REDACTED
SUPPLEMENTAL
DIRECT TESTIMONY

OF

PHIL A. HARDAS

FINANCE DEPARTMENT

FINANCIAL ANALYSIS DIVISION

ILLINOIS COMMERCE COMMISSION

ILLINOIS COMMERCE COMMISSION
ON ITS OWN MOTION
-VS-
UNION ELECTRIC COMPANY

DOCKET NO. 00-0655

PROPOSED TRANSFER OF DISTRIBUTION AND TRANSMISSION ASSETS
AND RETAIL ELECTRIC BUSINESS

NOVEMBER 2000

Q. Please state your name and business address.

A. My name is Phil A. Hardas. My business address is 527 East Capitol Avenue, Springfield, Illinois, 62701.

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

A. I am presently employed as a Financial Analyst with the Finance Department of the Financial Analysis Division.

Q. Please describe your qualifications and background.

A. In December of 1998, I received a Bachelor of Science degree in Finance from Southern Illinois University in Carbondale, Illinois. I am currently pursuing a Masters degree in Business Administration at the University of Illinois at Springfield. I have been employed by the Illinois Commerce Commission since May 1999.

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

A. On October 2, 2000, Union Electric Company ("AmerenUE") filed notice with the Commission of its intent to transfer all of its Illinois associated liabilities, its Illinois retail electric business, its Illinois distribution assets and all Illinois transmission assets other than those associated with AmerenUE's Venice facility, to an affiliate, Central Illinois Public Service Company d/b/a Ameren CIPS ("AmerenCIPS" or "Company"). The Commission initiated this proceeding to determine whether the proposed transfer of the specified distribution and transmission assets should be prohibited. One of the issues before the Commission under Section 16-111(g)(vi) of the Illinois Public Utilities Act ("Act") (220 ILCS 5/16-111(g)(vi)) is whether there is a strong likelihood that consummation of the proposed transaction will result in the Company being entitled to request an increase in its base rates during the mandatory transition period pursuant to Section 16-111(d) of the Act. Towards that end, my testimony presents my evaluation of the Company's projected earned rates of return on common equity ("ROEs"). I will address the likelihood that consummation of the proposed transaction will result in the Company being entitled to request an increase in base rates during the mandatory transition period pursuant to the Act.

Q. Please summarize your findings.

A. In AmerenUE Appendix F, the Company provided AmerenCIPS' projected two-year average ROEs for each year from the date of the notice through December 31, 2004, both with and without the proposed transfer. The Company's projected ROEs assume a gradual decrease in retail sales. The Company subsequently adjusted Appendix F in its response to Staff data requests PH-1.03 and PH-1.04 to reflect 0% and 100% retail sales retention. (See Schedule 2.1) After reviewing the Company's calculations, I have determined that the Company's projected ROEs indicate that there is not a strong likelihood that consummation of the proposed transaction will result in the electric utility being entitled to request an increase in base rates during the mandatory transition period pursuant to Section 16-111(d).

Q. What are the Company's projected ROE's?

A. Based upon the Company's response to PH-1.03 and PH-1.04, under 0% retail sales retention, the two-year averages of projected ROEs are % and %, giving effect to the proposed transfer, and between % and % were the proposed transfer not to occur. Under 100% retail sales retention, the two-year averages of projected ROEs are between % and % giving effect to the proposed transfer, and between % and % were the proposed transfer not to occur.

Q. How were the Company's projected ROEs calculated?

A. The Company calculated its projected ROEs for the period December 31, 2000 through December 31, 2004 using amounts derived from projected financial statements with and without the proposed transfer. ROEs were calculated by dividing the 2-year average of Net Income Applicable to Common Stock by the average of the beginning and ending balances of Common Equity for the same two-year period. In the Company's response to PH-1.03 and PH-1.04, the Company assumes that the proposed transaction does not cause adjustments to intangible assets or regulatory assets. ROEs not adjusted to remove the after-tax impact of accelerated depreciation or amortization during each of the relevant years would be lower than ROEs with the adjustments. Therefore, removing either intangible asset or regulatory asset amortization would increase the Company's ROEs.

Q. Do you have any concerns with the Company's ROE calculations shown on the Company's responses to PH-1.03 and PH-1.04?

A. Yes, I have one concern with the Company's ROE calculations. AmerenCIPS assumes no future residential rate decreases. It is possible that AmerenCIPS will have to reduce residential rates 5% in 2002 pursuant to Section 16-111(b) of the Act.

Q. Do you have any recommendations for the Company's adjusted ROE calculations shown on the Company's responses to PH-1.03 and PH-1.04?

A. Yes, I do. I recommend that the Company submit revised ROEs reflecting a potential residential rate reduction of 5% in 2002 pursuant to Section 16-111(b) of the Act.

Q. Based on your analysis, do the projected ROEs for the Company indicate a strong likelihood that consummation of the proposed transaction would result in the Company being entitled to request an increase in base rates?

A. If the Company does not have to reduce residential rates by 5%, its projected ROEs do not indicate a strong likelihood that the proposed transfer would result in the Company being entitled to request an increase in base rates. Under Section 16-

111(d), if the Company's two-year average of earned ROE is below the two-year average of the monthly average yields of the 30-year U. S. Treasury bonds for the same two-year period, then the Company may request an increase in its base rates. Under Section 16-111(g), two-year average of projected ROEs are required to determine the likelihood that the Company would be entitled to request an increase in base rates. As shown on Company's responses to PH-1.03 and PH-1.04, the Company's two-year average of projected ROEs from December 31, 1999 through December 31, 2004 are higher than the spot yield for 30-year U.S. Treasury bonds on November 2, 2000 of 5.79% and the two-year average for 30-year U.S. Treasury bonds for the period ending December 31, 1999 of 5.72%.[1]

Since the future yields of U.S. Treasury bonds are unknown, I examined the historical variability of those yields. Standard deviation measures the dispersion of data around a mean value. The standard deviation for the two-year average of monthly average yields of the 30-year U.S. Treasury bonds from January 1989 through December 1999 equals 0.90%. Under all transfer scenarios, the two-year averages of projected ROEs are at least two standard deviations above the current U.S. Treasury bond yield and the most recent two-year monthly average of the U.S. Treasury bond yields. This indicates that there is a low probability that the two-year average of monthly average yields of the 30-year U.S. Treasury bonds would exceed the two-year average of ROEs. These results indicate, absent a further 5% decrease in residential rates, the likelihood of the Company qualifying to request an increase in base rates is not strong. However, the Company should model the 0%

[1] http://www.bog.frb.fed.us/releases/h15/data/m/tcm30y.txt

and 100% retention scenarios assuming that it must further reduce residential rates 5% on October 1, 2002.

Q. Does this conclude your direct testimony?

A. Yes, it does.

Staff Schedule

4.1

is confidential.