Docket No. 04-0294
ICC Staff Exhibit 11.0
Redacted

REDACTED

DIRECT TESTIMONY

of

MICHAEL McNALLY

FINANCE DEPARTMENT

FINANCIAL ANALYSIS DIVISION

ILLINOIS COMMERCE COMMISSION

ILLINOIS POWER COMPANY

APPLICATION FOR APPROVAL OF A REORGANIZATION

Docket No. 04-0294

July 9, 2004

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WITNESS IDENTIFICATION

Q. Please state your name and business address.

A. My name is Michael McNally. My business address is 527 East Capitol Avenue, Springfield, IL 62701.

Q. What is your current position with the Illinois Commerce Commission ("Commission")?

A. I am presently a Senior Financial Analyst in the Finance Department of the Financial Analysis Division.

Q. Please describe your qualifications and background.

A. In May of 1993, I received a Bachelor of Arts degree in Economics from the University of Illinois at Urbana-Champaign. In May of 1999, I received a Master of Business Administration degree, with a concentration in Finance, from the University of Illinois at Urbana-Champaign. I have been employed by the Commission since June of 1999. I was promoted to Senior Financial Analyst in April of 2002.

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

A. The purpose of my testimony is to present my analysis of 1) the effect of Ameren Corporation's ("Ameren") proposed acquisition of Illinois Power Company ("IP") (together, the "Applicants") on IP's cost of capital; 2) the Applicants' estimation of anticipated purchased power and gas savings; and 3) the amount of debt redemption premiums and stock issuance costs allowable for recovery in this proceeding.

REVENUE REQUIREMENT

Q. Why is it necessary to evaluate the proposed transaction's effect on IP's revenue requirement?

A. Pursuant to Section 7-204(b)(7) of the Public Utilities Act (the "Act"), no authorization should be granted for the proposed reorganization of an Illinois public utility unless the Commission finds that "the proposed reorganization is not likely to result in any adverse rate impacts on retail customers."

Cost of Capital

Q. Why is it necessary to evaluate the proposed transaction's effect on IP's cost of capital?

A. The cost of capital is a component of the revenue requirement calculation. As noted above, the proposed reorganization of IP should not be allowed if the Commission finds that it would likely have an adverse impact on retail rates.

Q. Is the proposed reorganization likely to adversely impact IP's cost of capital?

A. No. Based on my analysis, the cost of capital under Ameren ownership, as proposed, would remain very close to that under continued Dynegy ownership.

Q. Please describe your cost of capital analysis.

A. I estimated the cost of capital for IP under two scenarios: 1) under Ameren ownership[1] and 2) under Dynegy, Inc. ("Dynegy") ownership.[2] My overall cost of capital summary is presented on Schedule 11.1.

Q. Please describe how you estimated the balance and cost of debt under the Ameren and Dynegy Scenarios.

A. I prepared long-term debt schedules for IP under Ameren and Dynegy ownership using IP's 2003 Form 21 ILCC annual report, adjusted to reflect continued amortization and expected debt retirements through 2006. Those schedules are presented as Schedule 11.2. For the Ameren Scenario, I also incorporated the long-term debt retirements the Applicants propose.[3] In addition, the Dynegy Scenario reflects the following adjustments to reflect the effect of Section 9-230 of the Act on IP's authorized rate of return on rate base: 1) the allowable yield on the $550 million, 11.5% first mortgage bonds issued in December 2002 was reduced to 6.5%; 2) the allowable discount and expense on the 11.5% bonds was reduced to $2,186,102; and 3) the principal outstanding on the 11.5% bond issuance was reduced to $525 million.

[1] Hereafter referred to as the "Ameren Scenario."
[2] Hereafter referred to as the "Dynegy Scenario."
[3] Applicants' revised response to Staff data request FIN 2.03.

Q. Please explain the basis for each of your adjustments related to the 11.5% bonds.

During 2002, the credit ratings of IP and its Dynegy affiliates were downgraded from BBB+ to B.[4] The credit ratings reports clearly link the decline in IP's credit ratings to that of Dynegy. For example, Fitch ratings states:

> The ratings for IP are constrained by those of DYN [Dynegy] due to a large intercompany note [Dynegy Note], as well as the structural and functional ties between the affiliated companies... On a standalone basis, IP has historically demonstrated a stable financial profile, with low risk transmission and distribution operations. (Fitch Ratings, November 4, 2003)

Further, IP's financial statistics for the period 2000 through 2002 do not show any material decline in IP's standalone financial strength. Therefore, I conclude that IP would have maintained the BBB+ credit rating it had prior to the credit rating downgrades both IP and its Dynegy affiliates experienced during 2002.

Next, I reviewed the original issue yields on other debt of comparable maturity and rating issued around that same time. The yields on those debt issues were generally in the 6.25% to 6.5% range. Thus, I estimated that costs above and beyond the 6.5% yield would be disallowed pursuant to Section 9-230 of the Act. In addition, I adjusted the original discount and expense of the 11.5% bonds to a level commensurate with the original discount and expense of several prior IP issues, which had average debt discount and expense rates of 0.66% and 0.18%, respectively. Finally, I reduced the principal outstanding to $525 million,

[4] www.ratingsdirect.com.

as lower discounts and expenses would have required less debt to be issued to obtain the same net proceeds.

Q. How did you estimate the cost of new debt in each scenario?

The Applicants forecast that, under Ameren ownership, IP will issue *** x x x x x x x x x x x x x x x *** debt through 2006.[5] Thus, for the Ameren Scenario, I used Ameren's projected cost of *** x x x x x *** debt in 2006 of *** x x x ***.[6] In the Dynegy Scenario, the Applicants assume that all new IP debt will be *** x x x x x ***.[7] However, it is not clear that IP would fill this funding need with *** x x x x x *** debt. Indeed, IP meets its current financing requirements with cash advances from Dynegy in the form of prepaid interest, which IP obtains interest-free. Nonetheless, Dynegy's financial capacity to make interest prepayments in the future is uncertain. Given those uncertainties, I treated IP's new debt under Dynegy ownership as *** x x x x x *** debt for consistency in my comparison of IP under both owners. Thus, for IP's cost of new debt under Dynegy ownership, I added 14 basis points to the *** x x x x x *** debt cost under the Ameren Scenario.[8]

Overall, my weighted cost of total debt for IP under Ameren is *** x x x ***, while my estimate for IP under continued Dynegy ownership is *** x x x ***. In comparison, Applicants witness Craig D. Nelson estimated a 6.0% cost of debt

[5] Applicants Exhibit 13.1.
[6] Applicants' supplemental response to Staff data request FIN 2.03.
[7] Applicants' second supplemental response to Staff data request FIN 1.01.
[8] 14 basis points is the current spread between *** XXXXXX *** rates available to companies with Ameren's A– credit rating and those available to companies with the BBB+ ratings IP had prior to Dynegy's credit rating downgrade.

for IP under Ameren and an 8.8% cost under Dynegy, which he capped at 7.0% under his most restrictive rate recovery assumption.[9]

Q. What debt balances did you include in your cost of capital analysis?

A. For long-term debt, I used the carrying values of $1,474,092,808 for IP under Dynegy ownership and $804,937,956 of IP under Ameren, as would be used in a rate setting proceeding.[10]

For IP's new debt balance under Ameren ownership, I subtracted IP's projected balance of CWIP (both gas and electric) of *** x x x x x x *** from its *** x x x x x x *** projected balance of short-term debt as of December 31, 2006, which produced a balance of *** x x x x x x ***.[11]

For IP's new debt balance under Dynegy ownership, I subtracted the same *** x x x x x x *** CWIP projection from the projected *** x x x x x x *** of new borrowings.[12] In addition, I also subtracted approximately $77.8 million to reflect the portion of the total debt expense of the 11.5% debt that I estimate is not recoverable pursuant to Section 9-230 of the Act. To clarify, as discussed previously, I reduced the balance, interest rate, discount, and expense associated with the 11.5% debt pursuant to Section 9-230 of the Act. Given those reductions, IP's operating income would have been approximately $32.3 million higher per year from the time the debt was issued at the end of 2002 through the end of 2006, the measurement date I used in this analysis. After

[9] Applicants' Corrected Revised Exhibit 3.4.
[10] See Schedule 11.2.
[11] Applicants' Exhibit 13.1.
[12] Applicants' supplemental response to Staff data request FIN 1.01.

taxes, IP would have realized approximately $77.8 million additional earnings over that four-year period; thus, the IP would have had to borrow approximately $77.8 million less over that period. My calculation of IP's new debt balance under Dynegy ownership as of December 31, 2006 is *** x x x x x x ***.

Q. Did you include preferred stock in your overall cost of capital analysis?

A. Yes. My analysis includes a balance of preferred stock of $45.4 million for IP under both Dynegy and Ameren ownership. To both balances I applied a cost of 5.05%. The $45.4 million balance and 5.05% cost were authorized by the Commission in IP's previous electric delivery services rate case;[13] neither the balances nor associated expenses have changed since that case. Mr. Nelson's revenue requirement analysis did not specify a balance or cost for IP's preferred stock.

Q. What common equity balances did you include in your cost of capital analysis?

A. My cost of capital includes balances of common equity of *** x x x x x x x *** under the Dynegy Scenario and *** x x x x x x x *** under the Ameren Scenario. The balance under the Dynegy Scenario was derived by removing *** x x x x x x *** of projected prepaid interest payments from the *** x x x x x x x *** year-end 2006 Total Common Stockholder's Equity balance the Applicants forecasted for IP under Dynegy ownership.[14] I removed the prepaid interest because interest payments that have been received but have not yet been earned should be classified as a liability rather than common equity. The

[13] Order, Docket No. 01-0432, March 28, 2002, p. 55.
[14] Applicants' second supplemental response to Staff data request FIN 1.01.

balance of common equity under the Ameren Scenario reflects the year-end 2006 Total Common Stockholder's Equity balance the Applicants forecasted for IP under Ameren ownership.[15]

Q. What costs of equity did you include in your cost of capital estimate?

A. My analysis includes costs of common equity of 10.50% for IP under Dynegy ownership and 10.35% under Ameren ownership. As Mr. Nelson noted, the absolute level of return on equity is largely irrelevant in this proceeding; rather, it is the difference in equity returns assumed under Dynegy and Ameren ownership that is significant.[16] The 10.50% cost for IP under Dynegy ownership was taken directly from the Applicants' Corrected Revised Exhibit 3.4. I reduced that result by 15 basis points to estimate IP's cost of equity under Ameren ownership because the lower debt ratio projected under Ameren ownership implies a slightly lower level of risk, which translates into a slightly lower equity return requirement. Based on Standard & Poor's ("S&P") credit rating target ratios, a debt ratio difference of approximately four percentage points is consistent with a rating difference of slightly more than one step (e.g., the difference between an A– and a BBB+ is one step).[17] Recent credit spreads suggest that a one step difference in credit rating in the A+ to BBB– range translates to roughly a 9-18 basis point difference in long-term debt costs.[18] Thus, I reduced the cost of common equity for the Ameren Scenario by 15 basis points.

[15] Applicants' Exhibit 13.1.
[16] Applicants' Exhibit 13.0, p. 10.
[17] Standard & Poor's, "New Business Profile Scores Assigned for U.S. Utility and Power Companies; Financial Guidelines Revised," June 2, 2004.
[18] Reuters Corporate Spreads for Utilities, www.bondsonline.com, June 23, 2004.

Q. What are your overall cost of capital estimates?

A. My analysis produces capital structures of *** x x x *** equity, 1.37% preferred stock, and *** x x x *** debt for IP under Dynegy ownership and *** x x x *** equity, 2.21% preferred stock, and *** x x x *** debt for IP under Ameren ownership. Further, my analysis employed costs of debt, preferred stock, and common equity of *** x x x ***, 5.05%, and 10.50%, respectively, for IP under Dynegy ownership and *** x x x ***, 2.21%, and 10.35%, respectively, for IP under Ameren ownership. Those inputs produce overall cost of capital estimates of 7.444% for IP under Dynegy ownership and 7.443% for IP under Ameren ownership.

Q. Are those cost of capital estimates reasonable?

A. Yes. My capital structure and capital component costs produce a pre-tax interest coverage ratio for IP of 3.96x under Dynegy ownership and 4.45x under Ameren ownership. In *absolute* terms, those pre-tax interest coverage ratios are both indicative of investment grade utilities based on S&P credit rating target ratios.[19] In *relative* terms, those pre-tax interest coverage ratios are consistent with the difference between the A– rating of Ameren and its subsidiaries and a BBB+ rating for IP, which, as discussed previously, I assumed in estimating the recoverable cost of the 11.5% debt.[20]

[19] The credit rating target ratios refer to those in existence prior to June 2, 2004. On that date, S&P dropped pre-tax interest coverage from its financial guidelines. Standard & Poor's, "Utility Financial Targets are Revised," June 18, 1999; and Standard & Poor's, "New Business Profile Scores Assigned for U.S. Utility and Power Companies; Financial Guidelines Revised," June 2, 2004.

[20] Based on S&P credit rating target ratios, a pre-tax interest coverage ratio difference of approximately 0.5x is consistent with a rating difference of slightly more than one step. Standard & Poor's, "Utility Financial Targets are Revised," June 18, 1999.

Q. Are you suggesting that the capital structure you derived is appropriate for setting IP's rates?

A. Not necessarily. The capital structure appropriate for rate setting depends on several factors, including capital component costs, which change with current market conditions. Thus, in setting IP's rates in a future proceeding, Staff might not endorse the same capital structure that I estimated for use in this proceeding.

Moreover, since, as indicated previously, the absolute level of return on capital is largely irrelevant in this proceeding, my analysis focused on IP's relative costs under Dynegy ownership and Ameren ownership. Therefore, the absolute level of my capital component cost estimates was not measured with the same consideration Staff would normally use in an actual rate setting proceeding. For example, I did not attempt to measure the current investor-required rate of return on IP's cost of common equity.

An appropriate capital structure for rate setting needs to be determined at the time of, and with regard to the capital cost components used in, a given rate case. Therefore, I recommend that the Commission's Order note that authorization of this transaction constitutes an endorsement of neither IP's forecasted capital structure nor Ameren's capital structure targets for ratemaking purposes.

Purchased Power and Gas Savings

Q. Please comment on the savings the Applicants assume IP will achieve for purchased power and gas due to the improved credit ratings they expect.

A. In his revenue requirement analysis, Mr. Nelson estimates that IP will be able to purchase power and gas for approximately $42 million less annually under Ameren ownership than it would under continued Dynegy ownership.[21] The Applicants indicate that the assumed savings is due, in part, to favorable terms received because of lower perceived counter-party risk.[22] That is, the Applicants assume that suppliers currently charge IP a 4.65% premium on gas and power purchases due to IP's speculative-grade credit rating. The Applicants believe the proposed transaction would boost IP's credit rating to investment grade, indicating less counter-party risk for suppliers. Thus, suppliers would no longer charge IP the same premium, netting IP more favorable terms.

Q. Do you agree that if IP's credit rating improved, it would be able to buy purchased power and gas at lower rates?

A. Perhaps. However, the Applicants have not sufficiently supported their assumption of 4.7% achieved savings under Ameren ownership. Until they do so, I recommend that the Commission assume no "credit-related savings" will be achieved under the proposed transaction. That is, the Total Revenue Required under Dynegy ownership should be $42 million less than the amount currently presented on Applicants' Corrected Revised Exhibit 3.4 until such time as the Applicants adequately demonstrate that, under continued Dynegy ownership, IP

[21] Applicants' Corrected Revised Exhibit 3.4.
[22] Applicants' response to Staff data request FIN 2.02.

will pay a 4.65% premium on its power and gas purchases relative to what it would pay if the proposed transaction were approved.

Q. What deficiencies do the Applicants need to address to sufficiently support a "credit-related" savings estimate?

A. The Applicants indicate that IP under Ameren ownership could "obtain electric and gas supply on substantially better terms" than under Dynegy ownership due to the investment grade credit rating they expect IP to receive, given the proposed transaction. The Applicants need to explain more precisely what they mean by "better terms." The Applicants' statement that IP "would pay approximately 4.7% more for electricity and gas"[23] under Dynegy ownership suggests that they expect "better terms" in the form of lower underlying commodity prices under the proposed transaction. However, the Applicants measured the premium they expect IP to pay under Dynegy ownership with credit spreads and indicate that suppliers are concerned about the risk of non-payment, both of which suggest that "better terms" refers to lower financing costs. Thus, whether the Applicants expect that the actual underlying commodity price will be lower under Ameren ownership or if the total cost of the purchase will be lower due to reduced financing costs remains unclear. If the Applicants believe that credit ratings directly affect commodity costs, they should submit evidence that 1) less creditworthy companies pay a higher commodity price for energy than more creditworthy companies and 2) the magnitude of the commodity price premium, expressed in percentage terms, equals the difference in yields companies pay on long-term debt.

[23] Applicants' Corrected Revised Exhibit 3.4.

The Applicants indicate that energy and gas suppliers charge buyers with lower credit ratings a premium to mitigate the risk of non-payment or failure to fulfill the contract. According to language from the Gas Industry Standards Board and North American Energy Standards Board standard contract, as provided by the Applicants, adequate assurance of performance may take the form of "a standby irrevocable letter of credit, a prepayment, a security interest in an asset acceptable to the demanding party or a performance bond or guarantee by a creditworthy entity."[24] This suggests that power and gas suppliers do not typically charge a premium for the commodity, but do require the buyer to financially secure the purchase, a service for which the buyer would likely have to pay an outside party, such as a bank. For example, for a substantial majority of its natural gas purchases, IP provides financial security in the form of prepayments, which are "generally made immediately prior to the month of delivery for base load purchases."[25] Theoretically, IP would incur a financing or opportunity cost as a result of those prepayments.[26, 27] Using credit spreads to reflect differences in financing costs is reasonable, assuming that appropriate financing terms and ratings are used. However, if the premium the Applicants expect IP to realize under Ameren ownership reflects anything other than financing costs, it remains unclear how a credit spread relates to that premium.

The Applicants should also demonstrate that the securities used to estimate the credit spread are appropriate for determining the savings on purchased power

[24] Applicants' response to Staff data request FIN 3.02.
[25] Applicants' response to Staff data request FIN 3.01.
[26] Id.
[27] In practice, IP finances prepaid gas purchases with zero-cost prepaid interest on the $2.3 billion Intercompany Note from Illinova. Further, IP currently provides security for its electric power purchases in the form of a parental guarantee, for which IP incurs no specific charge or fee. Applicants' response to Staff data request FIN 3.01.

and gas. The yield on a debt security reflects the timing, magnitude, and uncertainty associated with each of its contractually specified cash flows (i.e., interest and principal repayment) along with the expected degree of recovery of each remaining cash flow in the event of default. For example, an unsecured debt instrument that pays interest semi-annually, and repays no principal until the end of the ten-year term, will likely carry a different yield than a debt instrument secured with an asset that can be quickly resold, pays interest monthly, and repays an equal portion of the principal on a monthly basis over a three-year term. Thus, using the credit spread between issuers rated A– and B– to compare the credit spread of IP under Ameren to that of IP under Dynegy, as Mr. Nelson did,[28] is reasonable only if IP's credit rating will be either A– under the Ameren Scenario or B– the Dynegy Scenario at the time for which the energy price savings are measured. Additionally, using a 10-year bond yield to establish the credit spread, as Mr. Nelson did,[29] appears reasonable only if the power or gas contract being analyzed has a similar payment pattern (i.e., receipt of all the gas at the beginning of the contract with payment deferred for ten-years excepting the semi-annual payment of interest on the unpaid balance) and has similar prospects for recovery in the event of default. The Applicants need to demonstrate that the ratings and terms relied upon are appropriate.

Q. Please provide an example of how credit worthiness could affect the costs of financing energy purchases.

A. Assume the following: 1) IP would receive an A– credit rating under Ameren ownership, while it would receive a B– credit rating under Dynegy ownership; and

[28] Applicant's Exhibit 13.0 at 15.
[29] Id.

2) that given IP's non-investment grade B– rating under Dynegy ownership, IP would be required to prepay for gas purchases immediately prior to the month of delivery, but that under Ameren ownership, IP would pay for gas purchases one month after delivery; and 3) there is a one-month interval between the time IP accepts delivery of gas from the supplier and the time IP collects payments for the resale of that gas to its retail gas customers. Thus, under Dynegy ownership, there would be a two-month interval between the time that IP would have to pay its gas supplier and the time it would recoup its costs through the collection of payments from its retail gas customers; in contrast, under Ameren ownership, payments would be made to suppliers and collected from customers on the same day. Therefore, IP would incur gas financing costs for two months under Dynegy ownership, but would incur no financing costs under Ameren ownership. Given IP's two-month financing under Dynegy ownership, the appropriate debt instrument to use to calculate the credit spread would be short-term. In addition, even if the gas contract has a ten-year term, the financing would be rolled over every two months; thus, no more than one-sixth of a year's gas purchases would be financed at any given time. Therefore, if IP contracted to purchase $900 million of gas during the year, it would only be financing one-sixth of that amount, or $150 million, throughout the year. Thus, if IP's annualized interest rate for short-term debt was 5.0% under Dynegy ownership, IP's financing costs would be $7.5 million ($150 million X 5.0%) for the entire year. In contrast, IP's financing costs under Ameren ownership would be $0, since no financing would be required. That $7.5 million difference in incremental finance charges represents the savings between the two Scenarios.

The above example assumes that IP would incur no financing costs under Ameren ownership. However, in reality, it is quite possible that IP would incur financing costs under either Scenario. For example, if, in the above illustration, there is more than a one-month interval between wholesale delivery and the collection of revenues from retail sales, IP would incur financing costs under either Scenario. For any period during which IP would incur financing costs under either Scenario, the savings would be based on the difference between the amount being financed by, and the interest rate available to, IP under Dynegy ownership and the amount being financed by, and the interest rate available to, IP under Ameren ownership.

AMORTIZATION OF REGULATORY ASSET

Q. Please describe the portion of the regulatory asset you will address.

A. IP seeks to recover $67 million of the costs incurred in completing the proposed transaction. The Applicants present a list totaling $454 million of various costs and fees associated with the transaction that Ameren has incurred, or expects to incur. However, IP does not specify the precise amount of each cost and fee category included in the $67 million it wishes to recover. The $454 million costs and fees include $100 million in debt redemption premiums and $35 million in stock issuance expenses, both of which I will address.

Q. Do you have any concerns regarding the possible double recovery of the debt redemption premiums and stock issuance costs if they are allowed in this proceeding?

A. Yes. If the costs that are being recovered through the amortization of a regulatory asset are not identified, or alternatively, the Commission does not clearly identify which costs IP would be precluded from recovering in future rate proceedings, then IP could recover the debt redemption premiums and stock issuance costs twice: once through the regulatory asset and once through the rate of return. Indeed, the Applicants would not agree to forego recovery of stock issuance costs through the requested rate of return in IP's next rate proceeding, if granted recovery of those costs in this proceeding.[30]

Debt Redemption Premiums

Q. Do you believe that the $100 million of debt redemption premiums presented in Tab D to the application should be eligible for recovery through IP's rates?

A. No. The Commission generally does not allow the recovery of debt redemption and stock issuance costs unless the utility can demonstrate that such costs have been incurred. The Applicants obviously have not paid $100 million of debt redemption premiums, since the redemptions from which those premiums would arise are merely proposals at this time.

Q. Assuming that the specified debt issuances are retired as proposed and that the Applicants could demonstrate that they paid $100 million of debt

[30] Applicants' response to Staff data request FIN 2.01.

redemption premiums, do you believe that cost should be eligible for recovery through IP's rates?

A. Not in its entirety. The Applicants propose to retire *** x x x

expenses due to its speculative-grade credit rating, which in turn was caused by Dynegy's weak financial condition; with lower discounts and expenses, IP would have had to issue only approximately $525 million debt to obtain the same net proceeds. Thus, I applied the 2.5% premium to $525 million to estimate a maximum recoverable call premium of approximately $13.125 million for the 11.5% FMBs.

The *** x x x x x x x x x x x x x x x x x x x *** collective redemption premium for the *** x x x x x x x x x x x x x x *** would normally be recoverable, if the specified debt issuances were retired as proposed. Adding the estimated $13.125 million maximum recoverable redemption premium for the 11.5% FMBs produces a total maximum recoverable debt redemption premium of *** x x x x x x x x ***. Therefore, if the specified debt issuances are retired as proposed, I recommend that the Commission allow a debt redemption premium in the range of *** x x x x x x x x x x x x x x x *** be recovered through rates.

Stock Issuance Costs

Q. Do you believe that the $35 million of stock issuance expenses presented in Tab D to the application should be eligible for recovery through IP's rates?

A. Not in its entirety. The costs Ameren incurs in raising funds for the purpose of buying IP (i.e., funds paid to Dynegy) should not be recoverable from IP's ratepayers. Only the issuance costs associated with capital infused into the target utility to fund the target utility's operations should be recoverable. Under the proposed transaction, IP is expected to receive an equity infusion of *** x x x

x x x ***,[33] which the Applicants project IP would use to retire approximate *** x x x x x x *** of debt, incurring approximately *** x x x x x x *** of redemption premiums.[34] As discussed above, at most approximately *** x x x x x x x x x x x x x x x *** of debt redemption premiums would have been incurred if not for IP's affiliation with Dynegy; thus, I subtracted *** x x x x x x x x *** of non-recoverable debt redemption premiums from the *** x x x x x x *** amount of common equity to be infused into IP to derive a total value of common equity of *** x x x x x x x *** for which issuance costs could be recoverable.

Ameren has, to date, issued $875 million of equity for uses associated with the proposed transaction; it has incurred $21,922,658 of associated issuance costs, which equates to approximately 2.5% of the issuance.[35] Based on the total of *** x x x x x x x *** of proceeds for which the Applicants have identified projected uses, Ameren intends to issue an additional *** x x x x x x x x x x x x x x x x x x x x x x x x x x x ***.[36] Applying the same 2.5% issuance costs as Ameren incurred for the original $875 million for all equity issued to fund the proposed transaction to the *** x x x x x x x x *** equity for which issuance costs should be allowed produces an allowable issuance cost of *** x x x x x x ***. However, the Applicants estimate that Ameren will incur issuance costs of up to *** x x *** of the additional issuance. If Ameren incurs *** x x *** issuance costs for the additional issuance, the weighted average issuance cost rate would be approximately *** x x ***, which applied to the *** x x x x x x x x *** equity for

[33] Applicants' Exhibit 13.1.
[34] Applicants' Exhibit 4.1.
[35] Applicants' response to Staff data request FIN 9.01.
[36] Id.

which issuance costs should be allowed produces an issuance cost of *** x x x x x x ***. Thus, I estimate the allowable common equity issuance expense to be between *** x x x x x x x x x x x x x x ***.

PUSH-DOWN ACCOUNTING

Q. Please comment on the Applicant's proposed use of push-down accounting.

A. If the proposed transaction is authorized, I recommend that the Order in this proceeding instruct IP to not include push-down adjustments in its annual reports to the Commission. The Applicants have agreed to reverse the effect of push down accounting for ratemaking purposes.[37] However, the Applicant's response to Staff data request FIN 2.04 suggests that IP intends to reflect push-down accounting in Accounts 221 and 204. Those accounts do not permit adjustments for push-down accounting. The Uniform System of Accounts ("USoA") for electric utilities states that Account 204 is to reflect the cash consideration received for preferred stock. Similarly, the USoA for electric utilities states that Account 221 is to reflect the face value of bonds. The proposed reorganization does not change the cash consideration received for preferred stock nor the face value of outstanding bonds. Thus, IP should not reflect push-down adjustments for debt or preferred stock in its annual reports to the Commission.

Q. Does this conclude your direct testimony?

A. Yes, it does.

[37] Applicants' Exhibit 5.0, p. 6.

Illinois Power Company

Projected Weighted Average Cost of Capital
December 31, 2006

Dynegy Ownership

	Amount	Percent of Total Capital	Cost	Weighted Cost
New Debt				
Long-term Debt	$ 1,474,092,808	44.49%	6.91%	3.07%
Preferred Stock	$ 45,400,000	1.37%	5.05%	0.07%
Common Equity			10.50%	
Total Capital	$ 3,313,484,119	100.00%		
Weighted Average Cost of Capital				**8.744%**

Ameren Ownership

	Amount	Percent of Total Capital	Cost	Weighted Cost
New Debt				
Long-term Debt	$ 804,937,956	39.25%	6.93%	2.72%
Preferred Stock	$ 45,400,000	2.21%	5.05%	0.11%
Common Equity			10.35%	
Total Capital	$ 2,050,637,956	100.00%		
Weighted Average Cost of Capital				**8.743%**

Illinois Power Company Under Dynegy Ownership

Embedded Cost of Long-Term Debt

December 31, 2006

Coupon Rate (A)	Debt Issue Type (A)	Date Issued (B)	Maturity Date (C)	Original Principal Amount (D)	Face Amount Outstanding (E)	Unamortized Debt Discount or (Premium) (F)	Unamortized Debt Expense (G)	Carrying Value (H)	Coupon Interest Expense (I)	Amortization of Debt Discount or (Premium) (J)	Amortization of Debt Expense (K)	Total Expense (L)
14.5, 12	Loss on Reacquired Debt	9/1/86	9/1/16	$158,520,000	$ -	$ -	$ 2,148,088	$ (2,148,088)	$ -	$ -	$ 221,985	$ 221,985
10.5	Loss on Reacquired Debt	5/1/91	9/1/04	50,000,000			0	0			0	0
var	Loss on Reacquired Debt	5/1/01	11/1/28	111,770,000			1,118,668	(1,118,668)			51,193	51,193
var	Loss on Reacquired Debt	5/1/01	3/1/17	75,000,000			351,857	(351,857)			34,589	34,589
MIPS	Loss on Reacquired Debt	8/1/01	12/1/43	93,000,000			2,433,098	(2,433,098)			65,862	65,862
8.625	Loss on Reacquired Debt	4/1/93	3/1/05	100,000,000			0	0			0	0
10.75	Loss on Reacquired Debt	12/1/93	11/1/28	111,770,000			1,617,649	(1,617,649)			74,027	74,027
11.625	Loss on Reacquired Debt	5/1/94	2/1/24	35,615,000			433,130	(433,130)			25,331	25,331
10.75	Loss on Reacquired Debt	7/1/91	12/1/24	84,150,000			722,394	(722,394)			40,286	40,286
9.875	Loss on Reacquired Debt	11/1/90	7/1/16	63,500,000			63,045	(63,045)			6,632	6,632
9.375	Loss on Reacquired Debt	3/1/93	2/1/23	125,000,000			2,159,094	(2,159,094)			134,117	134,117
7.625	Loss on Reacquired Debt	6/1/97	4/1/32	150,000,000			1,748,011	(1,748,011)			69,177	69,177
8.3	Loss on Reacquired Debt	7/1/87	4/1/17	33,755,000			818,883	(818,883)			79,832	79,832
8.875	Loss on Reacquired Debt	3/1/93	2/1/23	100,000,000			1,088,648	(1,088,648)			67,624	67,624
12	Loss on Reacquired Debt	1/1/88	11/1/12	6,827,000			57,400	(57,400)			9,827	9,827
8.25,10	Loss on Reacquired Debt	8/1/93	7/1/25	150,000,000			527,323	(527,323)			28,485	28,485
6	Loss on Reacquired Debt	3/1/98	3/1/28	52,455,000			378,647	(378,647)			17,877	17,877
7.375	Loss on Reacquired Debt	7/1/99	12/1/08	84,710,000			1,451,186	(1,451,186)			755,611	755,611
7.95	Loss on Reacquired Debt	12/1/98	12/1/08	72,000,000			2,719,983	(2,719,983)			1,416,254	1,416,254
8.75	Loss on Reacquired Debt	1/1/99	12/1/08	57,061,000			1,368,660	(1,368,660)			712,640	712,640
8	Loss on Reacquired Debt	1/1/99	12/1/08	229,000,000			2,917,153	(2,917,153)			1,518,917	1,518,917
9.45	Loss on Reacquired Debt	3/1/99	12/1/08	3,872,500			40,646	(40,646)			21,164	21,164
6.5	Loss on Reacquired Debt	2/1/99	12/1/08	72,000,000			128,845	(128,845)			67,087	67,087
7.5	Loss on Reacquired Debt	1/1/99	12/1/08	68,370,000			1,446,256	(1,446,256)			753,044	753,044
TOPRS	Loss on Reacquired Debt	9/1/01	1/1/45	100,000,000			2,558,976	(2,558,976)			67,288	67,288
7.5	Loss on Reacquired Debt	4/1/96	7/1/25	23,000,000			(245,893)	245,893			(13,283)	(13,283)
6	Loss on Reacquired Debt	8/1/99	12/1/08	10,000,000			(223,149)	223,149			(116,190)	(116,190)
7.5	Loss on Reacquired Debt	10/1/99	12/1/08	11,000,000			(278,673)	278,673			(145,101)	(145,101)
6.25	Loss on Reacquired Debt	10/1/99	12/1/08	4,325,000			(48,183)	48,183			(25,088)	(25,088)
7.5	Loss on Reacquired Debt	1/1/00	12/1/08	32,000,000			220,443	(220,443)			114,781	114,781

	Debt Issue Type Coupon Rate (A)	Date Issued (B)	Maturity Date (C)	Original Principal Amount (D)	Face Amount Outstanding (E)	Unamortized Debt Discount or (Premium) (F)	Unamortized Debt Expense (G)	Carrying Value (H)	Coupon Interest Expense (I)	Amortization of Debt Discount or (Premium) (J)	Amortization of Debt Expense (K)	Total Expense (L)
6.50%	Mortgage Bond	12/20/02	12/15/10	540,000,000	525,000,000	0	2,186,102	522,813,898	34,125,000	0	552,199	34,677,199
5.38%	Illinois Power Special Purpose	12/1/98	6/1/05					0	0			0
5.54%	Illinois Power Special Purpose	12/1/98	6/1/07	175,000,000	33,800,000			33,800,000	1,872,520			1,872,520
5.65%	Illinois Power Special Purpose	12/1/98	12/25/08	139,000,000	139,000,000	16,365	1,278,899	137,704,735	7,853,500	8,239	643,860	8,505,599
6.75%	New Mortgage Bond	3/15/93	3/15/05			0	0	0	0	0	0	0
4.00%	PCB Series X Adjustable	5/1/01	3/1/17	75,000,000	75,000,000		1,309,325	73,690,675	3,000,000		128,711	3,128,711
	Remarketing & LOC Fees	5/1/01	3/1/17						415,092			415,092
5.70%	New Mortgage Bond	2/1/94	2/1/24	35,615,000	35,615,000	3,800,909	1,042,487	30,771,604	2,030,055	222,293	60,969	2,313,317
7.40%	New Mortgage Bond	12/1/94	12/1/24	84,150,000	84,150,000	503,923	2,321,820	81,324,257	6,227,100	28,103	129,483	6,384,685
7.50%	New Mortgage Bond	7/22/93	7/15/25	200,000,000	65,630,000	561,464	51,839	65,016,697	4,922,250	30,266	2,794	4,955,311
4.00%	PCB Series W Adjustable	5/1/01	11/1/28	111,770,000	111,770,000		2,973,989	108,796,011	4,470,800		136,097	4,606,897
	Remarketing & LOC Fees	5/1/01	11/1/28						564,256		0	564,256
4.00%	PCB Series P,Q,R Adjustable	4/10/97	4/1/32	150,000,000	150,000,000		3,058,898	146,941,102	6,000,000		121,056	6,121,056
	Remarketing & LOC Fees	4/10/97	4/1/32						301,726			301,726
5.40%	PCB Series S	3/6/98	3/1/28	18,700,000	18,700,000		412,979	18,287,021	1,009,800		19,498	1,029,298
5.40%	PCB Series T	3/6/98	3/1/28	33,755,000	33,755,000		417,136	33,337,864	1,822,770		19,694	1,842,464
7.50%	New Mortgage Bond	6/29/99	6/15/09	250,000,000	250,000,000	90,454	578,414	249,331,132	18,750,000	36,807	235,363	19,022,170
	TOTAL ENDING BALANCE			172,800,000	1,522,420,000	4,973,115	43,354,077	1,474,092,808	93,364,869	325,708	8,103,692	101,794,269
					1,530,540,837						**Embedded cost of long-term debt =**	**6.91%**

Source:
Illinois Power Company 2003 Form 21 ILCC Annual Report

Illinois Power Company Under Ameren Ownership

Embedded Cost of Long-Term Debt

December 31, 2006

Debt Issue Type Coupon Rate (A)		Date Issued (B)	Maturity Date (C)	Original Principal Amount (D)	Face Amount Outstanding (E)	Unamortized Debt Discount or (Premium) (F)	Unamortized Debt Expense (G)	Carrying Value (H)	Coupon Interest Expense (I)	Amortization of Debt Discount or (Premium) (J)	Amortization of Debt Expense (K)	Total Expense (L)
14.5, 12	Loss on Reacquired Debt	9/1/86	9/1/16	$158,520,000	$ -	$ -	$ 2,148,088	$ (2,148,088)	$ -	$ -	$ 221,985	$ 221,985
10.5	Loss on Reacquired Debt	5/1/91	9/1/04	50,000,000			0	0			0	0
var	Loss on Reacquired Debt	5/1/01	11/1/28	111,770,000			1,118,668	(1,118,668)			51,193	51,193
var	Loss on Reacquired Debt	5/1/01	3/1/17	75,000,000			351,857	(351,857)			34,589	34,589
MIPS	Loss on Reacquired Debt	8/1/01	12/1/43	93,000,000			2,433,098	(2,433,098)			65,862	65,862
8.625	Loss on Reacquired Debt	4/1/93	3/1/05	100,000,000			0	0			0	0
10.75	Loss on Reacquired Debt	12/1/93	11/1/28	111,770,000			1,617,649	(1,617,649)			74,027	74,027
11.625	Loss on Reacquired Debt	5/1/94	2/1/24	35,615,000			433,130	(433,130)			25,331	25,331
10.75	Loss on Reacquired Debt	7/1/91	12/1/24	84,150,000			722,394	(722,394)			40,286	40,286
9.875	Loss on Reacquired Debt	11/1/90	7/1/16	63,500,000			63,045	(63,045)			6,632	6,632
9.375	Loss on Reacquired Debt	3/1/93	2/1/23	125,000,000			2,159,094	(2,159,094)			134,117	134,117
7.625	Loss on Reacquired Debt	6/1/97	4/1/32	150,000,000			1,748,011	(1,748,011)			69,177	69,177
8.3	Loss on Reacquired Debt	7/1/87	4/1/17	33,755,000			818,883	(818,883)			79,832	79,832
8.875	Loss on Reacquired Debt	3/1/93	2/1/23	100,000,000			1,088,648	(1,088,648)			67,624	67,624
12	Loss on Reacquired Debt	1/1/88	11/1/12	6,827,000			57,400	(57,400)			9,827	9,827
8.25,10	Loss on Reacquired Debt	8/1/93	7/1/25	150,000,000			527,323	(527,323)			28,485	28,485
6	Loss on Reacquired Debt	3/1/98	3/1/28	52,455,000			378,647	(378,647)			17,877	17,877
7.375	Loss on Reacquired Debt	7/1/99	12/1/08	84,710,000			1,451,186	(1,451,186)			755,611	755,611
7.95	Loss on Reacquired Debt	12/1/98	12/1/08	72,000,000			2,719,983	(2,719,983)			1,416,254	1,416,254
8.75	Loss on Reacquired Debt	1/1/99	12/1/08	57,061,000			1,368,660	(1,368,660)			712,640	712,640
8	Loss on Reacquired Debt	1/1/99	12/1/08	229,000,000			2,917,153	(2,917,153)			1,518,917	1,518,917
9.45	Loss on Reacquired Debt	3/1/99	12/1/08	3,872,500			40,646	(40,646)			21,164	21,164
6.5	Loss on Reacquired Debt	2/1/99	12/1/08	72,000,000			128,845	(128,845)			67,087	67,087
7.5	Loss on Reacquired Debt	1/1/99	12/1/08	68,370,000			1,446,256	(1,446,256)			753,044	753,044
TOPRS	Loss on Reacquired Debt	9/1/01	1/1/45	100,000,000			2,558,976	(2,558,976)			67,288	67,288
7.5	Loss on Reacquired Debt	4/1/96	7/1/25	23,000,000			(245,893)	245,893			(13,283)	(13,283)
6	Loss on Reacquired Debt	8/1/99	12/1/08	10,000,000			(223,149)	223,149			(116,190)	(116,190)
7.5	Loss on Reacquired Debt	10/1/99	12/1/08	11,000,000			(278,673)	278,673			(145,101)	(145,101)
6.25	Loss on Reacquired Debt	10/1/99	12/1/08	4,325,000			(48,183)	48,183			(25,088)	(25,088)
7.5	Loss on Reacquired Debt	1/1/00	12/1/08	32,000,000			220,443	(220,443)			114,781	114,781

	Debt Issue Type Coupon Rate (A)	Date Issued (B)	Maturity Date (C)	Original Principal Amount (D)	Face Amount Outstanding (E)	Unamortized Debt Discount or (Premium) (F)	Unamortized Debt Expense (G)	Carrying Value (H)	Coupon Interest Expense (I)	Amortization of Debt Discount or (Premium) (J)	Amortization of Debt Expense (K)	Total Expense (L)
6.50%	Mortgage Bond	12/20/02	12/15/10									
5.38%	Illinois Power Special Purpose	12/1/98	6/1/05									
5.54%	Illinois Power Special Purpose	12/1/98	6/1/07	175,000,000	33,800,000			33,800,000	1,872,520			1,872,520
5.65%	Illinois Power Special Purpose	12/1/98	12/25/08	139,000,000	139,000,000	16,365	1,278,899	137,704,735	7,853,500	8,239	643,860	8,505,599
6.75%	New Mortgage Bond	3/15/93	3/15/05									
4.00%	PCB Series X Adjustable	5/1/01	3/1/17	75,000,000	75,000,000		1,309,325	73,690,675	3,000,000		128,711	3,128,711
	Remarketing & LOC Fees	5/1/01	3/1/17						415,092			415,092
5.70%	New Mortgage Bond	2/1/94	2/1/24	35,615,000	35,615,000	3,800,909	1,042,487	30,771,604	2,030,055	222,293	60,969	2,313,317
7.40%	New Mortgage Bond	12/1/94	12/1/24									
7.50%	New Mortgage Bond	7/22/93	7/15/25									
4.00%	PCB Series W Adjustable	5/1/01	11/1/28	111,770,000	111,770,000		2,973,989	108,796,011	4,470,800		136,097	4,606,897
	Remarketing & LOC Fees	5/1/01	11/1/28						564,256			564,256
4.00%	PCB Series P,Q,R Adjustable	4/10/97	4/1/32	150,000,000	150,000,000		3,058,898	146,941,102	6,000,000		121,056	6,121,056
	Remarketing & LOC Fees	4/10/97	4/1/32						301,726			301,726
5.40%	PCB Series S	3/6/98	3/1/28	18,700,000	18,700,000		412,979	18,287,021	1,009,800		19,498	1,029,298
5.40%	PCB Series T	3/6/98	3/1/28	33,755,000	33,755,000		417,136	33,337,864	1,822,770		19,694	1,842,464
7.50%	New Mortgage Bond	6/29/99	6/15/09	250,000,000	250,000,000	90,454	578,414	249,331,132	18,750,000	36,807	235,363	19,022,170
	TOTAL ENDING BALANCE			172,800,000	847,640,000	3,907,728	38,794,315	804,937,956	48,090,519	267,339	7,419,216	55,777,074
					855,760,837						**Embedded cost of long-term debt =**	**6.93%**

Sources:
Illinois Power Company 2003 Form 21 ILCC Annual Report
Applicants' response to Staff data request FIN 2.03