Docket No. 04-0294
ICC Staff Exhibit 18.0

REDACTED

REBUTTAL TESTIMONY

OF

DIANNA HATHHORN

Accounting Department

Financial Analysis Division

Illinois Commerce Commission

Confidential Information Identified As
*****x x x *****

Application for Authority to Engage in a Reorganization and to Enter Into Various Agreements in Connection Therewith

Illinois Power Company
Ameren Corporation

Docket No. 04-0294

August 13, 2004

Witness and Schedule Identification

Q. Please state your name and business address.

A. My name is Dianna Hathhorn. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. Have you previously filed testimony in this proceeding?

A. Yes, my direct testimony is ICC Staff Exhibit 8.0.

Q. What is the purpose of this testimony?

A. I am presenting my position based upon Illinois Power Company ("IP" or "Illinois Power") and Ameren Corporation ("Ameren) (collectively, the "Companies" or "Applicants") rebuttal testimony. Specifically, my testimony addresses whether the proposed reorganization complies with the requirements set forth in paragraph (7) of Section 7-204(b) of the Public Utilities Act ("Act"), as well as certain issues regarding the Applicants' asbestos rider proposal.

Q. Are you sponsoring any schedules with your testimony?

A. Yes. I prepared Schedule 18.1, Staff Revenue Requirement Comparison, described further below.

Section 7-204(b)(7) - Rate Impact

Q. Section 7-204(b)(7) of the Act provides that in reviewing any proposed reorganization the Illinois Commerce Commission ("Commission") must find that "the proposed reorganization is not likely to result in any adverse rate impacts on retail customers." Have you reviewed the Applicants' rebuttal testimony relative to rate impacts on retail customers?

A. Yes, I have.

Q. Please describe ICC Staff Exhibit 18.0, Schedule 18.1.

A. Schedule 18.1 is an updated version of ICC Staff Exhibit 8.0, Schedule 8.1, Staff's calculation of the projected difference in required revenues for IP under Ameren ownership and IP under Dynegy ownership (i.e., with and without the reorganization), used to compare Staff's calculation to the Applicants' rebuttal analysis on Applicants' Exhibit 23.1. Two case scenarios are presented. Case A reflects allowing Ameren to recover a portion of the regulatory asset it has requested. This Staff calculation shows $28 million more in required revenue requirement for IP under Ameren ownership than under Dynegy ownership. Case B reflects disallowing Ameren recovery of the regulatory asset. This Staff calculation shows $11 million more in required revenue requirement for IP under Ameren ownership than under Dynegy ownership. The Applicants' calculation on Applicants' Exhibit 23.1, Case B, reflects $6 million less in required revenue requirement for IP under Ameren ownership than under Dynegy ownership.

Q. What is your conclusion regarding Section 7-204(b)(7) of the Act?

A. As Staff's collective analysis shows, depending upon the disposition of the proposed regulatory asset, revenue requirements would be either $11 million or $28 million greater with IP under Ameren ownership than Dynegy, I cannot conclude that the proposed reorganization is not likely to result in an adverse rate impact on retail customers.

Q. What are the differences between the Staff's and Applicants' revenue requirement analyses?

A. There are four differences.

- Staff's analysis reflects Case A and Case B scenarios, based upon the testimony of Staff witness Ms. Bonnie Pearce (ICC Staff Exhibit 19.0) concerning the annual acquisition adjustment related to the requested regulatory asset. This issue is addressed in more detail in the testimony of Staff witness Pearce.
- Staff's analysis reflects my estimate of the Hazardous Materials Adjustment Clause ("HMAC Rider") net impact of $2 million annually under Ameren ownership, as discussed more below.
- Staff's analysis reflects the recommendation of Staff witness Mr. Michael McNally (ICC Staff Exhibit 21.0) that the 4.7% in annual purchased power and gas cost savings be zero. This reduces purchased power and gas under Dynegy ownership from $919 to $900 million. (Schedule 18.1, line

20, Under Dynegy ownership). This issue is addressed in more detail in the testimony of Staff witness McNally.

- Staff's analysis reflects the recommendation of Staff witness Mr. Eric Lounsberry (ICC Staff Exhibit 16.0) that the 1.5% in annual purchased power and gas cost savings be zero. This increases purchased power and gas under Ameren ownership from $887 to $900 million. (Schedule 18.1, line 20, Under Ameren ownership). This issue is addressed in more detail in the testimony of Staff witness Lounsberry.

Q. Applicants state that your asbestos adjustment represents Staff's assumption that $2 million of asbestos costs incurred in 2007 will be recovered through an HMAC Rider under Ameren ownership. (Applicants' Ex. 23.0, p. 12, lines 256-258) Is this a correct representation of your adjustment?

A. No. My adjustment, calculated in ICC Staff Exhibit 8.0, Schedule 8.2, presents an estimate of the net difference of asbestos costs to be recovered with an HMAC Rider by IP under Ameren ownership, as opposed to asbestos costs recovered in base rates by IP under Dynegy ownership. Since the adjustment is calculated on a net basis, it is appropriate to reflect it only in the Ameren ownership side of the analysis.

Q. Applicants also state that you suggest that, without a rider, IP will under-

recover its costs associated with asbestos claims. (Applicants' Ex. 23.0, p. 11, lines 246-247) Is this a correct characterization of your testimony?

A. No, the suggestion that IP will under-recover its asbestos claims costs without a rider is a suggestion that Ameren makes in support of its request for approval of the HMAC Rider. Ameren agreed that it has inextricably tied consummation of the proposed reorganization to the establishment of the HMAC Rider, (Applicants' Ex. 21.0, p. 9, lines 192-195) yet Ameren argues that the costs will be the same irrespective of how they are recovered. (Applicants' Ex. 23.0, p. 11, lines 241-242) Ameren argues further that the risk associated with being unable to recover the costs related to Illinois Power's asbestos litigation through normal ratemaking processes—either non-recovery (because damages and defense costs exceed the amounts, if any, built into base rates) or delayed recovery--was not acceptable. (Applicants' Ex. 14.0, p. 7, lines 149-152) Therefore, Ameren necessarily assumes a difference in costs exists, otherwise the recovery mechanism, i.e. rider versus base rates, would not be an issue. My adjustment simply reflects the assumptions and evidence Ameren has presented.

<u>HMAC Rider</u>

Q. Has IP provided additional information since your direct testimony concerning its contingent liability for asbestos exposure?

A. Yes. According to IP's confidential response to Staff Data Request DLH-8.02, IP's contingent liability of ***x x x x x x *** was calculated by assuming ***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 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 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 x x x x.*** The Marsh Report, also referred to as the MMC Enterprise Risk Report, was originally provided to Staff as Schedule POL 1.05.1 and is attached to Dr. Haas' Rebuttal testimony.

Q. Applicants state that asbestos claims have potential to be in the multi-million-dollar range (Applicants' Ex. 25.0, p. 17, lines 362-373), and that in Illinois, the Commission is limited in its authority to approve deferral of one-time, large judgments. (Applicants' Ex. 25.0, p. 19, lines 408-418) Are riders and deferrals the only options available to manage this risk?

A. No. As I stated in my direct testimony, if IP's experience demonstrates that an asbestos claim will cause it to not earn its authorized return, IP can seek to recover those costs through a petition for new rates. (ICC Staff Exhibit 8.0, p. 13, lines 288-293) Often times in general rate cases, an abnormally high or low test-year expense must be adjusted to a normal level. This is not considered a deferral, and would be an option for handling large judgments in the future.

Q. Ameren states that the forecasting that will take place with the HMAC Rider is short-term forecasting, with the longest forecast being for twelve months. Ameren claims the long-term forecasting could be eliminated if the rider is approved. (Applicants' Ex. 32.0, p. 2, lines 31-34) Are these statements consistent with IP's explanation of how its contingent liability was calculated?

A. No. According to IP's confidential responses to Staff Data Requests DLH-8.01 and 8.02, the contingent liability ****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 x x x x x x x x x x x x x x x x x x x x x***

Q. Ameren states it is willing to modify the HMAC Rider to impose an annual cap on the amount to be recovered, set at 3% of 2002 revenues. (Applicants' Ex. 25.0, p. 22, lines 478-479 and Applicants' Ex. 25.1) Do you have any comments on the cap or the amount of 2002 revenues?

A. To clarify, the cap is only a leveling mechanism in that it does not deny recovery of costs; it only defers the costs with a carrying charge added. Also, for the record, according to IP's 2002 Form 21, page 8, line 9-Total Sales of Electricity was $1,086,400,831. Multiplying this figure by 3%, then, results in an annual cap of $32,592,025.

Q. If the Commission approves the HMAC Rider, do you recommend any language changes regarding the 3% cap?

A. Yes. I believe it is more clear and straightforward for the rider to explicitly state the dollar amount rate cap, i.e. $32,592,025, rather than refer the reader to calculate "3% of the Company's retail revenue for sales to customers as reported in the Form 21 for 2002." (Applicants' Ex. 25.2, Terms and Conditions) The cap is based on known, historical information, and there is no need for the rider language to be vague. I have developed the following language, in legislative style to the Applicants' proposed HMAC Rider language, to incorporate my recommendation:

> The Annual Cost amount is subject to the condition that it not exceed $32,592,025, which is 3% of the Company's retail revenue sales to customers in the Form 21 for 2002. In the event the Annual Cost factor exceeds $32,592,025 ~~such 3% cap~~, the excess amount, plus carrying costs established by the Commission shall be eligible for inclusion in calculation of the HMAC for the next Annual Recovery period.

Q. Did Ameren provide the potential monthly effect of the HMAC Rider charged to a hypothetical, typical customer in each of the residential, commercial, and industrial classes at the level of the rate cap?

A. No, however, Ameren provided that data assuming an annual asbestos litigation cost of $10 million. (Applicants' Ex. 25.0, p. 20, lines 421-429) I recommend that Ameren provide the potential monthly effect of the HMAC Rider charged to a hypothetical, typical customer in each of the residential, commercial, and industrial classes in its surrebuttal testimony, using the same assumptions as its prior example, except based upon the rate cap level of $32,592,025.

Q. If the Commission approves the HMAC Rider, Ameren opposes excluding insurance premiums from the rider. (Applicants' Ex. 25.0, p. 23, line 494) What is the proper rate treatment of insurance premiums?

A. Insurance premiums are typically not volatile; therefore, it is inappropriate for those costs to be recovered in a rider. Insurance proceeds, however, are unknown year to year, and therefore should be used to offset asbestos costs to the extent those costs have been passed through to ratepayers in a rider. For example, if $2 million in asbestos claims flowed through the rider, and the Company received $2 million in insurance proceeds, all the proceeds would flow through the rider to reimburse ratepayers for costs previously paid by them. If the Company charged only $1 million in asbestos claims through the rider, and received the same $2 million in insurance proceeds, only $1 million would flow through the rider, because that is the amount the ratepayers have paid and is the proper amount due for a refund. The insurance proceeds credit, then, is directly tied to asbestos *claims* charged through the rider. There is no reason to include insurance premiums in this calculation.

Conclusion

Q. Does this question end your prepared rebuttal testimony?

A. Yes.

Docket No. 04-0294
ICC Staff Exhibit 18.0
Schedule 18.1
Case A

Illinois Power Company and Ameren Corporation
Staff Revenue Requirement Comparison
2007 Rate Case
(In Millions)

Under Ameren ownership

Line No.	Description (A)	% of RBase	Rate	Amount (B)	Source (C)
					(1)
1	Rate Base without transaction			$ 1,600	
2	Net change due to step-up			310	
3	New Rate Base			$1,910	
4	Equity	55.93%	10.35%		
5	Pref. Stock	2.21%	5.05%		
6	Debt	41.85%	6.79%		
7	Tax Rate =	39.75%			
8	Return on Rate Base =	8.743%		$ 167	
9	Interest Tax Savings =			(22)	
10	After-Tax Return Requirement =			$ 145	
11	EBIT =			$ 241	
12	Depreciation & Amortization			90	
13	Acquisition Adjustment Amortization			17	(2)
14	D&A =			107	
15	EBITDA =			$ 348	
16	O&M and G&A Expense			308	
17	Synergies			(33)	
18	Net O&M =			275	
19	Gross Margin =			$ 623	
20	Purchased Power + Gas =			900	(5)
21	Subtotal			$ 1,523	
22	Plus Net Cost of Asbestos (HMAC) Rider			$ 2	(3)
23	Total Revenue Required =			$ 1,525	

Under Dynegy ownership

Line No.	Description (A)	% of RBase	Rate	Amount (B)	Source (C)
					(1)
1	Rate Base			$ 1,600	
2	N/A				
3	Rate Base			$1,600	
4	Equity	52.68%	10.5%		
5	Pref. Stock	1.37%	5.05%		
6	Debt	45.95%	6.84%		
7	Tax Rate =	39.75%			
8	Return on Rate Base =	8.744%		$ 140	
9	Interest Tax Savings =			(20)	
10	After-Tax Return Requirement =			$ 120	
11	EBIT =			$ 199	
12	Depreciation & Amortization			90	
13	Acquisition Adjustment Amortization			-	
14	D&A =			90	
15	EBITDA =			$ 289	
16	O&M and G&A Expense			308	
17	Synergies			-	
18	Net O&M =			308	
19	Gross Margin =			$ 597	
20	Purchased Power + Gas =			900	(4)
21	Total Revenue Required =			$ 1,497	

Source:
(1) All amounts from Applicants' Ex. 23.1, Case B, unless otherwise noted.
(2) ICC Staff Exhibit 19.0
(3) ICC Staff Exhibit 8.0, Schedule 8.2, line 5, rounded
(4) ICC Staff Exhibits 21.0
(4) ICC Staff Exhibits 16.0

Illinois Power Company and Ameren Corporation
Staff Revenue Requirement Comparison
2007 Rate Case
(In Millions)

Under Ameren ownership

Line No.	Description (A)	% of RBase	Rate	Amount (B)	Source (C)
					(1)
1	Rate Base without transaction			$ 1,600	
2	Net change due to step-up			310	
3	New Rate Base			$1,910	
4	Equity	55.93%	10.35%		
5	Pref. Stock	2.21%	5.05%		
6	Debt	41.85%	6.79%		
7	Tax Rate =	39.75%			
8	Return on Rate Base =	8.743%		$ 167	
9	Interest Tax Savings =			(22)	
10	After-Tax Return Requirement =			$ 145	
11	EBIT =			$ 241	
12	Depreciation & Amortization			90	
13	Acquisition Adjustment Amortization			-	(2)
14	D&A =			90	
15	EBITDA =			$ 331	
16	O&M and G&A Expense			308	
17	Synergies			(33)	
18	Net O&M =			275	
19	Gross Margin =			$ 606	
20	Purchased Power + Gas =			900	(5)
21	Subtotal			$ 1,506	
22	Plus Net Cost of Asbestos (HMAC) Rider			$ 2	(3)
23	Total Revenue Required =			$ 1,508	

Under Dynegy ownership

Line No.	Description (A)	% of RBase	Rate	Amount (B)	Source (C)
					(1)
1	Rate Base			$ 1,600	
2	N/A				
3	Rate Base			$1,600	
4	Equity	52.68%	10.5%		
5	Pref. Stock	1.37%	5.05%		
6	Debt	45.95%	6.84%		
7	Tax Rate =	39.75%			
8	Return on Rate Base =	8.744%		$ 140	
9	Interest Tax Savings =			(20)	
10	After-Tax Return Requirement =			$ 120	
11	EBIT =			$ 199	
12	Depreciation & Amortization			90	
13	Acquisition Adjustment Amortization			-	
14	D&A =			90	
15	EBITDA =			$ 289	
16	O&M and G&A Expense			308	
17	Synergies			-	
18	Net O&M =			308	
19	Gross Margin =			$ 597	
20	Purchased Power + Gas =			900	(4)
21	Total Revenue Required =			$ 1,497	

Source:
(1) All amounts from Applicants' Ex. 23.1, Case B, unless otherwise noted.
(2) ICC Staff Exhibit 19.0
(3) ICC Staff Exhibit 8.0, Schedule 8.2, line 5, rounded
(4) ICC Staff Exhibits 21.0
(4) ICC Staff Exhibits 16.0