REDACTED

DIRECT TESTIMONY

OF

SHEENA KIGHT

FINANCE DEPARTMENT

FINANCIAL ANALYSIS DIVISION

ILLINOIS COMMERCE COMMISSION

ILLINOIS POWER COMPANY
AND
AMEREN CORPORATION

DOCKET NO. 04-0294

JULY 9, 2004

Q. Please state your name and business address.

A. My name is Sheena Kight. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. By whom are you employed and in what capacity?

A. I am employed by the Illinois Commerce Commission ("Commission") as a Financial Analyst in the Finance Department of the Financial Analysis Division.

Q. Please describe your qualifications and background.

A. In May of 1998, I received a Bachelor of Business degree in Finance and Marketing from Western Illinois University in Macomb, Illinois. I earned a Master of Business Administration degree, with a concentration in Finance, also at Western Illinois University in May 2001. I have been employed by the Commission in my present position since January of 2001.

Q. Please state the purpose of your testimony in this proceeding.

A. The purpose of my testimony is to present my evaluation of 1) the proposed reorganization of Illinois Power Company ("IP") under the ownership of Ameren Corporation ("Ameren") (together, the "Applicants") pursuant to Section 7-204(b)(4) of the Illinois Public Utilities Act, 220 ILCS 5/1-101 *et seq*. ("Act"); 2) Section 6-103 of the Act, 3) the Applicants' request for termination of the dividend restriction imposed on IP in Docket No. 02-0561 pursuant to Section 7-103 of the Act; 4) the Applicants' request for authorization under Section 7-101 of the Act for Ameren to make short-term loans to IP; and 5) the Applicants' request to include IP in the Ameren Money Pool Agreement pursuant to Sections 7-101 and 7-102 of the Act.

Q. Please summarize your conclusions.

A. I conclude that: 1) under Section 7-204(b)(4) of the Act, the proposed reorganization will not significantly impair IP's ability to raise necessary capital on reasonable terms or maintain a reasonable capital structure; 2) Ameren's proposed re-capitalization of IP meets the requirements of Section 6-103 of the Act; 3) the dividend restriction imposed on IP in Docket No. 02-0561 should be modified but not terminated; 4) Ameren should not be allowed to make short-term loans to IP, except under the Ameren Money Pool Agreement; and 5) IP should be allowed to participate in the Ameren Money Pool Agreement as a borrower, but not as a lender.

Q. Why is it necessary to evaluate the financial implications of the proposed reorganization?

A. In order to approve a proposed reorganization, Section 7-204(b)(4) of the Act requires the Commission to find that "the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure."

Q. Please describe the corporate relationship between IP and Dynegy, Inc. ("Dynegy").

A. IP is a wholly owned subsidiary of Illinova Corporation ("Illinova"), which is a wholly owned subsidiary of Dynegy.[1]

Q. How does IP raise capital under Dynegy ownership?

A. Dynegy and IP are responsible for raising debt or equity capital on behalf of IP.[2] IP has been able to satisfy its capital needs through long-term debt financing and prepayments of interest on the $2.3 billion Intercompany Note IP holds from Illinova ("Intercompany Note"). Although Illinova is directly responsible for paying IP interest on the Intercompany Note, Illinova relies on Dynegy for the funds needed to meet this obligation. If IP were to require additional debt capital from external sources, it would issue long-term debt directly.[3] Dynegy would be responsible for raising equity capital if IP were to require it.

Q. What is your assessment of IP's current financial condition?

A. IP's current financial condition is weak.

Q. How did you reach that conclusion?

1 Standard & Poor's, Ratings Direct, *Research: Illinois Power Co.*, June 11, 2004.
2 Response to Staff data request FIN 10.02.
3 *Ibid.*

A. I computed three measures of IP’s financial strength for the 2001-2003 period: funds from operations to total debt, funds from operations interest coverage, and total debt to total capital. Next, I compared the results of such measures to financial targets that Standard & Poor's (“S&P”) publishes by credit rating for utilities with IP’s business profile score of 6.[4, 5] As the table below shows, IP’s ratios are consistent with an S&P rating of BB.[6, 7] An obligor rated BB has a weakened capacity to meet its financial commitments.[8]

Ratio	IP’s 3-Year Average 2001-2003	BB Target Ratios	BBB Target Ratios
FFO to Total Debt	12.7%	12.0% - 18.0%	18.0% – 28.0%
FFO Interest Coverage	2.98x	2.0x – 3.0x	3.0x – 4.2x
Total Debt to Total Capital	59.1%	58.0% - 62.0%	48.0% – 58.0%

Q. Please describe Dynegy’s financial condition.

A. Dynegy has an S&P credit rating of B[9] and a Moody’s Investors Service (“Moody’s) credit rating of Ca.[10] According to S&P, an obligor rated B is “more vulnerable” than an obligor with a ‘BB’ rating, but “currently has the

4 Standard & Poor's, Ratings Direct, *Research: Illinois Power Co.,* March 4, 2004.

5 Staff’s use of the published S&P business profile score for IP for determining its financial strength in this proceeding should not be construed as a Staff endorsement of IP’s published business profile score as a means for establishing a fair rate of return for IP in the context of a rate proceeding.

6 IP’s ratios were derived from IP’s 10K for 2001, 2002, and 2003.

7 Standard & Poor's, Ratings Direct, *Research: New Business Profile Scores Assigned for U.S. Utility and Power Companies; Financial Guidelines Revised,* June 2, 2004.

8 Standard & Poor’s, Ratings Direct, *Standard & Poor’s Ratings Definitions*, December 10, 2002, p. 5.

9 Standard & Poor’s, Ratings Direct, *Research: Summary: Dynegy Inc*., June 10, 2004.

capacity to meet its financial commitments." However, "adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitments."[11] Moody's Ca rating indicates that an obligor is highly speculative and is likely very near default.[12]

Q. Does Dynegy's financial condition affect IP's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure?

A. Yes. IP receives interest payments of $170 million a year on the Intercompany Note.[13] IP also relies on prepayments of interest on this Note to meet its working capital needs.[14] If Dynegy were unable to make these payments, then IP would have to borrow money to meet its operating needs. Since IP does not have an investment grade credit rating, new debt would be expensive at best, and its availability would be uncertain.

Q. Would Ameren's financial condition affect IP under the proposed reorganization?

A. Yes, while IP would continue to issue its own long-term debt instruments to the market, as the owner of the capital stock of IP, Ameren would be the

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10 www.moodys.com, Dynegy Inc., June 22, 2004, p. 2.

11 Standard and Poor's, Ratings Direct, *Research: Standard & Poor's Ratings Definitions*, December 10, 2002.

12 www.moodys.com, *Rating Definitions*.

13 Standard and Poor's, Ratings Direct, *Research: Dynegy Inc.*, June 10, 2004, p. 1.

14 Standard and Poor's, Ratings Direct, *Research: Illinois Power Co.*, March 1, 2004, p. 1.

conduit through which IP would access the equity market. Further, Ameren and its subsidiaries would become IP's source for short-term debt capital.

Q. Will the proposed reorganization have a significant adverse effect on Ameren's financial strength?

A. No. S&P currently assigns Ameren an A-/watch negative corporate credit rating;[15] Moody's currently assigns Ameren an A3 rating, which is under review for a possible downgrade.[16] Those ratings indicate that Ameren's current financial position is strong, but the possibility of a downgrade exists. However, S&P expects Ameren to maintain an investment grade corporate credit rating upon completion of the acquisition based on the post-acquisition ratios. The following table illustrates Ameren's forecasted post-acquisition ratios compared with the target ratios for A and BBB rated companies with the same business profile score as Ameren:[17,18]

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15 Standard & Poor's, Ratings Direct, *Research: Ameren Corp*, May 3, 2004, p. 1.

16 www.moodys.com, Ameren Corporation, February 10, 2003, p. 2.

17 Ameren's business profile score is 5. This table was taken from a report issued before S&P released revised financial guidelines. Standard & Poor's, Ratings Direct, *Research: Ameren Corp*, May 3, 2004, p. 1.

18 Standard & Poor's, Ratings Direct, *Research: Utility Financial Targets Are Revised*, June 18, 1999.

Ameren's Post-Acquisition Comparison			
Ratio	A Rating	BBB Rating	Ameren's Estimated Post-Acquisition Ratios[19]
FFO to Total Debt	27% – 33%	20.5% – 27%	21%
FFO to Interest Coverage	4.0x – 4.8x	3.0x – 4.0x	4.5x
EBIT Interest Coverage	3.5x – 4.3x	2.4x – 3.5x	3.3x – 3.5x
Total Debt to Total Capital	41.5% - 47%	47% - 55%	Slightly below 50%

Thus, as IP's parent, Ameren's financial strength would not be significantly impaired.

Q. Will the proposed reorganization significantly impair IP's ability to raise necessary capital on reasonable terms?

A. No. The proposed transaction is viewed as a positive influence on IP's financial health by both S&P and Moody's.[20,21] Moody's upgraded IP's credit rating on its first mortgage bonds from B3 to B1 following the announced sale of IP to Ameren.[22] IP's ability to raise capital is currently constrained. As discussed previously, IP's financial condition is weak and Dynegy, its ultimate corporate parent, is also financially weak. The proposed transaction should improve IP's financial position for two reasons.

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19 Standard & Poor's, Ratings Direct, *Research: Ameren Corp*, May 3, 2004, pp. 3, 8-9.
20 Standard & Poor's, Ratings Direct, *Research: Illinois Power Co*., March 1, 2004, p. 2.
21 www.moody's.com, Illinois Power Co., February 4, 2004.
22 *Ibid*

First, a financially stronger company would own IP. Second, Ameren proposes to infuse capital to reduce IP's total amount of debt outstanding. These two actions should improve IP's access to capital on reasonable terms.

Q. How will the acquisition of IP by Ameren affect IP's capital structure?

A. IP's current capital structure contains almost 60% debt, and its total capitalization greatly exceeds the depreciated original cost of its utility plant.[23] Ameren plans to reduce IP's debt by $750 million as part of its re-capitalization of IP.[24] IP's capital structure, after the completion of the re-capitalization, will consist of 40-50% debt and 50-60% equity.[25] Reducing the amount of debt in relationship to cash flows and total capital lowers financial risk and increases financial flexibility. Therefore, the proposed acquisition of IP by Ameren will not significantly impair IP's ability to maintain a reasonable capital structure.[26]

Q. Why is it necessary to review the capitalization of a public utility in any reorganization?

A. Section 6-103 of the Act requires Commission approval of the capitalization of a public utility in any reorganization. This Section of the Act directs that

[23] Illinois Power Company's 10K.
[24] Applicant's Exhibit 4.0, p. 5.
[25] Applicant's Exhibit 4.0, p. 6.
[26] Staff's conclusion that the proposed reorganization will not significantly impair IP's ability to maintain a reasonable capital structure should not be construed as a Staff endorsement, for the purpose of setting rates, of Ameren's stated capital structure objectives for IP.

the Commission shall not approve a capitalization in excess of the fair value of the property involved.

Q. Will IP's capitalization after the completion of the acquisition proposed in this proceeding meet the requirements of Section 6-103 of the Act?

A. Yes. Based on the information presented in Applicants' Exhibit 13.1, IP's capitalization will not exceed the fair value of its property after the completion of the re-capitalization of IP by Ameren.

Q. Should the Applicants' request for approval to eliminate all payables and receivables associated with the Intercompany Note pursuant to Section 6-103 of the Act be granted? [27]

A. Yes. The elimination of the payables and receivables associated with the Intercompany Note reduces IP's capitalization to equal the fair value of its property as is required under Section 6-103 of the Act.

Q. Please describe the current restrictions on IP's ability to remit dividends.

A. In Docket No. 02-0561, the Commission imposed the following restrictions:

> Illinois Power Company shall not declare or pay any dividends on its common stock until Illinois Power's first mortgage bonds are rated at least BBB- by Standard &

[27] Petition, pp. 4-5 and 33.

> Poor's and at least Baa3 by Moody's Investor Services, and Illinois Power first obtains specific approval from this Commission for the declaration and payment of dividend on its common stock.

Q. Do you agree with the Applicants' request that the Commission terminate the dividend restriction imposed in Docket No. 02-0561 once IP achieves either a BBB- rating from S&P or a Baa3 rating by Moody's?[28]

A. No. Since IP currently requires prepayment of interest from the Intercompany note, and will need to borrow under the proposed acquisition, in order to meet working capital needs, the Commission should continue to restrict the payment of dividends until IP can show that it has sufficient earnings and cash flows to pay dividends while maintaining adequate reserves as required in Section 7-103(2)(a) of the Act. Even though the proposed restructuring should improve IP's financial strength, the amount of time that it takes IP to improve its financial strength to the point it can pay dividends is unknown. Therefore, the restriction imposed in Docket No. 02-0561 should not be automatically terminated should IP receive either S&P's BBB- credit rating or Moody's Baa3 credit rating.

However, an alternative to the dividend restriction should be added. The Applicant's proposal that IP either achieve a BBB- rating from S&P or a

[28] Petition, pp. 36-37.

Baa3 rating by Moody's [29] should be accepted as an alternative to the dividend restriction imposed in Docket No. 02-0561 provided that IP also meets the following three conditions: 1) Ameren must maintain a credit rating of at least BBB- from S&P and at least Baa3 Moody's; 2) IP completes defeasance of XXXXXXXXXXXXXXXXXXXX bonds;[30] and 3) IP obtains specific approval from the Commission for the declaration and payment of dividends on its common stock. Thus, under my proposal, IP must meet the conditions imposed in either Docket No. 02-0561 or in the current proceeding before it can declare and pay dividends.

Q. Please explain the basis for each of your three additional proposed conditions presented above.

A. With regard to the first condition, Ameren asserts that its investment grade credit rating and its recapitalization of IP will render the dividend restriction that the Commission enacted in its Order in Docket No. 02-0561 as unnecessary.[31] I agree that having a financially strong parent company reduces the probability that IP would be directed to declare a dividend it cannot afford. Nevertheless, Ameren's current financial strength cannot be guaranteed. Further, Ameren would be responsible for raising common equity capital for, and providing short-term loans to, IP. Finally, Ameren's

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[29] Petition, pp. 36-37.

[30] IP must refund the debt or put aside the money necessary to extinguish any non-refunded portion of XXXXXXXXXXXXXXXXXXXX bonds in an irrevocable trust or both. The amount set aside should include the principal, interest, and premium to retire the debt XXXXXXXXXXX XXXXX.

[31] Applicant's Exhibit 2.0, p. 8.

credit rating would influence the credit rating IP attains. Therefore, maintenance of Ameren’s financial strength is critically important for the resuscitation of IP’s financial strength.

The second condition adopts Ameren’s commitment to reduce the amount of IP debt outstanding as a requirement for IP’s resumption of common dividend payments. Eliminating XXXXXXXXXXXXXXXXXXXXXXXX bonds and XXXXXXXXXXXXXX in annual interest payments is a critical component to returning IP to financial health because IP’s total debt outstanding nearly equals the depreciated original cost of its utility plant in service.

The third condition would permit the Commission to assess whether the proposed reorganization of IP coupled with Ameren’s proposed re-capitalization of IP and the cancellation of the Intercompany Note leave IP with sufficient earnings and cash flow to pay common dividends while maintaining adequate reserves as required in Section 7-103(2)(a) of the Act. Even though the proposed reorganization should improve IP’s financial strength, the amount of time necessary for IP’s financial strength to improve to the point that it can pay common dividends is uncertain. Therefore, the common dividend restriction should not be terminated without further Commission review.

Q. Should the Applicants’ request for authorization for Ameren to make short-term loans to IP until January 1, 2007 be approved?

A. No. The applicants request for approval for Ameren to make short-term loans to IP must meet the Commission requirements for money pool agreements. Since the Applicants have not provided any written agreement that meets the requirements of Part 340 of the Administrative Code**,** their request for Ameren to make short-term loans to IP should be denied.

Q. Should IP be allowed to participate in the Ameren Money Pool Agreement?

A. Yes. IP does not have access to short-term financing.[32] IP currently funds its working capital needs with the prepayment of interest by Illinova on the Intercompany Note.[33] After the completion of the acquisition, IP will need an alternative source of short-term capital. Therefore, IP should be allowed to participate as a borrower only in the Ameren Money Pool Agreement ("Money Pool"). Ameren's financial forecasts of IP, shown in Exhibit 13.1, in the first two years after the acquisition indicate that IP will not generate sufficient cash flows to lend to the Money Pool. As with the dividend restrictions, IP should not be authorized to lend to the Money Pool until such time as it can show it has sufficient cash flows to do so. In addition, the Applicants' proposal that IP's borrowing be capped at $500 million from the Money Pool should be accepted. The $500 million cap allows enough short-term capacity to meet current working capital needs and allows IP time to

[32] Standard and Poor's, Ratings Direct, *Research: Illinois Power Co*., March 1, 2004, p. 1.

restore its credit rating before trying to access the capital markets for long-term debt.

Q. Does this conclude your direct testimony?

A. Yes, it does.

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[33] Petition, p. 40.