

Exhibit No.:
Issues: Return on Equity
Witness: Billie S. LaConte
Sponsoring Party: Missouri Energy Group
Type of Exhibit: Surrebuttal Testimony
Case No.: ER-2008-0318
Date Testimony Prepared: November 5, 2008

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a	)	
AmerenUE for Authority to File Tariffs Increasing	)	Case No. ER-2008-0318
Rates for Electric Service Provided to Customers	)	
In the Company's Missouri Service Area.	)	

SURREBUTTAL TESTIMONY

OF

BILLIE SUE LACONTE

ON BEHALF OF

MISSOURI ENERGY GROUP

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a)
AmerenUE for Authority to File Tariffs Increasing) Case No. ER-2008-0318
Rates for Electric Service Provided to Customers)
In the Company's Missouri Service Area.)

Affidavit of Billie S. LaConte

STATE OF MISSOURI)
)
COUNTY OF ST. LOUIS)

Billie S. LaConte, being of lawful age and duly affirmed, states the following:

1. My name is Billie S. LaConte. I am a consultant in the field of public utility economics and regulation and a member of Drazen Consulting Group, Inc.
2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony consisting of Pages 1 through 5.
3. I have reviewed the attached Surrebuttal Testimony and hereby affirm that my testimony is true and correct to the best of my knowledge and belief.



Billie S. LaConte

Duly affirmed before me this 5th day of November, 2008.



SHERYL M. FENELON
My Commission Expires
December 29, 2010
St. Louis County
Commission #06514106



Notary Public

My commission expires on December 29, 2010.

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SURREBUTTAL TESTIMONY OF BILLIE SUE LACONTE

CASE NO. ER-2008-0318

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A Billie S. LaConte, 8000 Maryland Avenue, Suite 1210, St. Louis, Missouri.

3 **Q ARE YOU THE SAME BILLIE SUE LACONTE THAT FILED DIRECT TESTIMONY IN THIS**
4 **PROCEEDING?**

5 A Yes, I am.

6 **Q WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY IN THIS PROCEEDING?**

7 A I shall address the rebuttal testimony filed by AmerenUE witness Dr. Roger Morin.

Response to Morin Rebuttal Testimony

8 **Q PLEASE DESCRIBE DR. MORIN'S COMMENTS.**

9 A Dr. Morin disagrees with several aspects of my calculation of the appropriate RoE for
10 AmerenUE. They include:

- 11 • Application of the standard Discounted Cash Flow (DCF) Model;
- 12 • Companies used to determine the RoE;
- 13 • Use of the "Plain Vanilla Version" of the Capital Asset Pricing Model (CAPM);
- 14 • Lack of a flotation cost adjustment; and
- 15 • Selective use of a risk premium analysis.

1 Based on his opinion of my analysis, Dr. Morin believes that my RoE is understated by
2 130 basis points.

3 **Q DO YOU AGREE WITH DR. MORIN'S RECOMMENDED ROE AND HIS CRITICISM OF**
4 **YOURS?**

5 A No. His recommended RoE is too high. Out of the four witnesses' recommendations,
6 his RoE is at least 70 basis points higher than the mid-point of the recommended range.

7 **Q PLEASE COMMENT ON HIS SURREBUTTAL.**

8 A Dr. Morin's surrebuttal addresses not only my method of calculating the appropriate
9 RoE for AmerenUE, but also the methods used by Staff's witness, Stephen Hill, and
10 MIEC's witness, Mike Gorman. Dr. Morin lists various reasons as to why he disagrees
11 with the recommendations. Each of the witnesses has his or her preferred method or
12 methods to use when estimating the RoE. This results in a range of recommended RoEs:

Table 1

Recommended RoE for AmerenUE

<u>Witness</u>	<u>Range</u>	<u>Recommendation*</u>
Gorman (MIEC)	9.81%-10.55%	10.2%
Hill (Staff)	9.0%-9.75%	9.5%
LaConte (MEG)	10.1%-10.6%	10.2%
Morin (AmerenUE)	10.3%-11.4%	11.2%
Overall range of recommended RoEs**	9.5%-11.2%	10.35%

*Without FAC.

**Recommended figure represents mid-point of the range of recommended RoEs.

Q WHY DO THE VARIOUS WITNESSES DIFFER ON THEIR RECOMMENDATIONS?

A Every method used is an estimate, using a model, empirical data, sometimes forecast expectations and judgment. As Dr. Morin points out, some witnesses rely on the Standard DCF, versus a two-stage DCF; others use the “Plain Vanilla CAPM” versus the Empirical CAPM; still others do not make an adjustment for flotation costs.

However, it should also be pointed out that even when two witnesses use the same model, the outcome varies. This is because of the difference in the assumptions, such as what companies to include in the analysis or what is the proper method to calculate the risk premium.

Q BASED ON THE DIFFERENCES IN THE METHODS AND ASSUMPTIONS, HOW SHOULD AN APPROPRIATE ROE BE DETERMINED?

A The recommendations to the Commission range from 9.5%-11.2% (without an FAC), the mid-point being 10.35%. In addition, the Commission may use other factors, such as UE’s business risk or financial risk, when determining the appropriate RoE. If the Commission allows AmerenUE a FAC, then the effect would be lower business risk and the RoE should be at the lower end of the range.

In the latest rate case a year ago, the Commission allowed a 10.2% return on equity. The risk-free rate at the time was approximately 5.0% or about 70 basis points *higher* than the current risk free rate. Determining the appropriate return on equity for a utility is not an exact science; one must take into consideration several factors when doing so, including the current risk faced by the company, including both the business

1 and financial risk of the company. In the previous case, the Commission did not allow
2 AmerenUE a fuel adjustment clause. If the Commission allows AmerenUE a FAC, it
3 seems appropriate that the allowed return on equity should reflect this reduction in
4 business risk for the Company, as well as reflect the reduction in interest rates.
5 Therefore, a return on equity of 10% is appropriate for AmerenUE.

6 ***Generic Cost of Capital Approach***

7 **Q DO YOU HAVE ANY OTHER COMMENTS REGARDING THE CALCULATION OF THE ROE?**

8 A Yes. The multiple conflicting claims regarding the model and assumptions to use
9 underscore the usefulness of a “generic” approach, which I recommended in my initial
10 testimony. The Commission is given an overwhelming amount of testimony and data to
11 review and use to assist with its decision as to the appropriate RoE for AmerenUE. The
12 methods and assumptions used do not vary greatly from year to year, not only for
13 AmerenUE, but for other electric utilities in Missouri, as well as water, gas and other
14 regulated utilities within the State.

15 **Q WHAT IS A “GENERIC” APPROACH AND HOW IS IT DETERMINED?**

16 A A generic approach is one where the Commission decides on a standard method and
17 resulting formula that sets a base return on equity for each year. This can be for a “low
18 risk” utility, with a specified increment for utilities determined to have higher risks. The
19 formula would be determined in a single hearing where all parties involved would
20 submit expert testimony with recommendations on what the formula should be and

1 how it should be modified for each utility to represent their level of risk. Once the base
2 is set, the value is reset every year, reflecting changes in interest rates.

3 **Q WHAT IS THE BENEFIT OF A GENERIC APPROACH?**

4 A It simplifies the regulatory process, provides more certainty and reduces the costs of
5 regulation. It reduces costs because it eliminates the need for return on equity
6 testimony and analysis by the utility Commission Staff and interveners. It gives the
7 Commission certainty and provides a fair method that is agreed upon by all parties for
8 determining the cost of capital.

9 **Q HAS THIS BEEN DONE ELSEWHERE?**

10 A Yes. A similar concept has been considered in California and New York. Most major
11 Canadian regulators have implemented this. The National Energy Board (similar to our
12 Federal Energy Regulatory Commission), explained the reason thus:

13 *. . . [T]he Board has noted that evidence submitted by expert financial witnesses*
14 *has tended to be much the same from one proceeding to the next. While the*
15 *financial parameters change from year to year, the techniques and*
16 *interpretations used in making rate of return on common equity*
17 *recommendations typically do not. (Reasons for Decisions, RH-2-94, Page 1,*
18 *March, 1995)*

19 **Q DOES THIS CONCLUDE YOUR TESTIMONY?**

20 A Yes.