

**ILLINOIS COMMERCE COMMISSION  
DOCKET NOS. 06-0070 / 06-0071 / 06-0072 (CONSOLIDATED)**

**SURREBUTTAL TESTIMONY  
OF  
MICHAEL G. O'BRYAN**

**Submitted On Behalf  
Of  
AMEREN COMPANIES**

**July 14, 2006**

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**SURREBUTTAL TESTIMONY**

**OF**

**MICHAEL G. O'BRYAN**

**Q. Please state your name and business address.**

A. My name is Michael G. O'Bryan. My business address is One Ameren Plaza,  
1901 Chouteau Avenue, St. Louis, Missouri, 63103

**Q. Are you the same Michael G. O'Bryan who provided testimony in this proceeding?**

A. Yes I am.

**Q. What is the purpose of your surrebuttal testimony?**

A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimonies of Commission Staff witness Alan Pregozen and the Cities of Champaign, Urbana and Bloomington, and the town of Normal, Illinois witness Richard Cuthbert, regarding capital structure component costs, adjustments and measurement methodology.

**SHORT-TERM AND VARIABLE INTEREST RATES**

23 **Q. Please respond to Mr. Pregozen's position regarding the updating of interest**  
 24 **rates for the short-term debt and the variable rate pollution control bonds.**

25 A. Mr. Pregozen states in his rebuttal testimony that he 'generally opposes moving  
 26 the dates for measuring the components of the cost of capital forward in time  
 27 during the rebuttal phase of rate proceedings'. Recent Staff practice has shown  
 28 otherwise, evidenced by Staff witness Michael McNally's update of interest rates  
 29 in his rebuttal testimony in the AmerenCIPS and AmerenUE gas cases (Docket  
 30 Nos. 02-0798/03-0008/03-0009 (cons.)). Mr. McNally used updated (May 21,  
 31 2003) spot rates for AmerenUE variable auction rate pollution control bonds for  
 32 his *rebuttal* testimony dated June 5, 2003. The long-term capital structure  
 33 components in this case were measured as of June 30, 2002. The Commission's  
 34 order adopted Mr. McNally's position by including these updated (as of May 21,  
 35 2003) rates in their final order. Mr. McNally also cited Docket No. 99-0534 (a  
 36 Mid American Energy Company gas rate proceeding) in his testimony which  
 37 addressed this issue. The following is an excerpt from the order in this Mid  
 38 American case:

39 Staff asserts that the Commission has consistently used the most recent market spot rate  
 40 or a forecasted rate to determine the cost of short-term debt and variable rate long-term  
 41 debt. Staff cites the following cases: Order, Docket No. 86-0310, Medina Utilities  
 42 Corporation, April 15, 1987, p. 9; Order, Docket No. 86-0342, Lake Holiday Utilities  
 43 Corporation, April 15, 1987, pp.11-12; Order, Docket No. 86-0480, Galena Territory  
 44 Utilities, Inc., September 2, 1987, p. 12; Order, Docket No. 92-0116, Illinois-American  
 45 Water Company, February 9, 1993, p. 62; Order, Docket No. 93-0252, Central Telephone  
 46 Company of Illinois, May 4, 1994, p. 33; Order, Docket No. 94- 0065, Commonwealth  
 47 Edison Company, January 9, 1995, p. 95; Order, Docket No. 95-0219, Northern Illinois  
 48 Gas Company, April 3, 1996, p. 39.

50  
 51 The Commission's conclusion in its order stated 'Based on the above arguments,  
 52 it is clear that the cost of short-term and variable rate long-term debt should be

53 measured using current interest rates... These current rates are, in the  
54 Commission's opinion, the best estimates of future rates.'

55

56 Although Mr. Pregozen did not agree with updating the short-term interest rates  
57 and variable rate pollution control bond interest rates to mid-May 2006, he moved  
58 the measurement dates for the variable interest rates to April 4, 2006 to coincide  
59 with both the measurement date for the short-term interest rates that he used in his  
60 direct testimony as well as the date that Staff witness Ms. Freetly measured the  
61 equity market rate of return to revise her cost of equity in her rebuttal testimony.  
62 However, Mr. Pregozen offers no case precedent or filing instructions to suggest  
63 that all cost components of capital structure need to be measured as of the same  
64 date. The arguments and citations that I have noted above for updating short-term  
65 and variable interest rates are silent on other cost components including the cost  
66 of equity. Mr. McNally, in the AmerenCIPS and AmerenUE case cited above,  
67 did not update his cost of equity recommendation when he updated variable and  
68 short-term interest rates.

69

70 Another issue that I find with Mr. Pregozen's variable rate and short-term interest  
71 rate measurement date of April 4, 2006, was that it was conveniently placed just  
72 before significant increases in the rates of the variable rate pollution control debt.  
73 On April 17<sup>th</sup>, 18<sup>th</sup> and 21<sup>st</sup> AmerenIP's auction series 1997 A, B, and C increased  
74 60.5, 35 and 50 basis points, respectively. On April 17<sup>th</sup>, AmerenIP's auction  
75 series 2001A (non-AMT) increased 35 basis points while AmerenIP's 2001AMT

76 auction series 2001 AMT increased 30 basis points. On April 19<sup>th</sup>, CIPS auction  
77 series 2004 increased 25 basis points while the CILCO auction series 2004  
78 increased 34 basis points. These significant increases in the cost of the variable  
79 rate pollution control bonds which happened nearly three months ago cannot be  
80 ignored. The interest rate environment today is very much different today than it  
81 was on April 4<sup>th</sup>. Since this date three month Libor, a key short-term interest rate,  
82 has increased about 48 basis points. Also since April 4<sup>th</sup>, the Federal Reserve has  
83 increased the Fed funds target rate twice for a total of 50 basis points amid  
84 elevated inflation worries. Further, Fed funds futures market as of Friday, July 7<sup>th</sup>  
85 was pricing better than a two-thirds chance (67%) for another Federal Reserve  
86 Fed funds rate increase at their August 8<sup>th</sup> meeting. So not only have rates risen  
87 significantly higher over the past three months, there is a good chance that rates  
88 are going to increase further.

89

90 **Q. Mr. Gorman recommends in his rebuttal testimony that a recent 6-month**  
91 **average should be used for the variable rate pollution control bonds and**  
92 **short-term debt rather than the interest rate for these securities on any one**  
93 **specific date. Please respond.**

94 Mr. Gorman's recommendation has been rejected by the Commission on several  
95 occasions. The arguments and case precedence that I have cited earlier in this  
96 testimony in favor of current spot rates obviously run counter to Mr. Gorman's  
97 proposal. In fact, the Commission's order in the AmerenCIPS and AmerenUE gas  
98 cases (Docket Nos. 02-0798/03-0008/03-0009 (cons.)) left no doubt on how it

99 views situations such as this when it made its ruling amid a historically low  
 100 interest rate environment:

101 The Commission agrees with Staff that there has not been a showing that historical  
 102 interest rates are more representative of future interest rates than is the most recent spot  
 103 rate. Moreover, even if it was true that interest rates tend to follow some sort of cyclical  
 104 pattern there is no evidence that they are mean reverting. As Staff suggests, in recent  
 105 years the Commission has routinely rejected the use of historical average interest rates in  
 106 favor of current interest rates when establishing the cost rate for variable rate long-term  
 107 debt. The Commission is of the opinion that mere existence of relatively low interest  
 108 rates is not a sufficient basis to use an average of historical interest rates to establish the  
 109 cost for variable rate long-term debt.

110  
 111 ...Consistent with its decisions in recent rate cases where this issue has been addressed,  
 112 the Commission finds that current interest rates are superior to historical averages for  
 113 establishing the cost of variable rate long-term debt.  
 114

115 **CAPITAL STRUCTURE MEASUREMENT PERIOD**

116 **Q. Mr. Pregozen makes a statement arguing against AmerenCILCO's \$100**  
 117 **million pro-forma adjustment to the short-term debt balances of January**  
 118 **through April 2005 to account for a May 2005 equity infusion, claiming that**  
 119 **it pretends that the Company refinanced \$100 million of short-term debt**  
 120 **with common equity before January 1, 2005, although the refinancing did**  
 121 **not occur until May 2005. Please respond.**

122 **A.** The pro-forma adjustment was made to four months of data, January 2005  
 123 through April 2005, recognizing that without the adjustment the last twelve month  
 124 average short-term debt balance would be misleading and overstated. The equity  
 125 infusion that occurred in May 2005 was used to permanently finance the short-  
 126 term debt balance at AmerenCILCO. The adjustment was made to account for a  
 127 known and measurable transaction and was both necessary and prudent to arrive  
 128 at a proper last twelve-month level of short-term debt at AmerenCILCO.  
 129

130 **Q. Please respond to Mr. Pregozen's argument that the measurement date for**  
 131 **the long-term components of AmerenIP's capital structure should not be**  
 132 **moved to December 31, 2005.**

133 A. I disagree. I also contest Mr. Pregozen's view that my reasoning given in rebuttal  
 134 testimony is not sufficiently compelling. First, Mr. Pregozen's claim that he did  
 135 not have sufficient time to verify the accuracy of the adjustments and thus  
 136 AmerenIP's capital structure components should not be measured as of December  
 137 2005 is far from convincing enough to disregard this data. The Staff had more  
 138 than a month to prepare rebuttal testimony. Additionally, the Company has made  
 139 employees available to Staff to answer questions and explain Company filings  
 140 and in fact conducted a call with Mr. Pregozen on March 10<sup>th</sup> to explain the  
 141 AmerenIP purchase accounting adjustments. Further, the purchase accounting  
 142 adjustments that I have detailed in earlier testimony in this case were not finalized  
 143 at December 31, 2004, just three months after the acquisition was finalized. As I  
 144 stated in earlier testimony, accounting rules dictate that these adjustments can  
 145 identified, calculated and adjusted up to twelve months after closing of the  
 146 acquisition. Lastly, Mr. Cuthbert agrees with my position. As he has stated in his  
 147 rebuttal testimony, he 'generally believe[s] it is best to use the actual capital  
 148 structure for a recent representative period'.

149  
 150 Mr. Pregozen suggests that the December 31, 2004 measurement date is optimal  
 151 for AmerenIP but not optimal for either AmerenCIPS or AmerenCILCO and  
 152 believes that the capital structure measurement date for AmerenCIPS and

153 AmerenCILCO should have absolutely no bearing on the measurement date for  
154 AmerenIP. He claims that AmerenIP's capital structure need not be measured at  
155 the same point in time as AmerenCIPS and AmerenCILCO any more than at the  
156 same point in time as Commonwealth Edison. While I do agree that AmerenIP,  
157 AmerenCIPS and AmerenCILCO are separate legal entities and have their own  
158 capital structures, I believe there are good reasons to have consistent dates. First,  
159 unlike Commonwealth Edison, AmerenIP along with AmerenCIPS and  
160 AmerenCILCO are under a single consolidated docket having filed cases on the  
161 same date and share the same test year. Under these circumstances I believe that  
162 there needs to be a compelling reason why the three utilities *would not* have  
163 consistent measurement dates. I agreed with Mr. Pregozen's recommendation to  
164 move forward the capital structure measurement dates for AmerenCIPS and  
165 AmerenCILCO in lieu of pro-forma adjustments. Similarly, AmerenIP's capital  
166 structure measurement date should be moved forward to account fully for the  
167 updated acquisition related purchase accounting items. And in all three of the  
168 companies' cases, the more recent data makes for a more relevant and  
169 representative capital structure--vitaly important in that will be used as a basis for  
170 future rates.

171

172 **COST OF AMERENIP TRANSITIONAL FUNDING TRUST**  
173 **NOTES ("TFTNs")**

174

175 **Q.**

**Please explain why Mr. Pregozen's arguments to understate the cost to  
176 AmerenIP of the TFTNs are misguided.**

177 A. As I stated in earlier testimony, TFTN funds are paid daily to the trustee while  
178 principal and interest are only credited quarterly, meaning that these funds are lost  
179 to the company for either investment, overnight lending to affiliates or for  
180 working capital needs. This differs from traditional fixed-income securities,  
181 where funds to be paid toward upcoming principal and interest is fully available  
182 to the company until the date of payment. Therefore, the Company should be  
183 allowed full cost recovery due to the peculiar nature of the securities.

184

185 **Q. Do you accept Mr. Pregozen's recommendations for including only a portion**  
186 **of the losses associated with the reacquisition of AmerenCILCO's \$7.56,**  
187 **\$7.72, and \$8.28 preferred stock series?**

188 A. I accept Mr. Pregozen's recommendation regarding the losses on reacquired  
189 AmerenCILCO preferred stock. In response, I have updated the Company's  
190 Embedded Cost of Preferred Stock in Ameren Exhibit \_\_\_\_ of this testimony.

191

192 **BALANCE AND EMBEDDED COST OF AMERENCILCO'S**  
193 **PREFERRED STOCK**

194

195 **Q. Mr. Pregozen cannot locate documentation related to AmerenCILCO's \$4.64**  
196 **Series issuance expenses and, as a result, cannot recommend inclusion in the**  
197 **Company's Embedded Cost of Preferred Stock calculation. Is this exclusion**  
198 **justified?**

199 A. No it is not. Mr. Pregozen argues in his rebuttal testimony that 'sometimes Staff  
200 inadvertently overlooks an adjustment due to circumstances beyond its control' as  
201 his basis for not including the expense in this case. Not only is this argument

202           dubious, it seems implausible for past Staff witnesses to incorrectly *include* an  
203           expense item as a result of overlooking an adjustment. Instead, an overlook  
204           would result in an *exclusion* of an adjustment. Further, as I noted in my rebuttal  
205           testimony, both Company and Staff witnesses included this expense item in the  
206           Company's most recent DST case (Docket Nos. 01-0465/01-0530/01-0637  
207           (Cons.)) and gas case (Docket No. 02-0837) without disagreement and the item  
208           was embedded in the Commission's final order. Mr. Pregozen's arguments,  
209           therefore, not only suffer from lack of substance and faulty logic but also go  
210           against past Staff testimony and Commission precedent.

211

212   **Q.    Does this conclude your surrebuttal testimony?**

213   A.    Yes

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