it was a little bit lower than my recommendation was in this case. So I think there has been a modest increase in the cost of capital since the last case, but at best it's modest.
Q. Now, let's focus on the last month. Would you agree or disagree that the last month has seen interest rates fall?
A. Treasury instrument yields have fallen, yes.
Q. And yet paradoxically at the same time would you agree that the last month has seen the

availability of capital severely constricted?

A. Outside of the treasury market, that's correct.

Q. So do the standard or classic tools of financial analysis even apply to a situation such as has been seen in the past month and continues today?

A. Well, classic financial models assume rational market expectations, and I believe the market activity over the last few weeks is extremely difficult for anybody to understand and form reasonable expectations of how those activities will translate into future changes in the market going forward.

So I don't think the rational expectation underlying assumption of traditional financial models would necessarily hold relying on current available security valuations and yields.

Q. Now, are you aware that Dr. Morin described your analysis as results-oriented, self-serving and inconsistent --

A. Yes.

Q. -- because you evidently used a different sort of DCF tool?

A. Yes.

Q. And what's your reaction to that? Do you agree or disagree?

A. Well, I disagree with that. My procedure for conducting the DCF analysis and recommending return relying on DCF studies was the same in this case as it has been in just about every piece of testimony I file. I don't simply conduct a cost of growth DCF analysis and offer it as a reasonable estimate without some review and test.

Over the 20 years I've been performing rate of return studies, I have found at times the DCF return from a constant growth model to be either too low or, as I have more recently found it, to be unreasonably high. The reason I had reached those conclusions was based on the sustainability of the growth rate estimate used in the constant growth model.

An important assumption in a constant growth DCF study is that the growth rate you use has to be sustainable over an indefinite period of time, that is over the life of the common equity security, which is in infinite life. If that growth rate is irrationally high or low, the DCF return produced from a cost and growth DCF analysis will not be reliable nor accurately estimate the cost of capital for the utility company.

Based on that overall assessment which has been -- I have employed generally consistently over the last 20 years, there have been times such as in the mid to early 1990s where I've rejected the constant growth DCF results because those results have been too low and more recently, for the reasons outlined in my testimony, I've been rejecting the constant growth DCF results now because the growth rates are unsustainably high and inflate the DCF return estimates.

So I have consistently applied that model. I've consistently tested that model, and in the unusual circumstances where I found the constant growth DCF return did not produce a reasonable result, I went into great detail explaining why. I didn't have confidence in it and reached my conclusion that the constant growth DCF result was not reasonable.

Q. Thank you. Now, with respect to the CAPM, did use the same CAPM analysis in this case that you have used in the past?

A. Yes.

Q. What about Dr. Morin, did he use the same CAPM analysis in this cases that he has used in the past?

A. He has used different -- he has used the same CAPM analysis, but he has used different beta estimates in that CAPM study. And, of course, the beta estimate used in the CAPM study is a little bit like the growth rate in the DCF. It's the lynch pin of the accuracy of the CAPM return estimates.

Just a few years ago when utility betas were -- electric utility betas in particular were abnormally low, Dr. Morin set aside those electric utility betas and used other proxy betas primarily from gas utility groups to plug into a CAPM study to support his return on equity recommendation for an electric utility company.

That's different than what he did in this case. So he has not consistently applied that CAPM analysis, but he explained why he used different information and -- and did that in support of what he thought to be an appropriate return on equity estimate.

Q. Okay. Now, would you agree with me that return on equity is profit?

A. Yes.

Q. And how much profit would your recommendation yield to AmerenUE on an annual basis given its equity ratio and its capital structure and its capitalization?

A. Approximately a $5.9 billion rate base at 51 percent common equity ratio of capital and a 10.2 percent return on equity, that equates to about $310 million of common equity return. The revenue requirement of that would be adjusted upward for income taxes. So that would be, roughly speaking, almost

$500 million of total revenue requirement to customers.

MR. THOMPSON: I have no further questions. Thank you.

JUDGE WOODRUFF: All right. For AmerenUE?

MR. BYRNE: Thank you.

CROSS-EXAMINATION BY MR. BYRNE:

Q. Mr. Gorman, I have your deposition. I'm not going to mark it as an exhibit, but I would like to refer to it if I could. And don't worry, it won't clutter the record in this case.

MR. CONRAD: Judge, I kind of wonder how the difference of treatment is if the materials are handed to the members of the Commission even though they're not marked as an exhibit or not admitted into the record. Does that seem somehow antithetical with protection of the record to you?

JUDGE WOODRUFF: Well, if it's not part of the record, obviously it won't be relied on in the decision.

MR. BYRNE: I am going to walk him through some of the questions and answers in the deposition.

JUDGE WOODRUFF: Mr. Conrad, would it be helpful if we marked it even if it's not admitted?

MR. CONRAD: Well, counsel can run his own case. I'm just questioning whether it's appropriate to give materials to the Bench that really are not going to be part of the record. It kind of creates the problem on the record, which is, in fact, why I'm making the statement, to indicate on the benefit of the record that this is what's going on.

JUDGE WOODRUFF: Do you wish to make it a formal objection?

MR. CONRAD: Well, I'd like not to, but if it's necessary to do so, I guess I will.

JUDGE WOODRUFF: All right. Mr. Byrne, is there a reason why we would need to have it?

MR. BYRNE: I don't know. Because I'm going to read from it. If you don't want to have it, I'll be glad to collect it back, whatever. I'm not going to --

MR. CONRAD: Once again, we went through this before, and I don't have an objection and wouldn't have had any objection for Mr. Byrne in the earlier example if we were using the deposition in the way that I understand at least is the proper way to use it.

JUDGE WOODRUFF: Which I assume is what you're planning on doing?

MR. BYRNE: That's what I'm planning on doing. I'm trying to comply with the ever-evolving standards to the use of depositions in a Commission proceeding.

MR. CONRAD: As far as ever-evolving, maybe I went to law school in a different era, but it's been that way since I've been around, so I'm not sure about evolving.

But that doesn't explain why the whole packet is there, if we want to use particular parts of it. And by the way, the rule on that is, if the witness is asked the question and issued an answer and they're inconsistent, that's the end of it. That comes in and the witness has been impeached. That's the end of it. So I'm still kind of at sea, your Honor, about why this big sheath of paper.

MR. BYRNE: Just tell me what you want me to do, Judge. I'll do it however you like.

JUDGE WOODRUFF: I'd say take them back.

MR. BYRNE: Okay. I will take them back.

JUDGE WOODRUFF: Less poundage for me to carry back upstairs.

MR. BYRNE: I think I'll take Stu's back as well as long as I'm taking it back.

BY MR. BYRNE:

Q. Okay. Try to stay calm here.

Good afternoon, Mr. Gorman.

A. Good afternoon.

Q. My understanding is that you are

recommending a range of returns on equities from 9.81 percent to 10.55 percent; is that correct?
A. Yes.
Q. And based on the deposition I took, my understanding is you would agree that anything within your range is reasonable?
A. Yes.
Q. Okay. And in order to arrive at that recommendation, you did a number of analyses, right?
A. Correct.
Q. And my understanding is you did three DCF analyses; is that correct?
A. Yes.
Q. And then a capital asset pricing model analysis; is that right?
A. Two of them actually, but yes.
Q. And then a risk premium analysis?
A. Again, two of them.
Q. Okay. Do you think you can just run over for me what the percentage for each one of those analyses were, the ROE that was used?
A. The results of the analysis?
Q. The results. That's the word I was searching for.
A. That's summarized at page 36 of my

testimony.

Q. Which testimony, direct?

A. Direct testimony, yes.

Q. So it looks like -- okay. You want to --

A. You probably haven't noticed, but the constant growth model is not on that table.

Q. Didn't notice that.

A. So that summarizes two of my three DCF studies, my risk premium results and my CAPM results. The constant growth DCF results are shown on page 18 of my testimony.

Q. So let me just read and make sure I get them right. The constant growth is 11.86; is that correct?

A. Yes.

Q. And then the final result of the two-stage growth DCF would be 9.73 percent?

A. Correct.

Q. And multi-stage growth DCF is 9.89?

A. Correct.

Q. Risk premium is 10.46 percent?

A. Yes.

Q. And CAPM is 10.63 percent?

A. Correct.

Q. Okay. And as I understand it, the one --

the one that you excluded, which isn't on the chart, is the constant growth one, and -- is that right?
A. Yes.
Q. And it seems like people have been inconsistently referring to it. Is that also known as single stage DCF?
A. Yes. That would be a consistent description of the model.
Q. Okay. And can you tell me the difference between each of the models, what is -- how does the constant growth or single stage DCF work for starters?
A. Description of the three DCF models?
Q. Yes.
A. The constant growth model is -- is based on a stock price and dividend to produce a yield and a growth rate that is expected that initially will be held into perpetuity. So there's one growth rate over the entire life of the investment.
The two-stage growth methodology assumes that there's two periods of growth over the life of the security, a first stage growth, which consists of the first five years and a second stage growth which starts in year six and runs through perpetuity.
The three-stage or multi-growth stage DCF analysis has three growth periods. The first five years,

there's a transitional growth stage between that first stage growth and the third stage growth which lasts from year six through ten, or six through nine, and then the third and final constant growth state which starts at the end of the second stage and continues into perpetuity.

Q. Would it be fair to say that the constant growth or single stage DCF model is the one that is most usually historically been used by this Commission and other commissions around the country?

A. It is normally a -- the DCF model that is given primary consideration in supporting authorized terms of equity.

Q. That's been your history at least, hasn't it?

A. It normally is appropriate to use that model to form a return on equity recommendation in a rate proceeding, yes.

Q. Okay. And let's talk for a minute about the two-stage and multi-stage. Well, let's just talk about the two-stage DCF. Isn't there some judgment in deciding where the break point is in those two stages? In other words, your break point is at five years; is that correct?

A. Yes.

Q. You calculate one growth rate for the first five years, and then year six to perpetuity is a second growth rate, right?

A. Yes.

Q. And wouldn't it have been possible to make the break point at four years or six years or three years or seven years?

A. Well, it is possible, but as we discussed at my deposition, there's -- there's legitimate reasons for structuring the growth periods based on the time period of the growth rate that is used for the short-term and long-term growth rate which those growth rates were made to represent.

For example, the analyst growth rate which is used as my constant growth rate, long-term sustainable growth rate and my constant growth rate or one-stage DCF model was used in the first-stage growth in my two-stage DCF model and my multi-stage DCF model.

That growth rate is designed by security analysts to represent growth over the next three to five years. So it would be appropriate to use that growth rate over the time period it was designed to reflect.

Q. But you could have made the break at three or four or five years, could you not have?

A. Yes.

Q. And for that matter, did those analysts

have a prediction for year six, seven and eight?
A. No.
Q. So you really don't know what the analysts are projecting for years six, seven and eight, do you?
A. That's the difficulty in understanding what a reasonable -- what the market is expecting for long-term sustainable growth. You can get some pretty good information of what they're expecting in the next three to five years, but after that it's very difficult to predict.
Q. I guess my point is just that it's not an exact science. You can break it at different points in the two-stage growth, couldn't you?
A. You can break it at different points, yes, but there are logical reasons to support a specific structure of the model.
Q. And haven't you been criticized before or people -- not maybe just you, but people use the two-stage growth model, hasn't that been a criticism in the past, that there's -- there's some discretion in where it can be broken?
A. That has been a criticism. It's just where the abnormally high -- well, recently the short-term doesn't have normally high growth stage, period. So the criticisms I've gotten from utilities more recently is how do you know the abnormally high growth will stop after

year five. Maybe it will continue through year ten. So I thought that was a reasonable criticism of what I was doing, so that's when I started implementing the multi-growth-stage DCF study.

Q. And isn't there some of the same kind of judgment in deciding how to structure a multi-stage DCF? I mean, don't you have the same issue of where are the break points? I guess you have just a few more break points in a multi-stage DCF, but isn't there the same kind of judgment as to where to make those break points?

A. There is the same kind of judgment, but again, there's logical and supportable considerations in just how to design those multi-growth periods.

Q. Sure. Sure. I mean, I'm not criticizing your judgment. I'm just saying there is judgment that has to be exercised; is that correct?

A. Yes.

Q. And let me ask a little bit more specifically about your history and using each one of these models. Okay. When did you start, you know, giving recommendations on return on equity? How long ago was that?

A. It was in the late '80s.

Q. Okay. And when you started, what DCF model did you use?

A. At the time I was using the constant growth DCF study.

Q. Okay. And my understanding from our deposition is you used that pretty consistently up until a point in the mid to late '90s; is that true?

A. About five years later, because three to five-year growth rate outlooks were very low for utility companies, largely because rate base were flat to declining and there was a major move to deregulation at that time. There was not expectations for significant growth to utilities over the next three to five years.

I found that those short-term growth outlooks were abnormally low, so at that point in time I started using a multi-growth-stage DCF analysis to reflect the rational expectation that this relatively short period of low growth would eventually transform into a period of higher, more normalized growth for utility companies.

Q. And I think you provided an exhibit that had six cases that took place in the mid to late '90s. I think the years were like '96, '7 and '8? Does that sound right? I don't have it in front of me. Maybe you know where it is.

A. It's on the surrebuttal, MPG-S-1, it was about the period '94 through '97, I believe, were the examples offered.

Q. And there were -- and there were I think, is -- are there six cases on that exhibit?
A. Yes.
Q. Are there any others that you know during that period where you didn't use the constant growth DCF?
A. Well, I mean, this was intended to represent the cases in which I used the non-constant growth DCF because I found the constant growth number to be unreasonably low, and I did not do an extensive study of all my previous testimony. I followed that procedure for many years around this point in time.
Q. But for many years it's '94, '95, '96, '97 time frame?
A. Yeah, around that time period.
Q. Okay. And let me ask you, what were you using during this time period? What DCF analysis were you using?
A. It was a multi-growth stage DCF study.
Q. And was it exactly like the multi-stage DCF study that you're using in this case?
A. It was an earlier generation of the study, and the problem I ran into at that time was that utility payout ratios, I think we -- Dr. Morin talked about that a little earlier today -- were at abnormally high rates.
Q. So how did -- what were the mechanics of

that multi-stage DCF that you used in the mid '90s?

A. The mechanics of it were a little more detailed than what I'm doing now. The first two stage reflect projected dividend growth, not earnings growth. The third stage was when constant growth parameters would come back and dividends earnings and book value would all grow at the same rate into perpetuity.

The significance of the study back at that point in time -- and by the way, a DCF study is designed to project dividend growth, not earnings growth. So if it's not reasonable to assume dividend, earnings are growing at the same rate, then it's appropriate to use dividend growth projections, not earnings.

But during this time period, dividends were expected to grow at a much slower rate than earnings because the utility's dividend payout ratios were very high, in some cases up nearly at 100 percent, in other cases, in most cases up around 90 percent, as Dr. Morin explained earlier today. Payout ratios have historically been around 70 percent and are --

Q. I think you --

A. -- around 65 percent now.

Q. I think you're not answering my question. I was just asking about the mechanics of how that --

A. I was trying to explain that. That was part of the mechanics of the model is it was designed to reflect slow dividend growth, slower than earnings growth, until the payout ratio came down to a level which would sustain constant or -- or long-term sustainable growth.

Q. What were the break points in years between the different stages in that model?

A. In that model, I was able to find security analysts projected dividend growth over five years. Starting in the third stage, I relied on a long-term sustainable growth rate based on either the overall market or the U.S. GEP. The transitional stage was the linear increase from the dividend -- the lower dividend growth rate at the end of year five systematically up to the higher long-term sustainable growth rate achieved starting in year 11.

Q. Okay. Then my understanding is you went back to the -- to using -- to relying exclusively on the constant growth DCF; is that true?

A. Around the late '90s, yes.

Q. Okay. And then keeping with your history, you stuck to that constant growth DCF until when?

A. It's been around 12 to 18 months, I believe.

Q. Okay. So --

A. Last 12 or 18 months.

Q. And when you switched in the last 12 or 18 months, what did you switch to? What was your initial switch from the constant growth?

A. Initially I went to the two-stage growth DCF model, and the --

Q. Okay. And did you ever average that or anything or did you just completely shift over from constant growth to two-stage?

A. No. At that time for a while I did continue to give some weight to the constant growth return.

Q. And then at -- I guess at a certain point you stopped and then it moved to -- and then it moved to no weight to the constant growth?

A. Correct.

Q. And then you were relying exclusively on the two-stage; is that correct?

A. Yes.

Q. And then you shifted again or moved a little again to incorporate the multi-stage with the two-stage; is that correct?

A. That's correct.

Q. Any other -- anything else in between or have I covered what you've done?

A. No. That's pretty much the pattern that I went through. I was troubled by the constant growth DCF, so I tried to test it.

Q. I think you've answered my question. And let me ask you this. In the Empire case, my understanding is part of the analysis the Commission did is they averaged your result from the constant growth with your result on the two-stage; is that correct?

A. I believe that's correct.

Q. Okay. I'm going to try to use some technology, but I may fail. Okay. I've tried to put up here, I don't know if everyone can see it, but I've tried to put what you are recommending in terms of the DCF, and make sure I've got it right, the part that's already up there. It says methods. So this is your recommended ROE, methods, two-stage DCF, multi-stage DCF, CAPM and risk premium. Are those the methods that you're using to develop your ROE in this case? And I think it's on page 36 of your direct testimony if you want to compare it.

A. Well, the first lines I agree with.

Q. Okay. What don't you agree with?

A. Well, I'm not sure where you're going with the middle section.

Q. No. I'm just on the very first one parallel with recommended ROE. That's all I'm talking about.

A. The first four lines under the column headings.

Q. Yeah. Those are correct, are they not, the two-stage DCF, the multi-stage DCF --

A. Yes.

Q. -- CAPM and the risk premium, those are the four analyses? I know you calculated the other one, but those are the four you're using, right?

A. Yes, shown on the page of my testimony I was just referring to.

Q. And I got your range, which I think you told me before was this 9.81 to 10.55 percent; is that correct?

A. Yes.

Q. And the net point you calculated was 10.20, right?

A. Well, that was rounded up. It was 10.18. I rounded it.

Q. Do you have a calculator with you?

A. I do.

Q. I guess my question is, could you calculate for me the average of those four analyses that you used of the four that you used?

A. All right. Without the constant growth?

Q. Without the constant growth. We'll get to that in a minute.

A. 10.18.

Q. Okay. And so I guess if you rounded up like you did for the midpoint it would be 10.2, 10.1 maybe?

A. Yes.

Q. 10.18. Okay. Then I guess I'm asking in the next section, what if you had added your constant growth DCF, what if you had given it one-fifth weight along with the other analyses, what would your recommendation have been, what would the average of those five have been and what would the range have been?

A. Well, I can give you the average and I can give you a range, but that's not my range.

Q. Sure. I understand.

A. The average is 10.51, and the range is 11.86 to 9.73.

Q. And what's the midpoint of that range?

A. 10.80.

Q. Okay. Then the next iteration is what if you would have done what you did 80 to 90 percent of the cases that you testified in, and that is use the old constant growth DCF and not the other ones, what would have been the average of your constant growth DCF calculation, your CAPM and your risk premium?

A. Just to be clear, I would not have done that in the last cases because I would have reached the same conclusion I did here, and that is a constant growth DCF result is not reasonable, but if I had not -- if I would have found the constant growth DCF result of 11.86 percent to be reasonable --

Q. Yep.

A. -- then the range -- well, the average of the constant growth with the risk premium and CAPM would be 10.98 percent, and the range would be 11.86 percent to 10.46 percent.

Q. And what would the midpoint of that range be?

A. 11.16.

Q. Okay. Now I'm going to ask you to do what the Commission did with your analysis in the Empire case, and my understanding is in that case they averaged your constant growth calculation with your two-stage DCF calculation, is that correct, and then used that as the DCF component of the --

A. Subject to check, I believe that's what they did.

Q. Okay. So the same questions with regard to that. What would the average be, what would the mid range be and what would midpoint be?

A. The DCF would average to 10.80 percent, and the average of that, that DCF result with the risk premium and CAPM would be 10.63 percent.

Q. Okay. And what would the range be?

A. The range would be 10.46 to 10.80.

Q. And what would the midpoint be?

A. 10.63.

MR. BYRNE: Okay. Your Honor, I'd like to have this chart marked as an exhibit. Obviously I'll need to make copies of it, but I'd like to offer it into evidence.

JUDGE WOODRUFF: All right. It will be No. 66.

(EXHIBIT NO. 66 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

JUDGE WOODRUFF: All right. Exhibit 66 has been offered into evidence. Are there any objections to its receipt?

(No response.)

JUDGE WOODRUFF: Hearing none, it will be received into evidence.

(EXHIBIT NO. 66 WAS RECEIVED INTO EVIDENCE.)

BY MR. BYRNE:

Q. I wanted to ask you, Mr. Gorman, there was some discussion in your testimony about the spread in yields between B double A bonds and A bonds; is that correct?

A. I believe the spread is between those utility bond yields and treasuries.

Q. Okay. Well, let me ask you this. Do you know what -- do you know what the current spread between B double A bonds and A bonds is?

A. I believe it's about a little more than a percentage point.

Q. Okay. Do you know what the current spread between, was it BAA bonds and treasuries that had been in your testimony, do you know what that currently is?

A. Currently, that's close to 400 to 450 basis points.

Q. Do you know what the yield, the absolute yield of BAA bonds is right now?

A. I think the latest yield I looked at is about 8.9 percent.

Q. In your deposition, I showed you some testimony from the state of Virginia that you had filed. Do you remember that?

A. Yes.

Q. You don't happen to -- well, it might be attached to your deposition.

A. Yeah, it's in here.
Q. Do you have that?
A. I have it.
Q. And it looks to me like it's from Case No. PUE-2007-00066 before the Commonwealth of Virginia State Corporation Commission; is that correct?
A. Yes.
Q. It's dated November 2nd, 2007?
A. Yes.
Q. And it's your direct testimony?
A. Appears to be, yes.
Q. And there was a provision that we talked about in your deposition, and it was on page 17, and I think this somewhat relates to something you were talking to Mr. Conrad about, but could you read the top, you know, the sentence beginning at the top of page 17 down to the end of the paragraph out loud.
A. Starting with the -- the first full sentence?
Q. Yeah.
A. My proxy group's average bond rating from S&P is lower than EPCO senior secured credit rating of A minus from S&P. The peer group's bond rating from Moody's is identical to that of EPCO's, comma, A3. Bond rating is an indication of the overall or total investment

risk of a utility company. Shareholders' risk is impacted by the credit risk because credit rating is an indication of likelihood that a utility will be able to fully meet its fixed financial obligations and thereafter meet equity investors' return expectations. Hence, the stronger the credit rating, the lower the risk and lower the cost of common equity. The bond rating indicates the proxy group is slightly more risky albeit comparable to EPCO.

Q. Is this what you were talking about a little while ago with Mr. Conrad?

A. Yes.

Q. And isn't it also sort of the theory behind an adjustment that the Commission made in the Empire case to your analysis where they added, as I recall, in their order they added 25 basis points to your analysis to reflect the difference in credit rating between your sample group and in that case Empire?

A. Well, I can't speak to -- speak specifically to the Commission's rationale for doing that, but --

Q. But they did it, would you agree?

A. The idea behind, as I understand what they did is they recognized a difference in bond rating can apply to difference in investment risk, and differences in investment risk can imply difference in cost of capital.

Q. My question was just did they do it? Did they adjust it by 25 basis points to account for that?
A. Subject to check, I believe they did that.
Q. Okay. And there was another adjustment in Empire where they made an adjustment to your recommendation based on the difference between quarterly and annual dividend assumptions; is that correct?
A. The quarterly versus the annual DCF model.
Q. And in that situation, my understanding is they adjusted five basis points to reflect that?
A. Subject to check, that sounds correct.
Q. And -- but that's the same kind of a thing Dr. Morin testified earlier would be -- would account for a 20 basis point differential. Is that what Dr. Morin was talking about?
A. He did say some number, but it would not be anything close to 20 basis points in today's market.
MR. BYRNE: Okay. Thank you very much, Mr. Gorman. That's all the questions I have.
THE WITNESS: Thank you.
MR. BYRNE: I won't offer his deposition.
JUDGE WOODRUFF: Very good. Questions from the Bench, then, Commissioner Murray?
QUESTIONS BY COMMISSIONER MURRAY:
Q. Good afternoon.

A. Good afternoon.

Q. My questions will be fairly brief. Can you say what is the nominal five-year and ten-year gross domestic product growth rate estimate right now currently?

A. Five and ten? Well, they have not changed. They were updated in October of this year, and they did not change from March earlier this year. The long-term forecasts are updated twice every year, but the five-year forecast is still 4.8 percent and the six-year, six through ten is about 5.0 percent.

Q. And how often did you say they're updated?

A. Twice a year. The longer term, the five and ten-year long-term GDP forecasts are updated every -- twice a year. The shorter term GDP projections are updated monthly, I believe.

Q. And do you know what the latest shorter term projection is?

A. I would have to check. I don't recall off the top of my head.

Q. You indicated in your testimony that utilities cannot sustain a growth rate that exceeds the growth rate of the overall economy for a long period of time; is that correct?

A. That is correct, yes.

Q. And have utilities -- how long have

utilities sustained a growth rate exceeding the growth rate of the economy?

A. Historically, if they have at all, has been for a relatively short period of time. Growth will increase as service area economics support large growth in the utility which supports large rate base growth. But eventually the growth rates decline to a more sustainable level, and historically speaking it's a level that's much lower than the GDP growth.

COMMISSIONER MURRAY: Thank you.

JUDGE WOODRUFF: Commissioner Jarrett?

COMMISSIONER JARRETT: Yes.

QUESTIONS BY COMMISSIONER JARRETT:

Q. Good afternoon, Mr. Gorman.

A. Good afternoon.

Q. I just have kind of a couple of quick questions. I believe you were here most of the day to hear some of the other testimony; is that correct?

A. Yes.

Q. I believe there was testimony, I believe it was by Dr. Morin, that the average ROE nationwide for a vertically integrated utility was 10.62. Does that number sound right? Do you recall that?

A. Yes. I think he did say that. He tried to pull out the T&D utilities, but I don't -- you didn't ask

this, but I don't think he calculated that correctly.
Q. Okay. And he also, I believe, testified that 90 percent of the vertically integrated utility companies had an FAC in place. So that 10.62 would contemplate 90 percent of the vertically integrated utilities having an FAC in place; is that correct?
A. Well, it reflects the investment risk and fair compensation for that risk as determined by the regulatory commissions. Fuel adjust -- the existence or nonexistence of a fuel adjustment clause would be one risk factor which would go into a financial analyst's review of the overall risk of the utility.
Q. Right. And is the, I guess the -- the ROE level, is it an indication of, I guess, relative risk, that the higher the ROE, the riskier the investment is, is that kind of a general rule?
A. Yeah. Fair compensation would suggest that the more risky the enterprise, the higher return investors will demand in order to make an investment in that enterprise.
Q. And would you agree that your recommendation of 10.2 is below the average for vertically integrated utility companies?
A. It's below that average of authorized returns on equity, but it's pretty close to the average

for all integrated electric or electric utility companies, which is how I looked at it in terms of comparable risk standpoint.

Q. So it -- but as far as authorized, it is lower, so you would consider AmerenUE to be a less risky utility than the average vertically integrated utility company?

A. Well, for most of 1998 the average electric utility authorized return on equity has been closer to 10.3 percent. So I would --

JUDGE WOODRUFF: You said 1998. Did you mean 2008?

THE WITNESS: I'm sorry. Yes. Thank you. So my recommendation would be lower than that, but I believe, based on the results of my independent review of the cost of capital for AmerenUE, that's fair compensation for AmerenUE.

BY COMMISSIONER JARRETT:

Q. Right. But do you believe that they are a more or less risky investment than the average vertically integrated utility company in the United States?

A. I would say they are average to slightly above average risk for an integrated utility.

Q. And why would they be -- why -- what's the basis for that conclusion?

A. Their bond rating. It's pretty close to my comparable groups on a Moody's basis, but the S&P bond rating was a little weak. I believe that's largely because of the affiliation risk that Standard & Poors considers in assigning a bond rating.

Q. I believe Dr. Morin testified that their bond rating actually had been downgraded since their last rate case. Were you aware of that?

A. Yes.

COMMISSIONER JARRETT: Thank you. No further questions.

COMMISSIONER MURRAY: Judge, I have another question.

JUDGE WOODRUFF: Go ahead.

FURTHER QUESTIONS BY COMMISSIONER MURRAY:

Q. I forgot to ask you one. In your testimony, you indicated that you propose no -- that you don't propose any adjustments to the capital structure proposed by Mr. -- or Mr. O'Bryan. Does that mean your position is the same as AmerenUE's on capital structure or you don't have a position?

A. Well, it's the same as AmerenUE's original proposed capital structure. As I understand, the update reflected including the equity, according to Mr. Hill's testimony, and I'm not taking an independent position on this, but if they're including common equity that's associated with nonregulated enterprises, then I agree with Mr. Hill, that shouldn't be included in the capital structure.

COMMISSIONER MURRAY: Thank you.

QUESTIONS BY JUDGE WOODRUFF:

Q. I do just have one question, and it concerns a proposal that Billie Sue LaConte made that the Commission establish some sort of a generic case to determine a general ROE to be applied to that -- various utilities. Do you have a position on that idea?

A. Well, I think the concept of regulatory efficiency is certainly something that's worth giving serious consideration to. I think the Missouri utilities at this point in time have significant financial challenges in front of them in terms of investment in additional infrastructure and meeting growing customer demands.

So I -- if a generic proceeding was implemented, I would recommend that you tie the cost of capital concepts along with various financing mechanisms to try to resolve many interrelated cost of capital and financial structure issues together in order to resolve them and give transparency to both customers for planning purposes and the utility for planning purposes what kind of capital structure, return on equity and other regulatory mechanisms would be generally found to be appropriate by the Commission in setting rates. And I agree also with Dr. Morin that that should be periodically reviewed to ensure it stays current.

JUDGE WOODRUFF: That's all the questions I have, then. So we'll go to recross based on questions from the Bench, beginning with MEG?

MS. LANGENECKERT: No recross.

JUDGE WOODRUFF: Noranda?

MR. CONRAD: No recross.

JUDGE WOODRUFF: State of Missouri?

MR. IVESON: Nothing, your Honor.

JUDGE WOODRUFF: Public Counsel?

MR. MILLS: No, thank you.

JUDGE WOODRUFF: Staff?

MR. THOMPSON: No, thank you.

JUDGE WOODRUFF: Ameren?

MR. BYRNE: No, thank you.

JUDGE WOODRUFF: Any redirect?

REDIRECT EXAMINATION BY MS. VUYLSTEKE:

Q. Mr. Gorman, I just want to review something with you. Why did you exclude the constant growth DCF methodology result from your recommendation and why did you find it unreasonable and unreliable?

A. Well, I excluded it based on a test of the reasonableness of whether the growth rate projections made by security analysts are rational estimates of long-term sustainable growth. In this case I found them to be much higher that what a rational outlook would be for sustainable long-term growth.

Generally, these capital models are based on the assumption of an efficient marketplace, and in an efficient marketplace investors will make rational investment decisions. Investors will not pay a price for a stock and expect to receive dividend growth that is much higher than one can reasonably expect that growth to be sustained over an indefinite period of time.

If you do make a conclusion that a growth rate that is irrationally high can be sustained over an indefinite period of time, you produce a return on equity estimate that is not reasonable, not reliable, and should not be given significant consideration. So for that reason, I did not rely on the results of my constant growth DCF study in this case.

Q. And do you in general find it to be inconsistent when an ROE expert uses a different methodology to reflect different circumstances or conditions?

A. I do not. As a matter of fact, I believe that to be mainstream. If you review the history of Dr. Morin's testimony, it applies his methodology in a reasonably consistent way, but there are times when he puts little to no weight on the results of his constant DCF study because he believes them to be understating the cost of equity.

There are other times when he modifies the betas he uses in his CAPM studies because he believes the published electric utility betas to understate the systematic risk of utility companies given those market conditions. He uses the available market information, uses informed judgment to make a recommendation.

I do the same thing. I take great efforts to try to review the parameters of the DCF, the risk premium and the CAPM models to offer a return on equity recommendation that is based on reasonable and rational expectations and generally consistent with what an efficient market would require for assuming the risk of the enterprise.

Q. Mr. Byrne asked you questions about the results in the Empire District Electric case and about your analysis in that case. Do you agree with the averaging of the results of return on equity methodologies?

A. Not when one of the results I believe is unreasonably high. It's an outlier, and it should not be given significant consideration, if any consideration at all. If that procedure was done in this case, I would recommend my constant growth DCF analysis either be disregarded or be given very little weight.

Q. Just taking that a step further, did you agree with the Commission's decision to average the results of your ROE methodologies in the Empire case?

A. No. That produced a return on equity that was outside of the range I found to be reasonable.

Q. Are you familiar with any of the -- any Commission that has accepted a quarterly DCF analysis for setting ROE?

A. The Illinois Commission has a longstanding practice of it. Most other jurisdictions, including the FERC, do not rely on that.

Q. Talking about fuel adjustment clauses, you've reviewed fuel adjustment clauses around the country and have knowledge of fuel adjustment clauses, correct?

A. I do, but I'm not prepared to discuss the specifics of them.

Q. In your view, do you know whether the majority of FACs have one to one or in other words 100 percent pass through clauses?

A. I heard Dr. Morin say that several times this morning and I kept shaking my head. No, that's not my understanding. There are fuel adjustment mechanisms which reconcile total fuel, prudently incurred fuel costs with actual fuel cost recovery.

But many utilities and jurisdictions have fuel adjustment mechanisms that either have band widths, have limitations on fuel cost adjustments based on an earnings test or have other restrictions on adjusting rates given the regulatory parameters that they find appropriate.

Q. Okay. I'm going to move on now to follow up on a few of Commissioner Jarrett's questions about the authorized returns around the United States. He had stated or mentioned a national average of 10.63 percent. Do you agree that that is the average return that's been awarded for ROEs?

A. I believe the question and the reference came from Dr. Morin's and whether or not the Regulatory Research document supported that finding after the transmission and distribution utilities' returns had been removed, and I don't believe that that's correct.

When you look at that document, you'll see that there are, for the first three quarters of 2008, many rates of returns above 10 percent, and just about every one of those rates of return are noted to be specifically for a regulatory plan that deals with the construction of a new generating unit.

That rate of return is not applicable to the entire integrated electric utility company. So if you strip those higher rates of return out and strip out the transmission and distribution utility, you get a better estimate of what the -- the authorized return on equity was for integrated utility operations without the incentive rates of return on equity for various investments.

I would also suggest that since it's in the document, that you also consider some of the higher returns on equity for the integrated utilities in comparison to their common equity ratios, which is also listed in that document. A lot of the higher returns on equities coincide with lower common equity ratios to what AmerenUE is proposing in this case.

Q. Mr. Gorman, then given your disagreement with Dr. Morin's conclusion mentioned by Commissioner Jarrett, that the average is 10.63 percent, what is the proper number?

A. Well, I don't have the proper number. I haven't done the calculation.

Q. You mentioned something about 10.3 percent?

A. 10.3 percent was the average return for the year including T&D utilities for the documents I was looking at and excluding those high rates of return for the regulatory plans, the incentive returns for generation investments.

Q. Last question. Is it important to consider regulatory mechanisms that apply to a utility in determining its risk, for example, what regulatory mechanisms might be available and might be used or approved for building, let's say for building a nuclear plant?

A. Yes. Those regulatory mechanisms, particularly in Missouri where detailed and complex regulatory mechanisms have been the result of negotiations between all the stakeholders, have been quite successful in maintaining the financial integrity of the utility in support of a major construction program.

Q. So just to elaborate a little bit, then, if, for example, if in Missouri, utilities have available to them and the Commission has approved regulatory plans, then to say that because there's not a -- because your CWIP is not available statutorily, a regulatory plan may be available, that could be a reason for the utility to have less risk?

MR. BYRNE: I'm going to object. It's outside the scope of cross-examination.

MS. VUYLSTEKE: I would say that's directly applicable to Commissioner Jarrett's questions.

JUDGE WOODRUFF: I think it's probably also compound. I couldn't follow it. Could you repeat the question?

BY MS. VUYLSTEKE:

Q. I'll ask it again. One of the -- AmerenUE has said that unavailability of CWIP increases its risk in Missouri, but the availability of a regulatory plan, would that in your view decrease Ameren's risk?

MR. BYRNE: It's leading. It's beyond the cross, and it's not compound anymore.

MS. VUYLSTEKE: I think it's in response to Judge Woodruff's question from the Bench and is relevant.

JUDGE WOODRUFF: My question was about generic ROEs. Is this --

MS. VUYLSTEKE: But a generic ROE, it would be a problem with a generic ROE if regulatory mechanisms vary from state to state and from utility to utility.

JUDGE WOODRUFF: I'll allow the question. Objection's overruled.

THE WITNESS: Well, major construction programs clearly impose a risk on the utility. So to the extent a regulatory mechanism can be reached where all stakeholders have some input into it, then that risk can be managed in the most efficient manner possible.

MS. VUYLSTEKE: No other questions. Thank you.

JUDGE WOODRUFF: Mr. Gorman, you can step down. You are excused.

THE WITNESS: Thank you.

JUDGE WOODRUFF: And I believe that concludes the return on equity portion of this. We now have Mr. O'Bryan for capital structure.

(Witness sworn.)

JUDGE WOODRUFF: You may be seated. You may inquire when you're ready.

MICHAEL O'BRYAN testified as follows:

DIRECT EXAMINATION BY MR. LOWERY:

Q. Good afternoon Mr. O'Bryan.

A. Good afternoon.

Q. Would you state your name and business address for the record, please.

A. Michael O'Bryan, 1901 Chouteau Avenue, St. Louis, Missouri.

Q. Mr. O'Bryan, am I correct that you caused to be prepared for filing in this docket direct testimony, supplemental direct testimony and rebuttal testimony which has been marked for identification as Exhibits 6, 7 and 8?

A. Yes.

Q. And do you have any corrections to any of that testimony?
A. No, I don't.
Q. If I were to ask you the same questions that are posed in that -- in Exhibit 6, 7 and 8, would you give the same answer?
A. Yes.
Q. Are all of those answers true and correct to the best of your knowledge and belief?
A. Yes, they are.
MR. LOWERY: With that, your Honor, I would offer Exhibit 6, 7 and 8 and tender the witness for cross examination.
JUDGE WOODRUFF: All right. 6, 7 and 8 have been offered. Are there any objections to their receipt?
(No response.)
JUDGE WOODRUFF: Hearing none, they will be received.
(EXHIBIT NOS. 6, 7 AND 8 WERE MARKED FOR IDENTIFICATION AND RECEIVED INTO THE RECORD.)
JUDGE WOODRUFF: And for cross-examination, we begin with MEG?
MS. LANGENECKERT: Nothing.
JUDGE WOODRUFF: Noranda?

CROSS-EXAMINATION BY MR. CONRAD:

Q. Yes. Good afternoon, Mr. O'Bryan. Just a couple quick things. Turn, please, to your Exhibit 6, which is your direct. Do you have that there, sir?

A. Yes.

Q. And I'm looking at page 7, near the bottom, I think the question and answer that begin on line 17. Are you with me?

A. Yes.

Q. I think actually on line 21 that's kind of where I want to be focused on, but you're talking about your short-term borrowings can be obtained from capital or bank markets, Ameren Corp or the utility money pool.

A. Yes.

Q. So far so good? All right. Looking at the banks, how many banks?

A. There's roughly in the area of 15 or so that syndicate our bank facilities.

Q. How many of those, if any, have gone under in the last couple months, let's say?

A. One.

MR. CONRAD: Thank you. That's all.

JUDGE WOODRUFF: Thank you. MIEC?

MS. VUYLSTEKE: No questions. Thank you.

JUDGE WOODRUFF: For the State?

MR. IVESON: Nothing, your Honor.
JUDGE WOODRUFF: Public Counsel?
MR. MILLS: No, thank you.
JUDGE WOODRUFF: Staff?
CROSS-EXAMINATION BY MR. THOMPSON:
Q. Good afternoon, Mr. O'Bryan.
A. Good afternoon.
Q. Would you agree with me that the undistributed earnings of subsidiaries adjustment remove $145 million from Ameren's common equity balance that represented the retained earnings of unregulated subsidiaries?
A. Yes.
Q. And would you agree with me that Ameren no longer owns those subsidiaries?
A. They no longer own them, and thus the retained earnings associated with those entities were shifted to the general retained earnings of Union Electric.
Q. So would that be a yes or a no to my question, sir?
A. That would be a yes.
MR. THOMPSON: Thank you. No further questions.
JUDGE WOODRUFF: All right. We'll come up

with questions from the Bench, then. Commissioner Murray?

COMMISSIONER MURRAY: I don't have anything. Thank you.

JUDGE WOODRUFF: Commissioner Jarrett?

QUESTIONS BY COMMISSIONER JARRETT:

Q.   Just one quick question. I just wanted to make sure that I'm understanding this correctly. You are proposing AmerenUE's actual capital structure as of December 31st, 2007?

A.   It was updated in my supplemental direct to March 31st, 2008.

Q.   But you're proposing that the actual capital structure?

A.   Yes.

COMMISSIONER JARRETT: Thank you.

JUDGE WOODRUFF: Chairman Davis?

CHAIRMAN DAVIS: No.

JUDGE WOODRUFF: Okay. I have no questions. So any -- we'll go back for recross based on questions from the Bench. Does anyone wish to recross?

(No response.)

JUDGE WOODRUFF: Any redirect?

MR. LOWERY: I think I have just one question. All right if I do that from here?

JUDGE WOODRUFF: Sure.

REDIRECT EXAMINATION BY MR. LOWERY:

Q. Mr. O'Bryan, why was the actual capital structure Commissioner Jarrett asked you about, why was it updated to March 31st as opposed to being December 31, 2007?

A. It was updated for -- for purposes of just the general update and the test year or the -- with the supplemental direct.

Q. Let me ask it this way. Does the test year end on March 31, 2008?

A. That's the capital structure date.

MR. LOWERY: Thank you.

JUDGE WOODRUFF: Then Mr. O'Bryan, you can step down. And I believe that takes care of the entire return on equity issues, and that concludes the witnesses that were on line for today. Since it's already four o'clock, I don't propose to try and bring in anybody from Monday's witnesses.

Anything anybody needs to bring up before we adjourn for -- to resume on Monday? All right. Then with that we are adjourned until Monday at 8:30.

WHEREUPON, the hearing of this case was recessed until November 24, 2008.

I N D E X

RETURN ON EQUITY

MEG'S EVIDENCE:

CAPITAL STRUCTURE

AMERENUE'S EVIDENCE:

EXHIBITS INDEX

C E R T I F I C A T E

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

I, Kellene K. Feddersen, Certified Shorthand Reporter with the firm of Midwest Litigation Services, and Notary Public within and for the State of Missouri, do hereby certify that I was personally present at the proceedings had in the above-entitled cause at the time and place set forth in the caption sheet thereof; that I then and there took down in Stenotype the proceedings had; and that the foregoing is a full, true and correct transcript of such Stenotype notes so made at such time and place.

Given at my office in the City of Jefferson, County of Cole, State of Missouri.

____
Kellene K. Feddersen, RPR, CSR, CCR
Notary Public (County of Cole)
My commission expires March 28, 2009.