

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

CENTRAL ILLINOIS LIGHT COMPANY d/b/a AmerenCILCO,	:	Docket Nos.
	:	09-0306 and 09-0309
CENTRAL ILLINOIS PUBLIC SERVICE COMPANY d/b/a AmerenCIPS,	:	Docket Nos.
	:	09-0307 and 09-0310
ILLINOIS POWER COMPANY d/b/a AmerenIP,	:	Docket Nos.
	:	09-0308 and 09-0311
Proposed general increase in electric and gas delivery service rates.	:	(Consolidated)

Rebuttal Testimony and Exhibits of

Michael P. Gorman

On behalf of

Illinois Industrial Energy Consumers

Project 9164
November 20, 2009



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Rebuttal Testimony of Michael P. Gorman

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

2 A My name is Michael P. Gorman and my business address is 16690 Swingley Ridge
3 Road, Suite 140, Chesterfield, Missouri 63017.

4 **Q ARE YOU THE SAME MICHAEL P. GORMAN WHO PROVIDED DIRECT**
5 **TESTIMONY IN THIS CASE AS IIEC EXHIBIT 2.0?**

6 A Yes, I am.

7 **Q WHAT IS THE SUBJECT OF YOUR REBUTTAL TESTIMONY?**

8 A I will respond to the rebuttal testimony of Illinois Power Company (“AmerenIP”),
9 Central Illinois Light Company (“AmerenCILCO”) and Central Illinois Public Service
10 Company (“AmerenCIPS”) witnesses Ms. Kathleen C. McShane and Ronald Stafford.
11 For purposes of this testimony, these three utilities will be referred to collectively as
12 Ameren Illinois Utilities (“AIU” or “Company”). I will also comment on Staff witness
13 Janis Freetly’s capital asset pricing model (“CAPM”) study.

14 The fact that I do not address an issue should not be interpreted as tacit
15 approval or acceptance of any position taken by any party, unless I state otherwise in
16 my testimony.

17 **Response to AIU Witness Ms. Kathleen C. McShane**

18 **Q PLEASE SUMMARIZE THE REBUTTAL TESTIMONY OF AIU WITNESS**
19 **MS. MCSHANE TO WHICH YOU WILL RESPOND.**

20 A At page 29 of Ms. McShane's rebuttal testimony, she recommends various
21 adjustments to my DCF analyses and CAPM studies. Based on her proposed
22 adjustments, she suggests my DCF and CAPM return estimates (with her changes)
23 would produce a reasonable return on equity for AIU's electric operations of 10.6%,
24 and gas operations of 9.8%. She further recommends that the return on equity for
25 electric operations reflect only the electric operating and financial risk, and that the
26 return on gas operations reflect the investment risk of that operation.

27 She disagrees with my proposal for a combined return on equity reflecting
28 AIU's actual combination gas and electric investment fundamentals. Finally, she
29 opines that even with her adjustments to the returns of my DCF and CAPM studies,
30 those implied returns on equity are too low because they do not reflect the difference
31 between the book value financial risk of AIU and the market value financial risk of the
32 proxy companies. (Ameren Ex. 36.0 at 29 and 30).

33 **Q DO YOU BELIEVE MS. MCSHANE'S REVISIONS TO YOUR DCF AND CAPM**
34 **RETURN ESTIMATES SUPPORT A RETURN ON EQUITY HIGHER THAN YOU**
35 **PROPOSED IN THIS CASE?**

36 A No. Capital market costs have declined as the economy and capital markets
37 recovered from the financial crisis that took place in the last half of 2008, and the first
38 quarter of 2009.

39 When my analysis is updated for more recent information and adjusted to
40 incorporate certain of Ms. McShane's proposed adjustments, my DCF and CAPM
41 studies still support my recommended return on equity of 10.0% for AIU. Table 1
42 below shows the results of my updated studies, with the McShane adjustments I
43 accepted.

<u>Description</u>	<u>Electric</u>	<u>Gas</u>
DCF	10.93%	9.86%
CAPM	<u>9.66%</u>	<u>9.22%</u>
Average	10.30%	9.54%

44 **Q BASED ON YOUR UPDATED STUDIES, AND MS. MCSHANE'S COMMENTS ON**
45 **YOUR STUDIES, WOULD YOUR RECOMMENDED RETURN ON EQUITY FOR**
46 **AIU'S ELECTRIC AND GAS OPERATIONS CHANGE?**

47 **A** No. These updated studies, including revisions and adjustments proposed by
48 Ms. McShane, still show that a return on equity of 10.0%¹ remains just and
49 reasonable for the combined electric and gas operations of AIU. However, if the
50 Illinois Commerce Commission ("ICC") chooses to determine distinct returns for AIU's
51 electric and gas operations as proposed by Ms. McShane, then a reasonable point
52 estimate for electric operations would be 10.30%, and a reasonable point estimate for
53 gas operations would be 9.50%. These estimates are based on the average results

¹Using the same weighting employed in my original analysis, $2/3 * 10.30\%$ and $1/3 * 9.54\% = 10.0\%$.

54 of my DCF and CAPM return estimates, reflecting several of Ms. McShane's
55 recommended changes, and updated cost of capital data.

56 **Updated Studies**

57 **Q HOW DID YOU UPDATE YOUR DCF STUDIES?**

58 A I updated my DCF analyses to incorporate: (a) a more recent 13-week average stock
59 price (period ending November 6, 2009); (b) earnings growth projections from the
60 same sources used in developing my original studies, downloaded from the Internet
61 on November 12, 2009; and (c) *Blue Chip Economic Forecasts* as of October 10,
62 2009. All of the DCF models were developed in the same manner as in my original
63 testimony, with one exception. The exception was the sustainable growth DCF
64 analysis. Based on Ms. McShane's comments, I included an external growth rate
65 factor in developing the growth rate in the updated study.² The updated results are
66 shown in the table below and are developed in IIEC Exhibit 6.1 through IIEC
67 Exhibit 6.5.

<u>Description</u>	<u>Electric</u>	<u>Gas</u>
Constant Growth (Analyst)	11.84%	10.31%
Sustainable Growth	10.23%	9.81%
Multi-Stage Growth	<u>10.73%</u>	<u>9.46%</u>
Average	10.93%	9.86%

²In my original analysis, I excluded this external growth rate factor, because many of the companies' stock prices at that time were below book value, which indicated a negative external growth component. I found negative external growth to be an unreasonable expectation and, therefore, excluded the negative growth factor from the sustainable growth rate.

68 Q HOW DID YOU UPDATE YOUR CAPM ANALYSIS?

69 A I continued to rely on *Value Line* betas and the most recent projected 30-year
70 Treasury yield, but, in my updated CAPM estimate, I relied on the range of market
71 risk premiums estimated by Ms. McShane using the data in my study. While I
72 disagree with most of her arguments, my updated CAPM estimates reflect her
73 proposed modifications to my market risk premium estimate. I offer this only to show
74 that my recommended 10.0% return on equity can be supported with updated
75 information and Ms. McShane's proposed adjustments. The market risk premium
76 used in this update with Ms. McShane's revisions was based on the alternative
77 market risk premium estimates outlined by Ms. McShane in her rebuttal testimony:
78 specifically, 5.6% based on actual nominal investment returns (Ameren Ex. 36.0 at
79 25); 6.25% and 6.5% income returns from historical achieved risk premiums from the
80 S&P 500 and the New York Stock Exchange (Ameren Ex. 36.0 at 26 and 27); and
81 6.7% based on her forward-looking estimate. The average of Ms. McShane's market
82 risk premium estimates is 6.3%.³ My updated CAPM estimates are shown on IIEC
83 Exhibit 6.7.

³Ms. McShane's conclusions related to my market risk premium were discussed at page 8 of her rebuttal testimony, where she identified a range of market risk premiums of 6.25% to 6.5%, and a 6.7% market risk premium based on the revised forward-looking estimate. She then opined that the market risk premium from this data supported a market risk premium of 6.5%. However, Ms. McShane excluded the nominal market risk premium of 5.6% based on an alternative method of using historical data and forward-looking inflation expectations to develop a forward-looking market return estimate.

84 **Ms. McShane's Criticisms**

85 **Q DID MS. MCSHANE TAKE ISSUE WITH YOUR CONSTANT GROWTH DCF**
86 **STUDIES?**

87 A Yes. At page 20 of her rebuttal testimony, she takes issue with my assessments that
88 the dividend yield is abnormally high and the growth rate is too high to be a
89 reasonable long-term sustainable growth. Ms. McShane argues that the dividend
90 yield currently is not abnormally high and is reasonably comparable to dividend yields
91 over the last 18 years. She acknowledges that growth cannot exceed the nominal
92 GDP growth indefinitely, but still recommends giving some weight to the constant
93 growth model in this case, even though it reflects an unsustainably high growth rate
94 estimate.

95 **Q PLEASE RESPOND TO MS. MCSHANE'S ARGUMENT THAT THE DIVIDEND**
96 **YIELD IS NOT ABNORMALLY HIGH?**

97 A Ms. McShane makes this argument based in part on her assessment that capital
98 market costs have been abnormally low over the last five years, and that the dividend
99 yield over this time period reflects these abnormally low levels. (Ameren Ex. 36.0 at
100 20). Unfortunately, what Ms. McShane does not recognize is that capital market
101 costs today as well as forward looking, continue to be as low as they have been over
102 the last five years. Hence, her conclusion that the dividend yield in my DCF is not
103 abnormally high, is inaccurate.

104 For example, as shown in my IIEC Exhibit 6.8, the yield on utility bonds rated
105 "A" and "Baa" and Treasury bond yields are currently comparable to the yields on
106 these securities over the last five years, and lower than they were in years prior to the

107 last five years. As shown in this exhibit, the current utility bond yields and Treasury
108 bond yields are more aligned with yields over the most recent five years. As also
109 shown in this exhibit, dividend yields are typically higher when utility bond yields are
110 higher. Since capital market costs are low today, and have been over the last five
111 years, the yield component of my constant growth DCF study was abnormally high. I
112 rejected its use, in part, for that reason.

113 **Q DO YOU AGREE WITH MS. MCSHANE'S DECISION TO PLACE EQUAL WEIGHT**
114 **ON ALL OF YOUR DCF MODELS IN THIS PROCEEDING?**

115 A No. I agree with much of Ms. McShane's assessment of evaluating the growth
116 outlooks in a DCF model. However, there is no dispute that short-term analysts'
117 growth rates in the market today are too high to be reasonable estimates of
118 sustainable long-term growth. The current short-term growth rate outlooks reflect
119 significant capital expenditures by utilities, which significantly increase rate base, and
120 cause a dramatic increase in short-term earnings growth outlooks. Ms. McShane's
121 proposal to give significant weight to a constant growth DCF result that includes
122 irrationally high growth, unreasonably inflates AIU's return on equity.

123 **Q AT PAGE 21, MS. MCSHANE STATES THAT IN AN ILLINOIS POWER COMPANY**
124 **RATE CASE (DOCKET NO. 01-0432) YOU USED A FORECAST GROWTH RATE**
125 **OF 6.8%, WHICH WAS HIGHER THAN THE GDP GROWTH RATE OF 6.15%.**
126 **PLEASE RESPOND.**

127 A In the case referred to by Ms. McShane, I estimated a range for the return on equity
128 of 10.2% to 12.1%. The high end of that range was based on my constant growth
129 DCF study, and was based on a 6.8% growth rate. My recommended midpoint

130 estimate was 11.1%, which was equal to the estimate from my non-constant growth
131 DCF study. In that case, my recommended return on equity in the estimated range
132 was more than 100 basis lower than my constant growth DCF study result. While I
133 did not explicitly reject it, I clearly did not recommend that a return on equity be
134 authorized based on the constant growth DCF estimate she criticizes.

135 **Q MS. MCSHANE ASSERTS THAT YOUR SUSTAINABLE GROWTH DCF RESULTS**
136 **ARE UNDERSTATED BECAUSE YOU IGNORED THE EXTERNAL GROWTH**
137 **COMPONENT. PLEASE RESPOND.**

138 **A** I agree with Ms. McShane that I did not include the external financing (the “sv” factor)
139 growth component. However, I disagree that this resulted in the understatement of
140 growth rate or DCF results. On the contrary, applying this component at the time my
141 testimony was prepared would have resulted in lower DCF returns for my electric
142 proxy group and slightly higher DCF returns for my gas group. When developing the
143 sustainable growth DCF model, I always review the companies’ external financing.
144 However, at the time I prepared my direct testimony the external financing component
145 for the electric proxy group was negative, which would have resulted in a lower
146 sustainable growth rate and lower DCF returns, as shown in the table below.

TABLE 3

Sustainable Growth DCF Model

<u>Line</u>	<u>Description</u>	<u>Electric</u>			<u>Gas</u>		
		<u>Average</u>	<u>Median</u>	<u>Midpoint</u>	<u>Average</u>	<u>Median</u>	<u>Midpoint</u>
		(1)	(2)	(3)	(4)	(5)	(6)
1	No External Financing ¹	10.59%	10.37%	10.48%	9.72%	9.52%	9.62%
2	External Financing ²	10.34%	10.18%	10.26%	9.96%	9.54%	9.75%

Sources:
¹IIEC Ex. 2.11.
²IIEC Ex. 6.10.

147 I do not believe that having a negative external financing component is
148 reasonable, and I disregarded the “sv” component. To be consistent with the electric
149 proxy group, I did not apply the external financing component to the sustainable
150 growth rate of the gas proxy group. On her Ameren Exhibit 36.0, Schedule 8, Ms.
151 McShane adjusts my sustainable growth model by applying a growth component
152 obtained from a more recent edition of *Value Line*. This is inconsistent with the other
153 inputs in my DCF model and leads to misleading results. So I updated the entire
154 sustainable growth model, as shown on IIEC Exhibit 6.4.

155 **Q DID MS. MCSHANE TAKE ISSUE WITH YOUR CAPM ANALYSIS?**

156 A Yes. Ms. McShane believes that my CAPM analysis was inappropriate because she
157 disagrees with my estimate of a market risk premium. She proposes instead to use
158 Morningstar’s estimate of the market risk premium of 6.25% to 6.5%, which is derived
159 from two historic S&P and NYSE risk premium estimates, and a 6.7% risk premium

160 estimate based on her revised forward-looking estimate. The average of these three
161 estimates is 6.5%. (Ameren Ex. 36.0 at 28).

162 **Q DO YOU AGREE WITH MS. MCSHANE'S CRITICISMS OF YOUR CAPM**
163 **ANALYSIS?**

164 A No, her call for demonstration of a correlation with historical market returns is
165 unfounded. I derived my equity risk premiums through the relationship of a risk
166 premium return estimate on the marketplace to projected Treasury bond yields. The
167 risk premium estimate was based on the principle that historical investments in the
168 market have yielded real returns, or returns above inflation. Those real returns are
169 reasonable expectations of forward-looking real returns on the market. I created a
170 nominal expected return on the market, based on the sum of the real return
171 experienced over the period 1926-2008 using Morningstar data, and a projected
172 inflation rate expected over the next year. This produces a risk premium expected
173 market return.

174 It is not necessary, as Ms. McShane contends, to demonstrate that the real
175 return is correlated with historical stock returns. Indeed, Ms. McShane does not claim
176 that it is necessary to show that a DCF derived return on the market (a method she
177 used to develop an equity risk premium) should be somehow correlated with historical
178 market returns. Hence, her correlation argument could also be made against her
179 market return estimate. It is not appropriate to create a restriction on the use of a risk
180 premium method for forecasting an expected market return, a method Ms. McShane
181 accepts, when that same restriction could legitimately be applied against all market
182 return estimates.

183 Q DO YOU AGREE WITH MS. MCSHANE THAT THE MARKET RISK PREMIUM
184 SHOULD BE 6.5%?

185 A No. Ms. McShane argues that an appropriate risk premium is around 6.5%, using
186 Morningstar data and her updated 6.7% forward-looking market risk premium.
187 Importantly, as discussed in my direct testimony, Morningstar publishes many
188 estimates of the market risk premium. Morningstar finds that the market risk premium
189 can range anywhere from 5.7% up to 6.5%, depending on the market index used, and
190 on whether adjustments are necessary to reflect price growth in the marketplace that
191 significantly exceeds earnings and dividend growth in the market. Importantly, all of
192 Morningstar's risk premiums are measured using the Treasury bond income returns,
193 and therefore, overstate the market risk premium that would be measured from total
194 Treasury bond returns. As such, Ms. McShane's market risk premium measured from
195 historical data, overstates the actual risk premium investors earn by investing in the
196 stock market rather than Treasury bond securities.

197 Q AT PAGE 28 OF HER DIRECT TESTIMONY MS. MCSHANE STATES THAT YOUR
198 DCF DERIVED MARKET RETURN OF 8.7% IS ILLOGICAL, WELL BELOW YOUR
199 MULTI-STAGE DCF ESTIMATES. PLEASE RESPOND.

200 A I agree the DCF derived market return of 8.7% is significantly low relative to historical
201 standards and produced a market risk premium of 3.71%. However, I did not
202 propose to use this market risk premium in my CAPM study. In fact, at page 50 of my
203 direct testimony, I explicitly stated that I will rely on the high end of my DCF market
204 risk premium of 6.0%. Therefore, Ms. McShane's criticism does not affect the market
205 risk premium used in my proposed CAPM result.

206 Q MS. MCSHANE ARGUES THAT IT IS NOT APPROPRIATE TO AWARD THE
207 SAME RETURN ON EQUITY FOR AIU'S ELECTRIC AND GAS UTILITY
208 OPERATIONS. PLEASE RESPOND.

209 A I believe a return on equity should be the same for both AIU's regulated electric and
210 regulated gas operations. I agree with Ms. McShane that if AIU had deregulated
211 assets that distorted the investment risk of the regulated operations, a risk adjustment
212 should be made to exclude the higher return for non-regulated operations. In this
213 case, AIU is a combination electric and gas utility, and this combined risk is reflected
214 in its bond rating, its operating risk, and the operating risk considered by bond holders
215 and equity holders of AIU. Hence, the return on equity should be reflective of this
216 combined investment risk, and should be consistently applied to equity investments in
217 AIU. I believe that combined risk supports a return on equity in this proceeding of
218 approximately 10.0%.

219 Q AT PAGE 44, MS. MCSHANE STATES THAT SHE FAILED "TO SEE WHY USING
220 FORECAST TREASURY BOND YIELDS IN THE APPLICATION OF THE CAPM IS
221 APPROPRIATE, BUT USING FORECASTS OF UTILITY BOND YIELDS IN THE
222 APPLICATION OF THE RISK PREMIUM TESTS, ..., IS NOT." IS HER CRITICISM
223 VALID?

224 A No. It is appropriate to use both forecasted and current observable market interest
225 rates in estimating return on equity in a rate proceeding. The accuracy of forecasted
226 yields is highly problematic, and the forecasted yields may or may not turn out to
227 reflect the utility's actual cost of capital when the rates are in effect. Indeed, current
228 observable yields are just as likely an accurate forecast of future yields as are
229 economists' projections of future yields. Therefore, because of the highly uncertain

230 accuracy of forecasted yields, I rely on both forecasted yields and actual observable
231 yields in estimating AIU's cost of capital. I believe this captures a reasonable overall
232 assessment of what a utility's actual cost of capital will be when the rates determined
233 in the rate proceeding are in effect.

234 **Q AT PAGES 45-49 OF HER REBUTTAL TESTIMONY, MS. MCSHANE HAS**
235 **RESPONDED TO YOUR CRITICISM OF HER FINANCIAL RISK ADJUSTMENT.**
236 **HAS MS. MCSHANE PRESENTED ANY NEW ARGUMENTS TO SUPPORT HER**
237 **FINANCIAL RISK ADJUSTMENT?**

238 A No. Ms. McShane has not presented any new arguments in support of her erroneous
239 financial risk return on equity adjustment. That adjustment serves only one purpose,
240 to inflate the fair and reasonable return for AIU. Therefore, this adjustment should be
241 rejected for the reasons discussed in my direct testimony.

242 **Response to Staff Witness Ms. Janis Freetly**

243 **Q PLEASE SUMMARIZE YOUR ASSESSMENT OF STAFF WITNESS**
244 **MS. FREETLY'S RETURN ON EQUITY RECOMMENDATIONS.**

245 A My only concern with Ms. Freetly's return on equity studies deals with her estimate of
246 a market risk premium used in her CAPM model.

247 **Q PLEASE EXPLAIN THE ISSUE YOU HAVE WITH MS. FREETLY'S**
248 **DEVELOPMENT OF THE MARKET RISK PREMIUM SHE USED IN HER CAPM**
249 **STUDY.**

250 A In developing of her market risk premium estimate, Ms. Freetly derived a DCF return

251 on the market (as proxied by the S&P 500 Index) of 12.70% and subtracted a
252 risk-free rate of 4.40%.⁴ This produced a market risk premium of 8.30%. Her
253 workpapers indicate that this market return DCF estimate reflects a dividend yield of
254 approximately 2.2% and a growth rate of approximately 11.5%. This DCF derived
255 market return of 12.70% yielded a market risk premium of 8.30%. This market risk
256 premium is not reasonable and resulted in an inflated risk premium return estimate.

257 **Q WHY DO YOU BELIEVE MS. FREETLY'S MARKET RISK PREMIUM IS NOT**
258 **REASONABLE?**

259 A I believe Ms. Freetly's market risk premium is unreasonable because the DCF derived
260 return of 12.70% is not a reasonable and accurate estimate of a DCF return on the
261 market. This return estimate reflects a growth rate of over 11%, which is more than
262 twice the expected long-term growth rate of the U.S. GDP. By relying on an
263 unreasonable growth rate, her constant growth DCF return on the market is inflated
264 and not reliable.

265 Ms. Freetly recognized the need for a sustainable long-term growth rate in
266 applying the DCF model to her utility proxy groups.⁵ However, the growth component
267 of her market DCF result is too high to be a reasonably sustainable long-term growth
268 rate. Because her market DCF return of 12.70% is overstated and flawed, her market
269 risk premium estimate of 8.30% is overstated and produces an overstated CAPM
270 return estimate.

⁴ICC Staff Ex. 6.0, Schedule 6.07, Electric and Gas Risk Premium (12.70% - 4.40%) = 8.30%.

⁵ICC Staff Ex. 6.0 at 5-6.

271 **Response to AIU Witness Ronald Stafford**

272 **Q DO YOU WISH TO RESPOND TO MR. STAFFORD'S REBUTTAL TESTIMONY ON**
273 **ANY ISSUE?**

274 A Yes. On pages 18 through 28 of his rebuttal testimony, Mr. Stafford responds to my
275 proposed adjustment to depreciation reserve to produce a timing match with the
276 Company's proposed post-test year gross plant additions. Mr. Stafford cites various
277 reasons in support of his proposal to include additions to gross plant in the post-test
278 year period, with no corresponding adjustments to accumulated depreciation reserve
279 for the same post-test year time period. However, Mr. Stafford has not provided
280 credible evidence in support of his position, and if his position is adopted, it will result
281 in rate base being overstated, because it will reflect a level of plant investment (i.e.,
282 net plant) that is not reasonably certain to occur. In fact, since the increases to
283 accumulated depreciation will certainly occur under the accounting rules and
284 Commission regulations that govern depreciation, the rate base scenario
285 Mr. Stafford's proposal represents (plant additions with accumulated depreciation
286 frozen in time) cannot occur. This overstatement of plant investment and rate base,
287 will result in the Company over-recovering its cost of capital.

288 For all these reasons, Mr. Stafford's proposed post-test year plant additions,
289 without an offset for accumulated depreciation reserve, should be rejected. Instead,
290 my proposal to offset these post-test year plant additions by a buildup in accumulated
291 depreciation reserve over the same post-test year period should be adopted.

292 Q DOES MR. STAFFORD ARGUE THAT HIS POST-TEST YEAR PLANT ADDITION
293 ADJUSTMENT WILL PRODUCE A NET UTILITY PLANT THAT IS REASONABLY
294 CERTAIN TO OCCUR?

295 A No. The primary flaw in Mr. Stafford's proposal, and the issue that I have with the
296 Company's post-test year plant addition adjustment, is that the Company is
297 overstating the impact on its test year net plant investment and rate base. The
298 Company failed to reflect known and measurable increases to accumulated
299 depreciation reserve that will offset the increase to net plant caused by the post-test
300 year adjustment to gross plant.

301 Because Mr. Stafford's post-test year plant addition adjustment overstates the
302 impact on the Company's net utility plant caused by the post-test year adjustment,
303 this adjustment does not reasonably capture changes to historical cost of service that
304 are reasonably certain to occur, and is, therefore, inconsistent with the ICC's test year
305 rules.

306 As outlined in my direct testimony, the ICC's test year rules allow for post-test
307 year adjustments for changes that are reasonably certain to occur in plant investment
308 cost of capital, revenue, and expenses.

309 The Company's proposed post-test year plant additions produces a net plant
310 investment component of rate base that is practically certain not to occur, and will
311 overstate the utility's cost of capital used to develop its revenue requirement.
312 Mr. Stafford's testimony simply does not show that the Company's post-test year
313 plant additions credibly meet the ICC's test year rules.

314 Q IN HIS REBUTTAL TESTIMONY, MR. STAFFORD IDENTIFIES PROCEEDINGS
315 BEFORE THE ICC IN WHICH THIS POST-TEST YEAR PLANT ADDITIONS AND
316 OFFSET TO ACCUMULATED DEPRECIATION ISSUE HAS BEEN CONSIDERED.
317 HAS THE ICC APPROVED A POST-TEST YEAR PLANT ADDITION LIKE THAT
318 PROPOSED IN THIS CASE FOR AIU?

319 A No. AIU has never received approval to set rates based on post-test year plant
320 additions (gross plant), without an accumulated depreciation reserve offset. In fact,
321 the only time the ICC specifically considered this issue for the AIU, it rejected the
322 position proposed here by Mr. Stafford. (Ameren Ex. 29.0 at 21-22). Mr. Stafford is
323 proposing an accounting adjustment to a historical test year in this proceeding that
324 has never been approved by the ICC in setting AIU rates.

325 Q DID MR. STAFFORD IDENTIFY OTHER ICC PROCEEDINGS WHERE THIS ISSUE
326 WAS ADDRESSED?

327 A Yes. Mr. Stafford identified proceedings for Commonwealth Edison Company, North
328 Shore Gas and Peoples Gas. While Mr. Stafford recognized that the Commission
329 allowed for post-test year plant additions without a full reflection of changes to
330 accumulated depreciation reserve in those cases, he failed to provide any evidence
331 that the Commission accurately measured changes to net plant for the utilities in
332 those rate cases.

333 This is significant because I provided evidence showing that where the
334 Commission did not accurately measure changes in ComEd's net plant and used the
335 methodologies approved in ComEd's last rate case, the consequences were
336 overstated net plant and rate base. The results in this case would be the same.
337 Hence, the important issue here is whether Mr. Stafford's proposed one-sided

338 adjustment to test year gross plant produces changes in post-test year net plant and
339 rate base that are likely to occur. Mr. Stafford's methodology does not meet this test
340 year rule standard.

341 **Q DID MR. STAFFORD IDENTIFY ANOTHER STANDARD FOR ASSESSING TEST**
342 **YEAR PLANT ADDITIONS WITHOUT AN OFFSET FOR ACCUMULATED**
343 **DEPRECIATION?**

344 A Yes. At page 22 of his rebuttal testimony, he states that the ICC Order in a
345 consolidated AmerenCIPS and AmerenUE case, approved a treatment that
346 considered both post-test year plant changes to gross plant and an accumulated
347 depreciation reserve offset to properly measure net plant in service. He states that
348 the ICC did not accept the Company's proposal in that case because there was not a
349 demonstrated trend of significant increases in net plant in service. He goes on to
350 state that the AIU electric utilities have experienced an increase of net plant of \$82.3
351 million, and \$27.6 million for its gas net plant.

352 **Q DO YOU BELIEVE THAT MR. STAFFORD'S COMMENTS ABOUT TRENDS IN**
353 **NET UTILITY PLANT SUPPORT HIS PROPOSAL?**

354 A No. Mr. Stafford has acknowledged that the relevant issue is changes to test year net
355 utility plant, and not simply to gross utility plant. Changes in AIU's net utility plant
356 drive changes in its cost of service and cost of capital. Trends based on data from
357 outside AIU's chosen test year do not affect either AIU's test year rate base or the
358 anticipated post-test year changes to plant investment that AIU wishes to recognize
359 as *pro forma* adjustments. Mr. Stafford has failed to support his position in this case.

360 I do not oppose reflecting an increase in the Company's net utility plant for
361 setting rates as permitted by the Commission's rules. I do oppose Mr. Stafford's
362 proposal to adjust AIU's gross plant for 17 months of plant additions after the end of
363 the test year, but ignore the known and measurable increases in accumulated
364 depreciation reserve that must occur over the same post-test year period. His
365 methodology does not measure changes in net plant that are reasonably certain to
366 occur.

367 It is not possible to estimate changes in net utility plant that are reasonably
368 certain to occur, without properly considering both additions to rate base via gross
369 plant contributions and the buildup of accumulated depreciation reserve during the
370 same post-test year time period. Mr. Stafford's methodology will simply overstate net
371 utility plant, and produces a hypothetical rate base that is based on a net utility plant
372 amount that is highly unlikely to occur, and that will overstate the utility's cost of
373 capital.

374 **Q ON PAGE 23 OF HIS REBUTTAL TESTIMONY, MR. STAFFORD**
375 **ACKNOWLEDGES THAT IN MISSOURI, AMERENUE PROPOSED AN**
376 **ADJUSTMENT FOR KNOWN AND MEASURABLE CHANGES TO ITS PLANT**
377 **INVESTMENT THAT REFLECTED BOTH CHANGES IN GROSS PLANT AND THE**
378 **BUILDUP OF ACCUMULATED DEPRECIATION RESERVE. IS THAT**
379 **CONSISTENT WITH AIU'S PROPOSAL HERE?**

380 **A** No, it is not. Mr. Stafford opines that while proper recognition and measurement of
381 net utility plant is appropriate for setting rates in Missouri, it is somehow not
382 appropriate for setting rates in Illinois. This is not credible. Missouri has different test
383 year requirements, and true-up requirements, but the objective in Missouri is the

384 same as that in Illinois – rates are designed to provide recovery of prudent and
385 reasonable costs and provide fair compensation on investment used to provide
386 service.

387 The objective in Missouri’s true-up procedures is to provide an accurate
388 measurement of net utility plant, rate base and other cost of service components.
389 The Illinois test year rules have the same ratemaking objective. There is no
390 difference in the jurisdictional objective to set rates based on actual reasonable and
391 prudent cost of service, and provide fair compensation.

392 **Q DID MR. STAFFORD RESPOND TO THE HYPOTHETICAL YOU OFFERED IN**
393 **YOUR DIRECT TESTIMONY EXPLAINING WHY NET PLANT WILL CHANGE**
394 **BASED ON CHANGES TO BOTH ADDITIONS TO GROSS PLANT IN-SERVICE,**
395 **AND ACCUMULATED DEPRECIATION RESERVE?**

396 **A** Yes. On page 24 of his rebuttal testimony, he seems to agree with the simple
397 accounting that net plant is measured from gross plant and accumulated depreciation
398 reserves at the same point in time. However, he did not reconcile this simple
399 acknowledgment with his proposal to measure net plant using a gross plant adjusted
400 to May 2010 and accumulated depreciation reserve at year end of 2008. Clearly,
401 Mr. Stafford’s proposed accounting of AIU net plant is flawed.

402 Q ON PAGES 24 AND 25 OF HIS REBUTTAL TESTIMONY, MR. STAFFORD
403 ARGUES THAT YOUR PROPOSAL TO ADJUST ACCUMULATED
404 DEPRECIATION RESERVE IS INCONSISTENT WITH 83 ADMINISTRATIVE CODE
405 287.40. CAN YOU SUMMARIZE HIS ARGUMENT?

406 A Mr. Stafford argues that adjusting accumulated depreciation reserve to offset
407 post-test year plant additions is inconsistent with the ICC's test year rules because it
408 will result in a movement of an entire rate base line item into a future test period. He
409 states that this proposal is no different than moving one line item of the capital
410 structure such as common equity to a future period and keeping all other components
411 of capital structure with the same historical period.

412 Q DID MR. STAFFORD OFFER AN ACCURATE ASSESSMENT OF YOUR
413 PROPOSAL?

414 A No. Indeed, Mr. Stafford has turned the facts upside down. Mr. Stafford is proposing
415 to adjust gross plant additions⁶ from the end of the historical 2008 test year balance
416 to include capital additions throughout the post-test year period ending May 2010.
417 Mr. Stafford fails to also reflect known and measurable changes in depreciation
418 reserve to May 2010. Hence, Mr. Stafford proposes to set rates by reflecting gross
419 plant in-service stated at May 2010, and accumulated depreciation reserve stated as
420 of December 2008, in effect moving the gross plant line item into the future. This
421 timing mismatch simply does not accurately measure net utility plant. Hence, there is
422 a timing imbalance between the gross plant balance, and the accumulated

⁶Mr. Stafford proposes to account for the relatively minor effect of depreciation on the new plant, but not the much greater effect of depreciation on the remainder of AIU rate base.

423 depreciation reserve balance. As such, this methodology does not accurately
424 measure a net utility plant balance that is reasonably certain to occur.

425 For these reasons, the Company's proposal, and not mine, is in violation of
426 the ICC's test year rules, because it does not result in a net utility plant estimate that
427 is reasonably certain to occur, it will inflate net plant and rate base, and it will
428 overstate AIU's cost of capital.

429 **Q DID MR. STAFFORD ALSO PROVIDE A COMMENT CONCERNING YOUR**
430 **COMPARISON OF THE NET PLANT DEVELOPED IN COMED'S RATE CASE,**
431 **WITH THE ACTUAL NET PLANT BASED ON COMED'S FINANCIAL**
432 **DISCLOSURES?**

433 **A** Yes. However, Mr. Stafford misses the point of that presentation. I showed that the
434 methodology the Commission approved in the ComEd case produced a net plant
435 amount that overstated ComEd's actual net plant. This was proven by a comparison
436 of the net plant used to set rates at June 30, 2008, with ComEd's actual June 30,
437 2008 net plant balance. This presentation is definitive proof that if post-test year plant
438 additions to gross plant are allowed then the buildup of accumulated depreciation
439 must also be considered in order to properly estimate the net plant that is reasonably
440 likely to occur. Without this appropriate timing balance between gross plant additions
441 and accumulated depreciation reserve, it is not possible to accurately measure
442 changes to net plant. By overstating net plant, AIU's rate base will be overstated and
443 its rates will be set to over-recover its cost of capital.

444 Q DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

445 A Yes.

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