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MISSOURI PUBLIC SERVICE COMMISSION

Case No. ER-2010-0036

SURREBUTTAL TESTIMONY

OF

JULIE M. CANNELL

ON

BEHALF OF

**UNION ELECTRIC COMPANY
d/b/a AmerenUE**

**St. Louis, Missouri
March 5, 2010**

Company
Exhibit No. 119
Date 3/19/10 Reporter DF
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SURREBUTTAL TESTIMONY

OF

JULIE M. CANNELL

CASE NO. ER-2010-0036

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

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

4 **Q. Are you the same Julie M. Cannell who filed rebuttal testimony and**
5 **additional rebuttal testimony regarding the fuel adjustment clause in this case?**

6 A. Yes, I am.

7 **Q. What is the purpose of your surrebuttal testimony?**

8 A. The purpose of my surrebuttal testimony is to respond to portions of the rebuttal
9 testimony of Missouri Public Service Commission ("PSC" or "Commission") Staff witness
10 David Murray.

11 **Q. Does Mr. Murray rely on reports authored by financial analysts in his**
12 **rebuttal testimony?**

13 A. Yes, he does.

14 **Q. In your opinion, does Mr. Murray properly utilize the analyses contained in**
15 **those reports in reaching his recommendation for Union Electric Company's**
16 **("AmerenUE" or "Company") return on common equity ("ROE")?**

17 A. No, I don't believe he does. As he did in his direct testimony, Mr. Murray
18 references the analytical methodology contained in investor reports, incorrectly pointing to some

1 of the elements and assumptions in the analysts' models as representing their required return on
2 equity.

3 **Q. Please elaborate.**

4 A. In his rebuttal testimony, Mr. Murray points to a recent Goldman Sachs report and
5 the authors' baseline price/earnings ("P/E") assumption for valuing regulated utilities. He
6 averred that because this P/E figure was higher than the P/E assumption incorporated by the
7 analysts in early summer 2009 but the same as had been used by them in March 2008, that this
8 implied "a cost of equity that is similar or possibly even lower than that which was estimated in
9 March 2008."¹

10 **Q. What is incorrect about Mr. Murray's conclusion?**

11 A. My rebuttal testimony addressed Mr. Murray's referencing the cost of equity
12 discount rates incorporated in investor reports as support for his lower ROE proposal. I noted
13 that this was an incorrect comparison on his part, as the discount rate in a dividend discount
14 model is a valuation tool, used for stock selection. The argument made in his rebuttal testimony,
15 which is based on P/E assumptions by the analysts, is similarly off the mark. As is the case of a
16 discount rate in a dividend discount model, investors use P/E ratios to value common stocks.
17 These ratios do not reflect their required return on equity for a utility investment.

18 **Q. Please explain why a P/E ratio does not represent the cost of equity.**

19 A. The P/E ratio is the multiple of earnings at which a stock is expected to sell. The
20 earnings figure used in this ratio is the company's financial earnings: either the actual historic
21 financial earnings of the company or the investor's projection of future financial earnings at a
22 specific point in time (e.g., the current year or the next year). These are the earnings either the

¹ Rebuttal testimony of David Murray at 26.

1 company has earned or what the analyst expects the company to earn, and are the earnings that
2 are publicly reported. These actual, financial earnings over a particular period of time do not
3 reflect normalizations or annualizations that are a standard part of the ratemaking process, and
4 they certainly do not reflect the investor's required return for an investment. To take an extreme
5 example, let's assume that, for a variety of reasons, a company's earnings are expected to be zero
6 or negative one year. That does not mean that the investor's required return on his equity
7 investment is similarly zero or a negative number. In other words, the expected return as related
8 to financial earnings is not equal to what the authorized return on common equity as established
9 in a regulatory proceeding should be. A related point is that the P/E ratio is connected with the
10 common stock of a company, not with that company's subsidiaries. In the case of Ameren
11 Corporation, the P/E applies to the corporation's publicly traded common stock, not to
12 AmerenUE.

13 **Q. As a practicing investor, did you use P/E ratios in your work? If so, how?**

14 **A.** I used P/E ratios frequently in relation to my responsibilities as a utility securities
15 analyst and portfolio manager. These ratios were one means I had of assessing whether an
16 existing or potential stock investment was undervalued, fairly valued, or overvalued in relation to
17 other available investment choice.

18 **Q. Specific to your previous utility investment responsibilities, in any analysis**
19 **you performed involving P/E ratios, were those ratios ever synonymous with your required**
20 **return for a utility operating company?**

21 **A.** No. My use of P/E ratios consistently related to stock valuation and the expected
22 performance of a stock. In no way did such ratios relate to fair, required equity returns.

1 **Q. Please summarize why a P/E ratio, as pointed to by Mr. Murray, does not**
2 **reflect an investor's required return on equity.**

3 A. Investors have a wide range of investment choices available to them. They must
4 determine how attractive one investment is relative to another. This determination can be made
5 through a variety of means, including utilization of P/E ratios. A P/E ratio represents the
6 magnitude by which the common stock price is expected to sell compared to the company's
7 historic or expected financial earnings. In short, this ratio is a valuation tool used by investors.
8 It is not an indicator of the required, fair return on a utility's common equity, which is
9 established through consideration of various methodologies and attendant factors in rate cases.

10 **Q. Does this conclude your surrebuttal testimony?**

11 A. Yes, it does.

In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service.

STATE OF NEW YORK)
) ss
CITY OF PURCHASE)

Julie M. Cannell

Rosmary K. Cook
Notary Public

My commission expires: My commission expires on November 17, 2018

