

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY)
)
Proposed general revision in electric rates,)
general restructuring of rates, price) Docket No. 05-0597
unbundling of bundled service rates, and)
revision of other terms and conditions)
of service.)

DIRECT TESTIMONY ON REHEARING OF EDWARD C. BODMER
ON BEHALF OF THE CITIZENS UTILITY BOARD,
THE COOK COUNTY STATE'S ATTORNEY'S OFFICE,
AND THE CITY OF CHICAGO

REVISED CUB-CCSAO-CITY EXHIBIT 7.0

OCTOBER 16, 2006

**TESTIMONY ON REHEARING OF
EDWARD C. BODMER**

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EXHIBITS

7.01	Report: ComEd/Exelon's Performance Under the Illinois Service and Rate Relief Law of 1997 and Beyond.
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1 **I. QUALIFICATIONS AND SUMMARY OF RECOMMENDATIONS**

2 **Q. What is your name and on whose behalf are you testifying?**

3 A. My name is Edward C. Bodmer. I am testifying on behalf of the Citizens Utility Board
4 (“CUB”), the Cook County State’s Attorney’s Office (“CCSAO”), and the City of Chicago
5 (“City”).
6

7 **Q. Have you submitted testimony in this proceeding?**

8 A. Yes. I submitted CUB-CCSAO-City Exhibit 1.0 on December 23, 2005, which included
9 my qualifications, and I submitted CUB-CCSAO-City Exhibit 4.0 on February 27, 2006.
10

11 **Q. What is the purpose of your testimony on rehearing?**

12 A. The purpose of my testimony is to comment on the statements made by Commonwealth
13 Edison Company “ComEd”) witness Barry Mitchell with respect to cost of capital and
14 capital structure issues.
15

16 My testimony on both issues focuses on recent financial information.
17

18 **II. CAPITAL STRUCTURE ISSUES**
19

20 **Q. Does Mr. Mitchell add any new information in his rehearing testimony with respect to
21 capital structure issues?**

22 A. Not really. He repeats his argument that ComEd’s actual capital structure should include
23 more than a billion dollars of goodwill, that the capital structure should include the \$803
24 million in equity that was booked at ComEd for the Exelon debt contributions associated
25 with pre-paid pension assets and that the capital structure should be based on the ComEd
26 data as of the first quarter of 2005. Mr. Mitchell refers to a Moody’s report that
27 downgraded ComEd’s credit rating on July 26, 2006 and he asserts that unless a \$17
28 million revenue adjustment is made to reflect a more equity-rich capital structure, dire
29 financial consequences will arise for the utility. Mr. Mitchell also argues that comparisons
30 with other companies should be used as a basis for an imputed capital structure, relying on
31 the same arguments made in his rebuttal and his surrebuttal testimony.
32

33 **Q. What information do you present in this testimony with respect to ComEd’s capital**
34 **structure?**

35 A. I present information from ComEd’s recent SEC filings related to its actual capital
36 structure without goodwill. I also discuss recent statements that ComEd’s parent has made
37 with respect to impairment of remaining goodwill at the company and the statements made
38 by Moody’s in the report referred to by Mr. Mitchell. Finally, I discuss distortions in the
39 comparisons made by Mr. Mitchell because the comparable samples are not adjusted for
40 goodwill.

41
42 **Q. What does the updated information show with respect to ComEd’s capital structure?**

43 A. It demonstrates that the Staff recommendation of a 37.11% equity ratio is appropriate.

44
45 **Q. What is ComEd’s current actual capital structure without goodwill but including the**
46 **funding of the prepaid pension asset?**

47 A. Including the \$803 million in Exelon debt booked as ComEd equity funding, ComEd’s
48 equity-to-debt ratio was 41.8% in June 2006, as shown in the table below:

49

ComEd Capital Structure with Equity Funding from Exelon (\$ Millions)		
	June 30, 2006	December 31, 2005
Total Debt	4,321	4,176
Equity without Goodwill	6,577	6,396
Less: Goodwill	3,476	3,475
Net Equity	3,101	2,921
Capital without Goodwill	7,422	7,097
Debt to Capital Ratio	58.2%	58.8%
Equity to Capital Ratio	41.8%	41.2%

50

51

52 **Q. How does ComEd’s actual capital structure compare with the capital structure in the**
53 **Order?**

54 A. The capital structure in the Commission’s July 26, 2006 Order of 42.86% equity has more
55 equity than the actual 41.8% equity ratio shown above. Moreover, the actual 41.8% ratio
56 contains the financial alchemy used to reclassify debt issued by Exelon as equity in
57 ComEd’s equity balance.

58

59 **Q. What is ComEd’s actual capital structure without the \$803 million funding of prepaid**
60 **pension assets with equity funded by \$2 billion in Exelon debt?**

61 A. Removing the \$803 million in equity contribution associated with the pension contribution
62 implies that ComEd’s actual capital structure contains a 35% equity ratio as shown on the
63 table below:

64

ComEd Capital Structure without Equity Funding from Exelon (\$ Millions)		
	June 30, 2006	December 31, 2005
Total Debt	4,321	4,176
Equity Adjusted for Goodwill	3,101	2,921
Less: Exelon Pension Adjustment	803	803
Net Equity	2,298	2,118
Capital without Goodwill	6,619	6,294
Debt to Capital Ratio	65.3%	66.3%
Equity to Capital Ratio	34.7%	33.7%

65

66

67 This table shows ComEd’s most recent actual capital structure, which is appropriate for use
68 in regulatory proceedings. ComEd’s equity ratio of 34.7% is far lower than the 42.86%
69 included in the Commission Order.

70

71 **Q. What is Exelon’s current capital structure?**

72 A. Without goodwill, the debt-to-capital ratio was 68.7% in June 2006 as shown in the table
73 below:

74

Exelon Capital Structure With and Without Goodwill (\$ Millions)		
	June 30, 2006	December 31, 2005
Balance Sheet Elements		
Total Debt	13,727	13,964
Total Equity	9,735	9,125
Goodwill	3,476	3,475
Equity without Goodwill	6,259	5,650
Total Capitalization	23,462	23,089
Capitalization without Goodwill	19,986	19,614
Without Goodwill		
Debt to Capital	68.7%	71.2%
Equity to Capital	31.3%	28.8%
With Goodwill		
Debt to Capital	58.5%	60.5%
Equity to Capital	41.5%	39.5%

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This table shows that Exelon has an even higher debt-to-capital ratio than ComEd and that even if Goodwill is included on the balance sheet, Exelon has a lower capital equity ratio than the equity ratio of 42.86% used in the Commission Order.

Q. What is PECO’s actual capital structure?

A. Exelon’s other regulated subsidiary, PECO, has an equity ratio of 40.9% -- well below the equity ratio in the Commission Order. PECO’s capital structure is shown in the table below. Like ComEd’s equity ratio, PECO’s equity ratio is inflated because PECO reclassified as equity the pension asset that was funded by Exelon debt.

PECO Capital Structure (\$ Millions)		
Total Debt	4,143	4,378
Total Equity	2,868	2,936
Total Capitalization	7,011	7,314
Debt to Capital Ratio	59.1%	59.9%
Equity to Capital Ratio	40.9%	40.1%

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88
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90

91 **Q. How do ComEd and Exelon present their respective capital structures to the**
92 **investment community?**

93 A. The table below was taken from a presentation made September 27, 2006 and shows how
94 Exelon presents its credit quality to investors. Exelon's and ComEd's Funds From
95 Operations (FFO) to interest coverage are in the A range based on the actual capital
96 structure ratios above. The FFO to debt ratio is somewhat below the A standard for
97 Exelon, ComEd and PECO. The table shows that ComEd is presented as an A- rated
98 company despite Mr. Mitchell statements that after the July 26, Moody's action the
99 company is one notch away from "junk status."

100

Projected 2006 Key Credit Measures

(Stand-alone)			S&P Credit Ratings⁽¹⁾	"A" Target Range ⁽²⁾
Exelon Consolidated:	FFO / Interest	5.6x	BBB	4.5x – 6.5x
	FFO / Debt	27%		30% – 45%
	Debt Ratio	53% ⁽³⁾		
Generation:	FFO / Interest	11.2x	BBB+	5.5x – 7.5x
	FFO / Debt	77%		40% – 55%
	Debt Ratio	35%		
ComEd:	FFO / Interest	3.8x	A-	3.5x – 4.2x
	FFO / Debt	17%		20% – 28%
	Debt Ratio	39% ⁽³⁾		
PECO:	FFO / Interest	5.5x	A-	3.5x – 4.2x
	FFO / Debt	19%		20% – 28%
	Debt Ratio	52%		

Exelon's Balance Sheet is strong

Notes: Exelon consolidated, ComEd and PECO metrics exclude securitization debt. See last page of Appendix for FFO (Funds from Operations)/Interest and and FFO/Debt reconciliations to GAAP.
⁽¹⁾ Senior unsecured ratings for Exelon and Generation and senior secured ratings for ComEd and PECO; ⁽²⁾ Based on S&P Business Profiles 7, 8 and 4 for Exelon, Generation, and ComEd and PECO, respectively; ⁽³⁾ Reflects \$0.7 billion ComEd goodwill write off in 2006



101

102

103 **Q. Mr. Mitchell describes a downgrade of ComEd's debt by Moody's. Have you**
104 **reviewed the Moody's report?**

105 A. Yes. Mr. Mitchell claimed that the delivery service rate order had an "immediate and
106 dramatic" effect on credit ratings. Mr. Mitchell testifies:

107

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111

The Order's impact was immediate and dramatic. Since the filing of this case in August 2005, ComEd's credit ratings from all three agencies have suffered due, in the view of these agencies, to the political and regulatory climate in Illinois hindering ComEd's ability to recover its costs. On July 26, the day of the Order,

112 Moody's Investors Service ("Moody's") lowered ComEd's senior unsecured debt
113 rating to the very lowest of investment grade rating, expressly citing a "difficult
114 political and regulatory climate."
115

116 ComEd Ex. 51.0 at 4, L. 56-58. When one reads the Moody's report, one sees that it did
117 not even mention the delivery service rate order as demonstrated by the following excerpt:

118
119 A difficult political and regulatory environment, with rate increases being sought
120 to recover costs for purchased power that are expected to increase sharply starting
121 on January 1, 2007. The Governor, the Attorney General, and some members of
122 the state legislature have expressed strong opposition to ComEd's power
123 procurement plans, and the company has acknowledged that a portion of the
124 expected rate increase will need to be deferred.
125

126 Mr. Mitchell must have remarkable interpretation skills to conclude that the above
127 statement from Moody's reflects an "immediate and dramatic" response to the Commission
128 Order.

129
130 **Q. What other reasons were provided in the Moody's report to explain ComEd's**
131 **downgrade?**

132 A. The report mentioned the deferral of recovery of power procurement costs and actions
133 taken by Exelon management to worsen the credit of ComEd. Moody's latter point
134 regarding actions that Exelon management has taken to put ComEd's finances in jeopardy
135 are described below:

136
137 *Actions taken by management* during the first quarter 2006 to
138 further separate ComEd from the rest of its affiliates through the
139 establishment of a separate \$1 billion revolving credit facility and
140 the removal of ComEd from the Exelon subsidiary money pool.
141

142 **Q. Are you aware of any possible bases for the management actions discussed by**
143 **Moody's?**
144

145 **A. Apparently, Moody's is worried about Exelon causing a default on ComEd's debt**
146 **obligations by isolating the utility from its parent company and affiliates. This action also**
147 **allows Exelon equity investors to receive the substantial financial benefits that Exelon's**
148 **generating subsidiary is likely to make as part of the auction. Exelon appears to be**
149 **engaging in financial policies that would put ComEd at financial risk, thus putting pressure**

150 on State policymakers to protect ComEd from bankruptcy and to allow Exelon to continue
151 its incredible wealth-making machine.

152
153 **Q. Is it surprising that management at Exelon might engage in actions to isolate ComEd**
154 **and cause the financial position of the regulated utility to deteriorate?**

155 A. No. At the end of the day, the auction and this delivery service case amount to Exelon
156 asking for a multi-billion dollar rate increase when it is already by far the most prosperous
157 financial company in the industry. Exhibit 7.01 explains just how well Exelon’s investors
158 have fared. Now, Exelon apparently would allow ComEd to hang out to dry to protect the
159 profits of the parent. By engaging in actions that threaten ComEd’s financial security,
160 while earning record returns at Exelon, management of the holding company could well be
161 preparing to divest itself of the utility.

162
163 **Q. Please describe Exhibit 7.1.**

164 A. Exhibit 7.1 is a report I prepared earlier this year describing the benefits investors have
165 received from implementation of the Act relative to the costs and benefits for ratepayers.
166 At the time I prepared the report:

167
168 (1) Exelon’s shareholders were receiving a 21 percent return on their invested equity.
169 This was about double the profit margin that regulatory commissions typically allow
170 utilities to earn on their investment and the highest return of any electric utility in the
171 country.

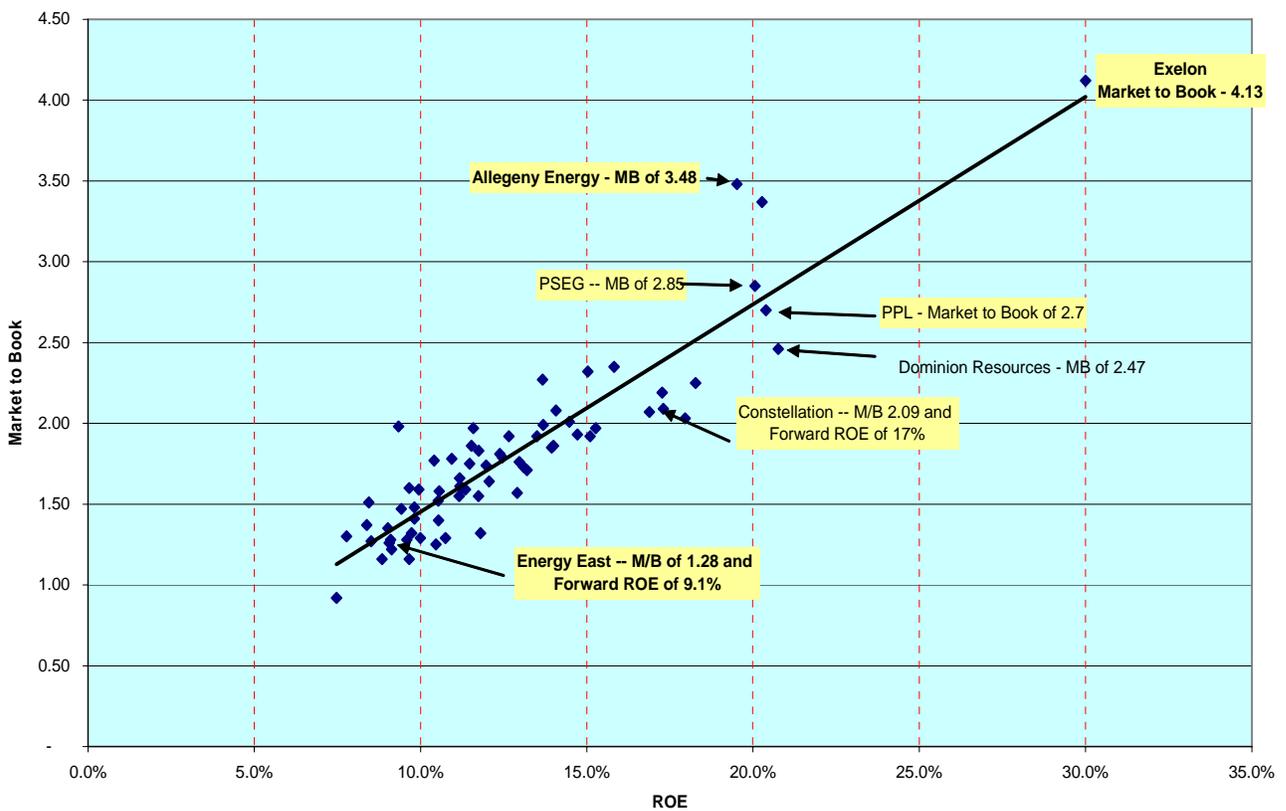
172
173 (2) From 1997 up until the time I prepared the analysis in early 2006, ComEd/Exelon’s
174 investors have dramatically outperformed alternative investments and have obtained four to
175 six times more value from dividends and stock price increases than the \$3 billion that
176 residential ratepayers have received in lower rates mandated by the Illinois Electric Service
177 Customer Choice And Rate Relief Law of 1997 (“the Act”).

178
179 (3) A forecast of Exelon’s financial position demonstrates that the parent company
180 does not need a significant rate increase for ComEd for it to remain financially healthy. The
181 parent company would post extremely high profit levels through 2012 even if rates were
182 reduced by 5 percent.

183 **Q. Have you updated the analysis of the relative value received by ratepayers and**
184 **shareholders that resulted from passage of the Act?**

185 A. Yes. Exelon's stock price has continued to increase as the magnitude of revenue increases
186 to Illinois ratepayers has been clarified by the power auction. Using data from the
187 finance.yahoo.com website, I have compared the market to book ratio of Exelon to other
188 companies in the industry. This graph shows that the gap between Exelon and other
189 companies has grown even larger since the beginning of the year.

Market to Book Ratio for Sample: All Utilities



190
191

192 To suggest that the equity investor of ComEd – Exelon – requires increased delivery
193 service revenues because it is experiencing financial distress is certainly not consistent with
194 the market to book ratio analysis shown above.

195

196 **Q. Have you updated the analysis of Exelon's forward return on equity from recent data**
197 **published on the yahoo website?**

198 A. Yes. I have computed the forward return on equity from analyst projections of earnings
 199 and the book value per share for each utility company in the utility industry. The table
 200 below shows that Exelon's forward return is far above the returns for other companies in
 201 the industry. As with the market to book ratio analysis, the forward return on equity
 202 statistics demonstrate that the Act has created immense wealth for investors.

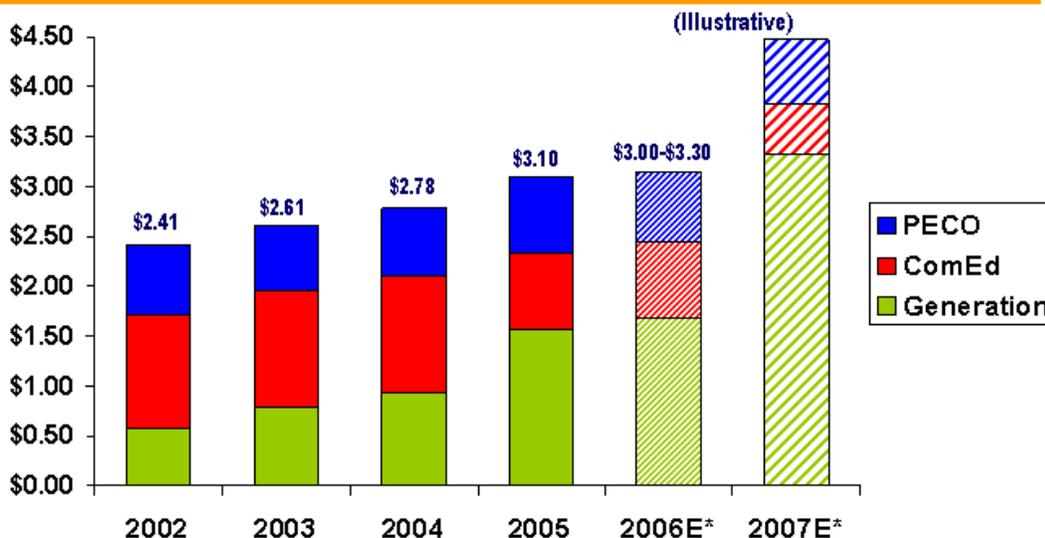
		Return on Equity
Exelon Corp. (EXC)	EXC	28.7%
Constellation Energy Group Inc (CEG)	CEG	18.4%
Allegheny Energy Inc. (AYE)	AYE	18.2%
PPL Corp. (PPL)	PPL	17.6%
Public Service Enterprise Grou (PEG)	PEG	17.3%
Dominion Resources Inc. (D)	D	16.7%
National Fuel Gas Co. (NFG)	NFG	15.6%
UGI Corp. (UGI)	UGI	15.3%
Duquesne Light Holdings Inc. (DQE)	DQE	15.1%
MDU Resources Group Inc. (MDU)	MDU	14.8%
Edison International (EIX)	EIX	14.6%
Southern Co. (SO)	SO	14.6%
NSTAR (NST)	NST	14.3%
Firstenergy Corp. (FE)	FE	13.8%
FPL Group Inc. (FPL)	FPL	13.8%
ALLETE Inc. (ALE)	ALE	13.8%
Entergy Corp. (ETR)	ETR	13.5%
OGE Energy Corp. (OGE)	OGE	13.4%
Sempra Energy (SRE)	SRE	13.4%
Nicor Inc. (GAS)	GAS	13.3%
New Jersey Resources Corp. (NJR)	NJR	13.2%
TECO Energy Inc. (TE)	TE	13.1%
South Jersey Industries Inc. (SJI)	SJI	13.0%
AGL Resources Inc. (ATG)	ATG	12.9%
Chesapeake Utilities Corp. (CPK)	CPK	12.4%
PG & E Corp. (PCG)	PCG	12.2%
Great Plains Energy Inc. (GXP)	GXP	12.1%
SCANA Corp. (SCG)	SCG	12.0%
ONEOK Inc. (OKE)	OKE	12.0%
Ameren Corp. (AEE)	AEE	12.0%
El Paso Electric Co. (EE)	EE	11.9%
Vectren Corp. (VVC)	VVC	11.9%
Energy West Inc. (EWST)	EWST	11.8%
Southern Union Co. (SUG)	SUG	11.8%
Hawaiian Electric Industries I (HE)	HE	11.8%
American Electric Power Co. In (AEP)	AEP	11.7%
Piedmont Natural Gas Co. Inc. (PNY)	PNY	11.6%
Alliant Energy Corp. (LNT)	LNT	11.5%
Otter Tail Corp. (OTTR)	OTTR	11.1%
WPS Resources Corp. (WPS)	WPS	11.1%
Laclede SA (LG)	LG	11.0%
Unisource Energy Corp. (UNS)	UNS	10.8%
Wisconsin Energy Corp. (WEC)	WEC	10.5%
Northwest Natural Gas Co. (NWN)	NWN	10.5%
MGE Energy Inc. (MGEE)	MGEE	10.5%
Cascade Natural Gas Corp. (CGC)	CGC	10.4%
Consolidated Edison Inc. (ED)	ED	10.3%
PNM Resources Inc. (PNM)	PNM	10.3%
Black Hills Corp. (BKH)	BKH	10.2%
CMS Energy Corp. (CMS)	CMS	10.2%
Xcel Energy Inc. (XEL)	XEL	10.1%
Southwest Gas Corp. (SWX)	SWX	10.1%
Cleco Corp. (CNL)	CNL	10.0%
WGL Holdings Inc. (WGL)	WGL	9.8%
Western Resources Ltd. (WR)	WR	9.8%
Pinnacle West Capital Corp. (PNW)	PNW	9.7%
Duke Energy Corp. (DUK)	DUK	9.6%
Atmos Energy Corp. (ATO)	ATO	9.5%
Avista Corp. (AVA)	AVA	9.5%
KeySpan Corp. (KSE)	KSE	9.4%
Detroit Edison (DTE)	DTE	9.3%
Green Mountain Power Corp. (GMP)	GMP	9.2%
IdaCorp, Inc. (IDA)	IDA	9.1%
UIL Holdings Corp. (UIL)	UIL	9.1%
Empire District Electric Co. (EDE)	EDE	9.1%
Pepco Holdings Inc. (POM)	POM	9.0%
Psivida Ltd. (PSD)	PSD	8.8%
Peoples Energy Corp. (PGL)	PGL	8.7%
Northeast Utilities (NU)	NU	8.7%
Progress Energy Inc. (PGN)	PGN	8.7%
Florida Public Utilities Co. (FPU)	FPU	8.3%
CH Energy Group Inc. (CHG)	CHG	8.3%

203

204 **Q. Has Exelon updated its presentation of projected earnings?**

205 A. Yes. In the September 27th analyst presentation filing referred to above, Exelon projected a
206 large increase in earnings per share from about \$3.15/share to about \$4.50/share as shown
207 in the graph below. This graph certainly does not portray the dire financial circumstances
208 that require increased delivery services described by Mr. Mitchell.

Composition of Operating EPS



A further shift in relative earnings contribution from Energy Delivery to Generation will occur in 2007 when ComEd becomes a pure wires company and Generation gets a market price for its Midwest production.

* 2006: represents mid-point of guidance range. 2007: represents Thomson First Call consensus EPS estimate of \$4.48 as of 8/31/06 for Exelon stand-alone, not company guidance. Segment results are illustrative only. Note: See presentation appendix for adjusted (non-GAAP) operating EPS reconciliations to GAAP.

Exelon

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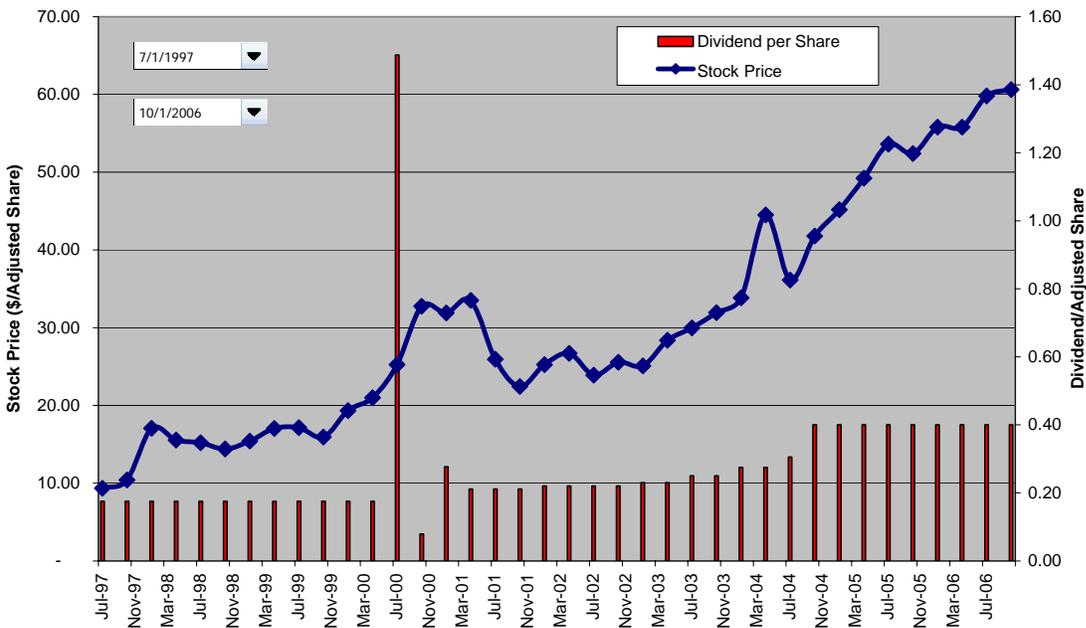
210

211 **Q. Have you updated the stock price analysis that was presented in Exhibit 7.1 with**
212 **respect to the rate of return earned by Exelon shareholders?**

213 A. I have. The graph below shows that Exelon shareholders have earned an internal rate of
214 return on equity of 29.1% since implementation of the Act.

215

**Unicom/Exelon Stock Price and Dividends
Adjusted for Exchange Ratio in Merger and Stock Splits
Annual IRR of 29.1%**



216
217

218

219 **Q. — Is it surprising that management at Exelon might engage in actions to isolate ComEd**
220 **and cause the financial position of the regulated utility to deteriorate?**

221 **A. — No. At the end of the day, the auction and this delivery service case amount to Exelon**
222 **asking for a multi-billion dollar rate increase when it is already by far the most prosperous**
223 **financial company in the industry. Exhibit 7.01 explains just how well Exelon’s investors**
224 **have fared. Now, Exelon apparently would allow ComEd to hang out to dry to protect the**
225 **profits of the parent. By engaging in actions that threaten ComEd’s financial security,**
226 **while earning record returns at Exelon, management of the holding company could well be**
227 **preparing to divest itself of the utility.**

228

229 **Q. Mr. Mitchell suggests that ComEd’s “ability to attract capital at a reasonable cost will**
230 **be further adversely affected” by the Moody’s downgrade. Do you agree with Mr.**
231 **Mitchell’s prognostications?**

232 **A. No. In his rebuttal testimony Mr. Mitchell explained that ComEd does “expect to finance**
233 **the majority of ComEd’s capital expenditures with internally generated cash.” ComEd Ex.**
234 **20.0 at 5, L. 105-08. Therefore, apparently ComEd has little need to attract capital. Also,**

235 the credit spread differential between Baa2 and Baa3 is not very high as shown on the table
 236 below taken from bondsonline.com.

237

Rating	1 yr	2 yr	3 yr	5 yr	7 yr	10 yr	30 yr
Aaa/AAA	5	10	15	22	27	30	55
Aa1/AA+	10	15	20	32	37	40	60
Aa2/AA	15	25	30	37	44	50	65
Aa3/AA-	20	30	35	45	53	55	70
A1/A+	30	40	45	58	62	65	79
A2/A	40	50	57	65	71	75	90
A3/A-	50	65	79	85	82	88	108
Baa1/BBB+	60	75	90	97	100	107	127
Baa2/BBB	65	80	88	95	126	149	175
Baa3/BBB-	75	90	105	112	116	121	146
Ba1/BB+	85	100	115	124	130	133	168
Ba2/BB	290	290	265	240	265	210	235
Ba3/BB-	320	395	420	370	320	290	300
B1/B+	500	525	600	425	425	375	450
B2/B	525	550	600	500	450	450	725
B3/B-	725	800	775	800	750	775	850
Caa/CCC	1500	1600	1550	1400	1300	1375	1500

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239

240

241 **Q. Is there a basis to include any of ComEd’s goodwill in the equity balance for**
 242 **ratemaking purposes?**

243 A. No. The arguments have already been discussed in my direct and rebuttal testimony as
 244 well as the testimony filed by Staff witness Ms. Kight, IIEC witness Mr. Gorman. I will
 245 not repeat them here. I do note that if Exelon did sell ComEd, the new buyer should place
 246 no value on the goodwill asset since distribution assets earn a regulated return equal to the
 247 cost of capital. By booking the goodwill at ComEd rather than at another subsidiary,
 248 ComEd increased its equity ratio and attempted to report a lower earned return for purposes
 249 of the earning cap. There may have been an argument that the value of the goodwill was
 250 somehow derived from collection of stranded investment charges and the CTC. With the
 251 end of the transition period, there is no cash flow stream at ComEd that justifies a positive
 252 value for goodwill.

253

254 **Q. What comments has Exelon made in SEC documents related to goodwill?**

255 A. In developing its 2006 earnings guidance, Exelon stated that it will make a further goodwill
 256 impairment even though some goodwill will apparently be left on its books. In describing
 257 goodwill, Exelon made the following statement in its second quarter 10-Q report:

258

259 Goodwill (Exelon and ComEd). As of March 31, 2006 and
 260 December 31, 2005, Exelon and ComEd had goodwill of
 261 approximately \$3.5 billion. Under the provisions of SFAS No. 142,
 262 “Goodwill and Other Intangible Assets” (SFAS No. 142), goodwill
 263 is tested for impairment at least annually or more frequently if

264 events or circumstances indicate that goodwill might be impaired,
 265 such as a significant negative regulatory outcome. Exelon and
 266 ComEd will perform their annual goodwill impairment assessment
 267 in the fourth quarter of 2006.
 268

269 **Q. Mr. Mitchell suggests that using the capital structure of other companies is**
 270 **appropriate for use in computing an imputed capital structure. Are there problems**
 271 **with this approach?**

272 A. Yes. Some of the companies in Dr. Hadaway’s sample and in the Staff sample have
 273 previously been engaged in mergers. These companies may have large amounts of
 274 goodwill on their books, which should be removed in any comparison. Further, there are
 275 many companies that have low debt-to-capital ratios as shown in the table below that I
 276 presented in my rebuttal testimony.

	S&P Bond Rating	Moody's Bond Rating	Equity Ratio
Equitable Resources	A-	A2	18%
Oneok Inc.	BBB	Baa2	28%
DPL, Inc.	BBB-	Baa1	38%
Duquesne Light	BBB+	Baa1	37%
Edison International	BBB+	A3	37%
TXU Corporation	BBB-	Baa2	6%
Centerpoint Energy	BBB	A2	12%
Dominion	A-	A2	34%
Northeast Utilities	BBB	Baa1	37%
Nstar	A	A1	34%
PNM Resources	BBB	Baa2	38%
PPL Corporation	A-	Baa1	38%
Public Service Enterprise Group	A-	A3	28%
TECO Energy Inc.	BBB-	Baa2	29%
Unisource Energy	BBB-	Baa3	32%

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279 **III. COST OF CAPITAL ISSUES**

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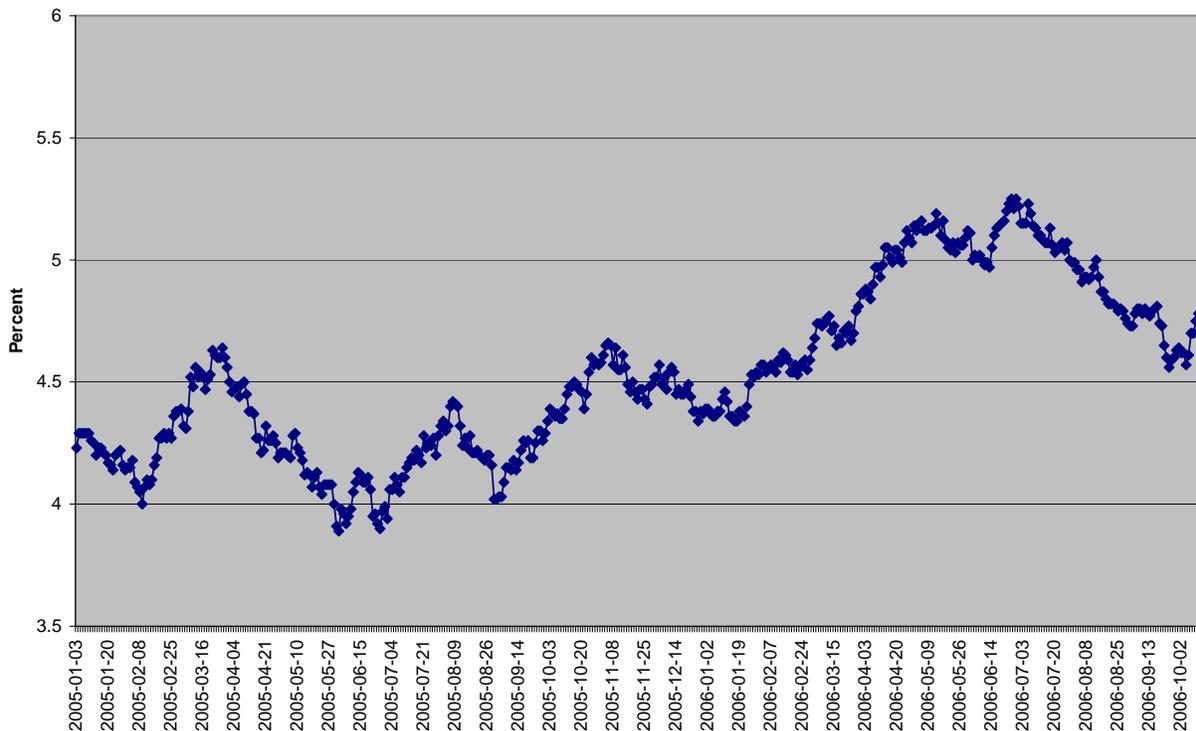
281 **Q. What information do you present with respect to cost of capital issues in this**
 282 **testimony on re-hearing?**

283 A. I show that updated 10-year Treasury bond yields are very different than the
 284 prognostications made by ComEd’s cost of capital witness. I also discuss how Lehman
 285 Brothers acknowledged that real world transactions use cost of equity capital of
 286 approximately 8%.
 287

288 **Q. What was Dr. Hadaway’s forecast of Treasury bond yields when he filed his**
289 **testimony in August 2005 and early 2006?**

290 A. Dr. Hadaway predicted that Treasury bond yields – the foundation for cost of capital
291 estimates -- would increase to almost 6%. In fact, despite all of the discussion about
292 increased inflation expectations, higher energy prices and other factors, yields have
293 remained about 5% as shown on the graph below.

10-Year Treasury Yield since 2005



294
295
296
297 **Q. Was the CUB-CCSAO-City recommendation of 7.75% only derived from cost of**
298 **capital estimates used by investment banks in transactions?**

299 A. No. The analysis was supported by a DCF and CAPM analyses that do not have the
300 fundamental errors typically made by cost of capital analysts in rate cases. The DCF
301 analysis avoided errors that occur from using upwardly biased analyst forecasts or
302 adjustment for quarterly discounting. The CAPM analysis avoided errors that occur from
303 assuming that Beta reverts to a mean of 1.0 and assuming an equity market risk premium

304 that is above what investors actually expect. Analysis using the traditional measurement
305 techniques verifies the investment banks estimates.

306

307 **Q. Did ComEd present evidence as to the cost of equity capital used by investment**
308 **banks?**

309 A. Yes. CUB-CCSAO-City made multiple requests for the cost of equity capital used by
310 investment banks to which ComEd did not provide a response. Then, in its surrebuttal
311 testimony late in the case, it attached a letter from Lehman brothers. This letter stated:

312 from a practical matter, regulatory authorized ROE's are typically
313 300 or more basis points more than the discount rate used in
314 investment fairness opinions.

315

316 ComEd Ex. 38.2. This statement implies that the cost of equity used by Lehman Brothers
317 was 8% -- the 11% request made by ComEd less 3%. Lehman Brothers' 8% rate is in line
318 with my recommended 7.75% cost of common equity.

319

320 **Q. Is there more up-to-date information about investment bank estimates that confirms**
321 **that the estimates made in the Exelon/PSEG proposed merger were not outliers?**

322 A. Yes. Estimates made in the Constellation/FPL merger included similar very low cost of
323 capital estimates:

324

325 For the FPL Group discounted cash flow analysis, Lehman
326 Brothers calculated terminal values by applying a range of terminal
327 multiples of 7.75x to 8.25x to FPL Group's 2008 EBITDA. This
328 range was based on the firm value to 2006 estimated EBITDA
329 multiple range derived in the comparable companies analysis. The
330 cash flow streams and terminal values were discounted to present
331 values using a range of discount rates from 5.18% to 6.18% with a
332 midpoint discount rate of 5.68%. From this analysis, Lehman
333 Brothers calculated a range of implied equity values per share of
334 FPL Group common stock.

335

336 For the Constellation discounted cash flow analysis, Lehman
337 Brothers calculated terminal values by applying a range of terminal
338 multiples of 7.50x to 8.00x to Constellation's 2008 EBITDA. This
339 range was based on the firm value to 2006 estimated EBITDA
340 multiple range derived in the comparable companies analysis. The
341 cash flow streams and terminal values were discounted to present
342 values using a range of discount rates from 5.57% to 6.57% with a
343 midpoint discount rate of 6.07%. From this analysis, Lehman

344 Brothers calculated a range of implied equity values per share of
345 Constellation common stock.

346
347 For the FPL Group discounted cash flow analysis, Morgan Stanley
348 calculated a range of terminal values at the end of the projection
349 period by applying a multiple to FPL Group's projected 2008
350 EBITDA. The Aggregate Value to EBITDA multiple range used
351 was 7.0x to 8.0x. The free cash flows and range of terminal values
352 were then discounted to present values using a range of discount
353 rates which were chosen by Morgan Stanley based upon analysis
354 of market discount rates applicable to comparable companies. The
355 weighted average cost of capital range used was 6.0% to 7.0%.

356
357 Goldman Sachs performed illustrative discounted cash flow
358 analyses to determine indications of illustrative implied equity
359 values for FPL Group and illustrative implied equity values per
360 share of FPL Group common stock based on forecasts delivered by
361 the management of Constellation. Goldman Sachs also performed
362 an illustrative discounted cash flow analysis to determine
363 indications of implied terminal value multiples for FPL Group
364 based upon projected 2008 EBITDA as provided by
365 Constellation's management. In performing the illustrative
366 discounted cash flow analysis, Goldman Sachs applied discount
367 rates ranging from 5.25% to 7.25% to the projected cash flows of
368 FPL Group for calendar years 2006 through 2008. Goldman Sachs
369 also applied perpetuity growth rates ranging from 2.50% to 3.50%.
370 For purposes of the equity value per share analysis, Goldman
371 Sachs utilized outstanding share information as of year-end 2005
372 for FPL Group as provided by the management of Constellation.

373
374 Constellation Energy Group, Inc. Form S-4 Registration Statement, June 23, 2006.

375
376 Q. Does this conclude your Testimony?

377 A. Yes, it does.

378

379