REBUTTAL TESTIMONY

of

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Illinois Commerce Commission

Central Illinois Light Company, d/b/a AmerenCILCO,

Central Illinois Public Service Company, d/b/a AmerenCIPS

and

Illinois Power Company, d/b/a AmerenIP

Proposed General Increase in Electric Rates
and
Proposed General Increase in Gas Rates

Docket Nos. 07-0585 – 07-0590 (Cons.)

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WITNESS IDENTIFICATION

Q. Please state your name, employer and business address.

A. My name is Rochelle Phipps. I am employed by the Illinois Commerce Commission ("Commission"), 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. Are you the same Rochelle Phipps who previously submitted direct testimony in this proceeding?

A. Yes, I am.

INTRODUCTION AND SUMMARY OF RECOMMENDATIONS

Q. What is the purpose of your rebuttal testimony in this proceeding?

A. I will respond to the rebuttal testimony of Mr. Michael G. O'Bryan, who testified on behalf of Central Illinois Light Company ("CILCO"), Central Illinois Public Service Company ("CIPS") and Illinois Power Company ("IP")[1] on capital structure and the cost of debt. I will also present the cost of capital for CILCO Electric, which incorporates Staff witness Janis Freetly's 10.68% cost of equity recommendation for CILCO's electric delivery services (ICC Staff Exhibit 17.0).

Q. Please summarize your conclusions and recommendations.

[1] CILCO, CIPS and IP are collectively referred to as the "Companies" or "Ameren utilities". Individually, CILCO, CIPS and IP are each referred to as the "Company".

A. Mr. O'Bryan's rebuttal testimony (Ameren Ex. 23.0) did nothing to change my opinion regarding the overall cost of capital for the Companies' gas and electric delivery services. His proposals serve only to inflate the cost of capital estimates for the Ameren utilities and should be rejected. I continue to recommend the overall cost of capital as presented in ICC Staff Exhibit 4.0, Schedules 4.01 CILCO (gas delivery services only), 4.01 CIPS and 4.01 IP. As shown on Schedule 16.01, the overall cost of capital for CILCO's electric delivery services equals 7.93%.

BALANCE OF SHORT-TERM DEBT FOR AMEREN UTILITIES

Q. Please summarize Mr. O'Bryan's criticisms of the measurement period you used to calculate short-term debt balances for the Ameren utilities.

A. Both Mr. O'Bryan and I use a 12-month measurement period to calculate the Ameren utilities' short-term debt balances, but we use different measurement periods. Mr. O'Bryan's measurement period ends on the measurement date for long-term debt and equity; in contrast, I use a measurement period that is centered on the date I measured long-term capital component balances. Mr. O'Bryan argues that my measurement period, which includes six months of data beyond the measurement date for long-term capital components, results in a measurement mismatch between balances of short-term debt and the other capital structure components.[2]

Mr. O'Bryan argues that my calculation results in a "measurement mismatch" because balances of short- and long-term capital components "tend to be inversely related in such cases as issuances, accumulation, repurchases, redemptions or maturities of equity or debt".[3] However, Mr. O'Bryan's argument is not pertinent in this case because there were no issuances, redemptions or maturities of equity or debt during those six months beyond the Ameren utilities' long-term capital measurement dates,[4] which would be included in my measurement period but not Mr. O'Bryan's.[5] Moreover, as I explained in Direct Testimony (ICC Staff Ex. 4.0),[6] aligning the midpoint of a twelve-month average balance with the measurement date of the long-term capital structure components ***minimizes*** the total number of months of misalignment (*i.e.,* 42 months using the midpoint vis-à-vis 78 months using the endpoint).[7] Since the number of months of misalignment in his calculation is greater than my

[2] Ameren Ex. 23.0, p. 7.

[3] Ameren Ex. 23.0, p. 7.

[4] January 2007 to June 2007 for IP and July 2007 to December 2007 for CIPS and CILCO.

[5] *Ameren Corporation December 31, 2007 Form 10-K*, pp. 55-56.

[6] ICC Staff Ex. 4.0, pp. 6-8 explains in detail why aligning the midpoint of a twelve-month average balance of short-term debt with the measurement date of the long-term capital structure components is superior to aligning the endpoint of a twelve-month average balance with the measurement date of the long-term capitals structure components.

[7] ICC Staff Ex. 4.0, lines 108-133.

calculation, then any measurement mismatch affects his capital structure more than it would mine.

Q. Mr. O'Bryan argues that short-term debt balances are the result of costs during the test year / measurement period.[8] Is he correct?

A. No. Mr. O'Bryan's argument against my short-term debt measurement period is based on the faulty premise that the terms "test year" and "measurement period" are synonymous, which they are not. 83 Illinois Administrative Code 285.115 states:

> "Capital Structure Measurement Period" refers to the period or point in time in which all long-term components of the capital structure are measured. This may differ from the "test year".[9]

Indeed, Ameren chose June 30, 2007 to measure the balances of long-term debt, preferred stock and common equity for CILCO and CIPS, which is six months after the end of the 2006 test year.

Q. How does using Mr. O'Bryan's short-term debt measurement period affect CILCO's, CIPS' and IP's cost of capital?

A. All else equal, using Mr. O'Bryan's proposed short-term debt measurement period in my cost of capital calculation for CILCO, CIPS and IP would cause the

[8] Ameren Ex. 23.0, p. 7.

[9] Order, Docket No. 02-0509 (7/9/2003).

Companies' overall cost of capital to increase by 54 basis points, 20 basis points and 8 basis points, respectively.[10]

Q. Please summarize Mr. O'Bryan's argument in favor of subtracting cash from the balance of short-term debt.

A. Mr. O'Bryan opposes my short-term debt calculation because I did not subtract cash from the Companies' short-term debt balances, which he alleges mismatches the cost of funds supporting assets and the returns those assets earn.[11] Mr. O'Bryan's position is based on the invalid assumption that it is possible to trace short-term debt to specific assets. He recognized such a task is impossible in the following response to an ICC Staff data request:

> The proceeds from the Companies' short-term debt borrowings are generally used for ongoing working capital needs and for other corporate purposes that are associated with day to day operations of the utilities. Given the fungible nature of cash and the Companies' many sources of and uses for cash, attempting to tie specific uses to short-term borrowings would be impossible. The requested information does not exist…[12]

Q. Is Mr. O'Bryan correct when he asserts that Staff assumes "cash is supported by a mix of capital equal to that supporting assets in rate base.

[10] Using the Companies' proposed measurement period reduces the short-term debt balances for CILCO and CIPS to $25 million each and IP's balance to approximately $48 million. Those calculations do not net cash out of short-term debt balances. Moreover, using the Companies' proposed measurement period would require applying an AFUDC formula based adjustment to the long-term capital components.

[11] Ameren Ex. 23.0, pp. 4-6.

[12] Companies' response to ICC Staff data request RP 5.06, which asked the Companies to specify the purpose of all short-term indebtedness during the January 2006 – June 2007 measurement period.

This means, in turn, that Staff believes the Ameren Illinois Utilities would raise cash at a cost of roughly 8% and invest it in money market accounts earnings roughly 3%"?[13]

A. No, To the contrary, Mr. O'Bryan's statement implies the cost of capital remains constant regardless of the riskiness of the assets it supports. In reality, the costs of the various sources of financing are a function of (1) the riskiness of the assets being financed; and (2) the amount of debt used to finance the assets.[14] Mr. O'Bryan's faulty rationale suggests that holding capital structure constant, a company's cost of capital would be the same whether its assets wholly comprised U.S. Treasury bills, electric distribution plant, or oil drilling equipment. If that were true, which it is not, then the Ameren utilities would not use short-term debt to finance cash since the cost of short-term debt is greater than the return on cash.

Furthermore, if Mr. O'Bryan's argument had any merit, which it does not, the Ameren utilities would not have any cash on their balance sheet unless they also had short-term debt outstanding because it would perforce be financed with "high cost" long-term debt and equity. That is not true for the Ameren utilities. During 2006, from January through November, CIPS' month-end short-term debt

[13] Ameren Ex. 23.0, p. 5.

[14] Ehrhardt, Michael C., *The Search for Value: Measuring the Company's Cost of Capital*, Harvard Business School Press (1994), p. 6.

balances were zero;[15] yet, during the same period, CIPS' month-end cash balances ranged from $0.5 million to $62.5 million.[16] Likewise, on May 31, 2007, CIPS had no short-term debt outstanding and a $44 million cash balance.[17]

Q. Mr. O'Bryan asserts that, "[t]he Ameren utilities are holding relatively high cash balances due to their credit standing in the aftermath of the legislative crisis involving the 2007 retail electric rate changes."[18] Do you agree?

A. No. Each of the Ameren utilities held substantial cash balances prior to March 2007,[19] which is when their issuer credit ratings were downgraded to below investment grade due to the Illinois Senate approving rate freeze legislation for the Ameren utilities.[20] On March 31, 2007, CILCO's cash balance equaled $200,000, and CIPS' cash balance equaled $47 million. In comparison, during

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[15] Company responses to ICC Staff data requests RP 1.08a and RP 11.04; the Ameren utilities' Confidential Money Pool Reports, provided pursuant to 83 Ill. Adm. Code 340.60.

[16] Company responses to ICC Staff data requests RP 8.02 and RP 11.04; the Ameren utilities' Confidential Money Pool Reports, provided pursuant to 83 Ill. Adm. Code 340.60.

[17] Company responses to ICC Staff data requests RP 1.08aand RP 11.04; the Ameren utilities' Confidential Money Pool Reports, provided pursuant to 83 Ill. Adm. Code 340.60.

[18] Ameren Ex. 23.0, p. 4.

[19] Company response to ICC Staff data request RP 8.02.

[20] On March 12, 2007, Moody's Investors Service downgraded the Ameren utilities' issuer ratings to Ba1; CIPS's and IP's senior secured ratings to Baa3; and CILCO's senior secured rating to Baa2. On April 23, 2007, Standard & Poor's downgraded the Ameren utilities' issuer ratings to BB and senior secured ratings to BBB-.

2006, CILCO held cash balances as high as $22 million and CIPS' held cash balances as high as $63 million.[21]

Q. Mr. O'Bryan alleges that cash must be netted out of short-term debt balances because "[n]o utility would do what Staff is assuming. The utility would take the cash and pay down the short-term debt if they could".[22] Is this statement accurate?

A. No. The Ameren utilities' own actions demonstrate that Mr. O'Bryan's allegation is false. Foremost, the utilities maintain cash balances even when they have outstanding short-term debt balances. On December 31, 2007, CILCO's short-term debt balance equaled $115 million and its cash balance equaled $6 million; CIPS' short-term debt balance equaled $125 million and its cash balance equaled $26 million; and IP's short-term debt balance equaled $175 million and its cash balance equaled $6 million.[23] Moreover, two of the utilities paid common stock dividends to Ameren Corporation rather than paying down short-term debt during 2007. Specifically, CIPS and IP paid Ameren Corporation common dividends totaling $40 million and $61 million, respectively.[24] Further, the utilities have borrowed from the credit facility to loan moneys to each other, moneys that

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[21] Those cash balances do not include loans to utility affiliates through the money pool. Company responses to ICC Staff data requests RP 8.02 and 11.04; the Ameren utilities' Confidential Money Pool Reports, provided pursuant to 83 Ill. Adm. Code 340.60.

[22] Ameren Ex. 23.0, p. 6.

[23] *Ameren Corporation December 31, 2007 Form 10-K*, pp. 86, 102 and 120.

[24] Companies' responses to ICC Staff data requests RP 4.13 and RP 4.15, respectively.

I have already removed from their short-term debt balances. That is, contrary to Mr. O'Bryan's allegation, the Ameren utilities have used cash for purposes other than paying down short-term debt during the short-term debt measurement period.

Q. Please respond to Mr. O'Bryan's argument that failure to net cash against short-term debt implies that cash should be part of rate base.[25]

A. Mr. O'Bryan is wrong. Cash does not need to be included in rate base because temporary cash investments already earn a return commensurate with their risk.

Q. Are there any other problems with Mr. O'Bryan's proposal to net cash out of the Ameren utilities' short-term debt balances?

A. Yes. Mr. O'Bryan's adjustment includes the Ameren utilities' contributions to the money pool that are used to make loans to affiliates.[26] As explained in my direct testimony, my short-term debt calculation removes those money pool contributions from each of the Ameren utilities' short-term debt balances. That is, I have already removed from the Ameren utilities' capital structure any short-term debt borrowings that are not financing the lender's utility operations.

[25] Ameren Ex. 23.0, p. 4.

[26] Company responses to ICC Staff data requests RP 8.02 and 11.04; Schedule D-2 work paper, provided in the Companies' Part 285 filings on November 2, 2007.

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY'S BALANCE AND EMBEDDED COST OF LONG-TERM DEBT

Q. Please summarize Mr. O'Bryan's testimony regarding CIPS' cost of long-term debt.

A. Mr. O'Bryan opposes my adjustment to remove from CIPS' embedded cost of long-term debt the incremental cost due to refinancing a 4.7% intercompany note with 6.7% senior secured notes. He argues the refinancing benefited CIPS by extending the maturity from 2010 to 2036 and eliminating the obligation to fund $6 million annual amortization payments. He argues it is erroneous to assume that if CIPS had a similar transaction with an unaffiliated counterparty (rather than Union Electric Co., or "UE") CIPS would require compensation to repurchase debt bearing a below-market interest rate.[27]

Q. Please respond to Mr. O'Bryan's allegation that your argument that CIPS should have received a discount on the repurchase price of the promissory note due to rising interest rates is erroneous.[28]

A. Mr. O'Bryan argues:

> I am not aware of any financial instrument in either the capital or credit markets which can be redeemed prior to final maturity at a

[27] Ameren Ex. 23.0, pp. 8-9.

[28] Ameren Ex. 23.0, pp. 8-9.

> discount. Make whole provisions for early redemptions always have a floor price no less than principal amount. Ms. Phipps is expecting the original intercompany note to have terms which do not exist anywhere in the financial markets and which never could have been made available to AmerenCIPS…[29]

Mr. O'Bryan's argument is wrong on two levels. First, it misses the point. An inverse relationship exists between interest rates and bond prices such that as interest rates rise, bond prices fall. Thus, the value of a loan to the investor (*i.e.*, lender) falls below face value whenever interest rates rise on loans with similar terms and risks. As such, in an arms length transaction, a borrower would not have to pay full principal amount to prepay a loan carrying a below market interest rate unless the original loan agreement required the borrower to do so.

Second, "make whole" provisions are designed to protect lenders' gains in market value in the event the borrower wants to refinance its debt should interest rates fall.[30] That is, "make whole" provisions require borrowers who want to refinance debt that bears above-market interest rates to pay in *excess of* the principal amount. Undoubtedly, lenders would negotiate a similar provision to protect their losses in market value whenever interest rates rise if they thought such a provision desirable. Of course, why an investor would want to protect a

[29] Ameren Ex. 23.0, p. 9.

[30] Since a gain on a bond is the excess of its market value over principal amount outstanding, to protect that gain, the redemption price on the indebtedness must be no less than face value of the principal amount outstanding.

loss is difficult to conceive.[31] Therefore, it is not surprising that Mr. O'Bryan is unaware of any financial instrument that would require a borrower to pay market value for debt it desires to redeem when interest rates fall.

Further, if an investor desired to receive at least the principal amount outstanding in the event that interest rates rose, it would have to offer the borrower a lower interest rate. Such a provision was not included in the intercompany note; thus, it follows that UE's principal amount was not protected from such a loss and should not have been granted it after-the-fact.

Mr. O'Bryan's allegation of CIPS' inability to pay less than principal amount for below market rate debt is inconsistent with IP's experience. During January 2000, IP redeemed $32 million of its 7.50% First Mortgage Bonds maturing in 2025. By January 2000, long-term Baa-rated utility bond yields had risen to 8.40%.[32] As shown on IP's long-term debt schedule, the Company realized a gain on that redemption due to higher long-term interest rates on the redemption date vis-à-vis the prevailing interest rate on the issuance date.[33]

Q. Based on Mr. O'Bryan's Rebuttal Testimony (Ameren Ex. 23.0), have you revised long-term debt schedule for CIPS?

[31] Protecting (*i.e.*, locking in) a loss should not be confused with protecting (or insulating) an investor *from* a loss. Investors seeking the latter type of protection can invest in shorter-term or adjustable rate debt further protecting any position.

[32] *Mergent Bond Record Monthly Update*, June 2004 Vol. 71, No. 6, p. 15.

[33] ICC Staff Ex. 4.0, Sch. 4.03 IP.

A. No. My recommended cost of long-term debt for CIPS is presented on ICC Staff Ex. 4.0, Sch. 4.03 CIPS.

ILLINOIS POWER COMPANY'S EMBEDDED COST OF TRANSITIONAL FUNDING TRUST NOTES ("TFTN")

Q. Did you make any adjustments to your calculation of the embedded cost of TFTNs for IP based on Mr. O'Bryan's Rebuttal Testimony?

A. No. As of December 31, 2006, IP's balance of TFTNs equals $171,533,494; the embedded cost of its TFTNs equals 4.92%.[34]

Q. Mr. O'Bryan argues that your calculation of the embedded cost of TFTNs, which annualizes the monthly discount rate used in the internal rate of return ("IRR") calculation rather than compounding it, understates the true cost to the Company because AmerenIP remits funds to the TFTN trustee on a daily basis. Is Mr. O'Bryan correct?

A. No. Using monthly compounding in the IRR calculation, as Mr. O'Bryan does, overstates the embedded cost of TFTNs and should be rejected.[35] The payment timing difference of TFTNs vis-à-vis a traditional fixed income security is more properly accounted for using a working capital adjustment than a cost of capital

[34] ICC Staff Ex. 4.0, Sch. 4.05 IP.

[35] ICC Staff Ex. 4.0, lines 461-477.

adjustment. Working capital for IP, as proposed by Staff witness Kahle (ICC Staff Ex. 15.0), includes this adjustment to reflect the timing difference between IP's TFTNs and its other long-term indebtedness.

Towards that end, in IP's prior electric delivery service rate case (Docket Nos. 06-0070/0071/0072 Cons.), Staff's proposed working capital allowance included a 91.5-day lead for conventional debt and a 2-day lead for TFTNs.[36] The Commission accepted this adjustment, and stated the following in its Order:

> The Commission has reviewed the record on this issue and concludes that Staff's method for calculating the embedded cost of TFTNs is correct. The cost of long-term debt, including TFTNs, is known with relative certainty and should be calculated on an annual basis. Multiplying the stated monthly rate by 12 produces an annualized embedded cost that is consistent with the entire test year revenue requirement calculation. Additionally, Ameren's concern about the economic impact of frequent remittance by IP to the trustee is recognized in the CWC allowance adopted in this order. The Commission finds that Staff's method for calculating the interest rate for IP's TFTNs when combined with the appropriate CWC calculation properly reflects IP's cost of providing service.[37]

Thus, Mr. O'Bryan's claim that the TFTN IRR calculation requires monthly compounding to adjust for IP's relatively frequent remittance of TFTN funds to the Trust is incorrect and should be rejected in the instant case as it was in IP's 2006 electric delivery services rate case.

[36] Staff Initial Brief, Docket Nos. 06-0070/0071/0072 Cons. (3/23/07), pp. 88-89, and App A, Sch. 9 (IPC).

[37] Order, Docket Nos. 06-0070/0071/0072 Cons. (11/21/06), p. 111, and Appendix C, pp. 6 and 9.

Q. Please explain why Mr. O'Bryan's statement that 2006 cash flows "must be included in the IRR analysis, as they make up the test year cost calculations" is incorrect.[38]

A. Mr. O'Bryan objects to my IRR analysis, which begins on the capital structure measurement date, or December 31, 2006. Specifically, he argues:

> Unlike the balance of TFTNs, which is a capital structure component and must be measured as of the end of the test year, the IRR calculates the true cost of the TFTNs and must incorporate the full test year cash flows.[39]

Calculating the embedded cost of the TFTNs using data from January 1, 2006, through December 31, 2008 (*i.e.,* the TFTN maturity date) overstates the cost of debt due to the twelve months of additional cash flows (*i.e.,* the present value of the TFTN collection amounts during 2006). Using my IRR analysis, and changing only the measurement period to include one additional year of cash flows, increases the TFTN IRR by approximately one percentage point (1.0%).[40]

Just as the embedded cost of long-term debt is calculated using unamortized balances of debt premiums, discounts and expenses as of the capital structure measurement date, it is appropriate to calculate the TFTN cost as of the capital

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[38] Ameren Ex. 23.0, p. 10.

[39] Ameren Ex. 23.0, p. 10.

[40] This changes the result of the IRR analysis to 5.43% (vs. 4.50%), which equals a 5.86% embedded cost for IP's TFTNs (vs. 4.92%). This change alone increases the cost of capital for IP's gas and electric operations to 8.78% and 8.75%, respectively (vs. 8.70% and 8.68% as provided in ICC Staff Ex. 4.0, Sch. 4.01 IP).

structure measurement date. Furthermore, Mr. O'Bryan's assertion that the 2006 cash flows must be included in the TFTN IRR analysis because those cash flows "make up the test year cost calculations" is incorrect. If Mr. O'Bryan's argument had merit, and it does not, then the cost of long-term debt should also be measured from the beginning of the test year. After all, long-term debt interest expense is part of the Companies' test-year cash working capital requirement. As I explained previously, pursuant to 83 Illinois Administrative Code 285.115, the measurement date for long-term capital structure components may differ from the test year. Importantly, calculating the IRR for the TFTNs from the beginning of the test year (January 1, 2006) results in a mismatch between the starting TFTN balance for the IRR calculation ($259,200,000) and the balance of TFTNs as of the December 31, 2006 measurement date for the long-term components of the capital structure ($172,800,000). Mr. O'Bryan chose the higher January 1, 2006 IRR rather than the lower December 31, 2006 IRR and combined it with the lower December 31, 2006 balance of TFTNs rather than the higher January 1, 2006 balance of TFTNs.

Finally, Mr. O'Bryan's IRR calculation violates the present value principle on which it rests: an asset equals the cumulative value of its <u>future</u> discounted cash flows.[41] Rather than restrict his analysis to future cash flows (as of the TFTN

[41] "Future cash flow" refers to those cash flows that occur subsequent to the measurement date of the outstanding obligation (*i.e.,* December 31, 2006).

balance measurement date), Mr. O'Bryan included cash flows from the twelve months that precede that measurement date.

Q. Please explain why it is necessary to add $100,000 to the "Net Proceeds Used to Retire Principal" in the TFTN IRR analysis.

A. Mr. O'Bryan's rebuttal testimony states:

> …Ms. Phipps adjusted the amount of "Net Proceeds Used to Retire Principal" to reflect a $100,000 subtraction to the capital subaccount, stating that I incorrectly did not include this in my calculations. Conversely, I did include this subtraction in the last line of the "Collection Amount" column in my IRR spreadsheet. Therefore, this amount is embedded in my IRR calculation.[42]

Subtracting $100,000 from the "Collection Amount" is correct;[43] in fact, my IRR analysis also includes a $100,000 reduction in the "Collection Amount". Mr. O'Bryan misses the point of my adjustment, which is necessary because Mr. O'Bryan performed only half of the required adjustment. That is, in addition to subtracting $100,000 from the Collection Amount in his IRR analysis, Mr. O'Bryan also should have added $100,000 to the amount of Net Proceeds Used to Retire Principal.

Although Mr. O'Bryan correctly modeled that $4,220,000 from the capital subaccount (along with $4,320,000 from the overcollateralization subaccount) will

[42] Ameren Ex. 23.0, p. 10.

[43] "Collection Amount" refers to the expected revenues reserved for repaying principal and interest on IP's TFTNs.

be returned to IP in December 2008, he incorrectly modeled that $4,320,000 of the TFTN proceeds were deposited in the capital subaccount in December 1998. Pursuant to the terms of the *$864,000,000 Illinois Power Special Purpose Trust Transitional Funding Trust Notes, Series 1998-1, Prospectus Supplement ("TFTN Prospectus"),* the TFTN Trust will retain proceeds in amount at least equal to $4,220,000, not $4,320,000, as Mr. O'Bryan modeled, which will be held in the Capital Subaccount.[44] In other words, Mr. O'Bryan's approach understates the net proceeds from the TFTN issuance available to IP by $100,000. As such, to avoid overstating the embedded cost of the TFTNs, the IRR analysis must also subtract $4,220,000 from the amount of "Net Proceeds Used to Retire Principal" rather than $4,320,000 because the former is the amount deposited into the Capital Subaccount. Thus, my adjustment to include an additional $100,000 in the amount of proceeds for retiring TFTN principal more accurately estimates the TFTN cost because it reflects the full amount of cash flows available to retire the TFTNs upon maturity. Failing to make that adjustment, would result in an artificially low amount of cash available to retire the TFTNs, thereby inflating the results of the TFTN IRR analysis.

ILLINOIS POWER COMPANY'S POLLUTION CONTROL BONDS

Q. What is your estimate of the balance and embedded cost of long-term debt for IP?

[44] *$864,000,000 Illinois Power Special Purpose Trust Transitional Funding Trust Notes, Series 1998-1, Prospectus Supplement*, pp. S-17, S-18, 103 and 104.

A. As Schedule 4.03 IP shows, as of December 31, 2006, IP's balance of long-term debt equals $709,096,036; the embedded cost of long-term debt equals 7.34%.

Q. Please describe Mr. O'Bryan's update to IP's long-term debt schedule (Ameren Ex. 23.5) and its effect on IP's embedded cost of long-term debt.

A. Mr. O'Bryan updated IP's long-term debt schedule to reflect the April 2008 refinancing of IP's auction rate Pollution Control Bonds ("PCBs") by including (1) $337 million of 6.25% Senior Secured Notes; and (2) unamortized losses and annual amortization expense for the PCBs. This update effectively increases the embedded cost of the PCB-related indebtedness by approximately 2 percentage points (to 6.5% from 4.6%) and increases the embedded cost of debt for IP to 7.98% from 7.14%.[45]

Q. Please describe why Mr. O'Bryan's updated long-term debt schedule for IP is problematic.

A. Foremost, Mr. O'Bryan's long-term debt schedule for IP mismatches measurement periods by reflecting March 31, 2008 balances of unamortized loss for the reacquired PCBs only, which is fifteen months beyond the December 31, 2006 balances for every other long-term debt issue.

[45] Per AmerenIP Ex. 8.2, the embedded cost of the PCBs equals 4.63% (i.e. $15,346,155 of annual interest expense (including amortization of debt expense), divided by $331,429,020 carrying value). Per Ameren Ex. 23.5, the embedded cost of the Senior Secured Notes, including the loss on reacquiring the PCBs, equals 6.47% (i.e. $21,146,535 annual interest expense (including amortization of debt discount and expense and losses on reacquired debt), divided by $326,915,905 carrying value).

Not only does Mr. O'Bryan selectively update his long-term debt schedule for the new indebtedness, but his sole update to IP's long-term debt schedule increases IP's cost of capital while ignoring updates to costs and balances of the other capital structure components. Some of the changes to IP's embedded cost of long-term debt that have occurred since December 31, 2006, but which Mr. O'Bryan notably excluded from his selective update, include IP's November 2007 $250 million long-term debt issuance;[46] the March 31, 2008 TFTN balance and reduction of its embedded cost rate; and the approximately $8.6 million reduction in unamortized debt discount, premium and expense on long-term debt outstanding from December 31, 2006 to March 31, 2008. Furthermore, IP's March 31, 2008 common equity balance is $52 million lower than its December 31, 2006 balance;[47] and Staff's cost of common equity for the Ameren utilities' electric delivery services operations as measured in April 2008 is lower than Staff's original recommendation (measured in February 2008) whereas Staff's cost of common equity for the Ameren utilities' gas delivery services as measured in April 2008 is one basis point higher than Staff's original recommendation (measured in February 2008). Clearly, the Company's selective update to IP's long-term debt schedule provides neither an accurate nor complete view of IP's cost of capital on either December 31, 2006, or during April 2008.

[46] *Ameren Corporation December 31, 2007 Form 10-K*, p. 129.

[47] *Ameren Corporation December 31, 2006 Form 10-K*, p. 105; *Ameren Corporation March 31, 2008 Form 10-Q*, p. 28.

Furthermore, during April 2008, CILCO and CIPS redeemed $19 million and $35 million of Series 2004 auction rate PCBs. Unlike IP, CILCO and CIPS have not issued senior secured notes to replace the auction-rate bonds.[48] Notably, the Ameren utilities did not update either CILCO's or CIPS' capital structures to reflect the incremental increase in short-term debt when those utilities redeemed their auction rate PCBs. Thus, Mr. O'Bryan's proposed update to IP's cost of long-term debt should be rejected.

Q. What is your recommendation if the Commission decides that IP's cost of capital needs to be updated because IP has refinanced its auction rate PCBs?

A. Although I recommend against allowing selective updates to the Ameren utilities' cost of capital for the reasons described previously, should the Commission determine it would be appropriate to update IP's cost of capital to reflect the 6.25% interest rate senior secured notes IP issued to redeem its auction rate PCBs, I recommend the Commission limit any updates to the costs of variable rate debt issues (short and long-term) and the cost of common equity, leaving the capital structure balances unchanged. Further, since CILCO and CIPS also refinanced PCBs during April 2008, their variable rate debt and common equity cost should be updated as well.

[48] *Ameren Corporation March 31, 2008 Form 10-Q*, p. 38.

Q. What are the updated costs of short-term debt, variable rate long-term debt, and common equity?

A. The updated cost of short-term debt for CILCO, CIPS and IP are 3.95%, 3.92% and 3.74%, respectively. I calculated those costs beginning with the 2.80% one-month LIBOR rate on April 30, 2008.[49] For each utility, I added to LIBOR (1) the applicable Eurodollar margin; (2) a dollar-weighted usage fee; and (3) the applicable facility fee, using the same methodology and weighting factors described in my Direct Testimony, which Mr. O'Bryan did not oppose.[50] For IP only, the cost of short-term debt also includes a weighted money pool rate.[51]

The updated cost of long-term debt for CILCO, CIPS and IP are 6.63%, 6.24% and 7.94%, respectively. For CILCO and CIPS, I updated the interest rate for auction rate PCBs to equal their respective updated short-term debt cost. For IP, I updated the interest rate for auction rate PCBs to 6.25%, which is the interest rate for the Senior Secured Notes that IP issued in April 2008 to replace auction rate PCBs.

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[49] *The Wall Street Journal*, "Markets Data Center," April 30, 2008 (www.wsj.com).

[50] ICC Staff Ex. 4.0, pp. 9-13, 17-18, 20-21, 24-25; Ameren Ex. 23.0, p. 3.

[51] On April 30, 2008, IP's dollar-weighted bank loan rate equaled 4.09%. For IP only, the internal money pool rate equaled the AA Non-Financial commercial paper rate on April 30, 2008, or 2.07%; the external money pool rate equaled the average of CILCO's and CIPS' updated cost of short-term bank loans, or 3.94%. I used the following dollar weighted proportions for internal money pool loans, external money pool loans and bank loans, respectively: 16.8%; 5.3% and 77.9%. See ICC Staff Ex. 4.0, lines 409-431.

As of April 30, 2008, Staff witness Freetly's cost of equity recommendation for the Ameren utilities' gas operations equals 10.73% and the cost of equity for the Ameren utilities' electric operations equals 10.32%.

Q. Why do you advise against updating the balances of the capital structure components?

A. I advise against updating the balances of the capital structure components because the short-term debt balances beyond March 31, 2008 are not available.[52] Consequently, average short-term debt balances centered in time at April 30, 2008 (i.e., October 31, 2007 to October 31, 2008) cannot be calculated.

Q. What would the costs of capital be for the Companies if their costs of short-term debt, variable rate long-term debt and common equity were updated to April 30, 2008?

A. Should the Commission determine it is necessary to update the Ameren utilities' cost of capital estimates due to recent financing activity in connection with redeeming and refinancing auction rate PCBs, then the cost of capital for CILCO's, CIPS' and IP's gas delivery services operations would be 7.94%, 8.14%, and 8.90%, respectively. Those cost of capital recommendations reflect Staff witness Freetly's updated 10.73% cost of equity estimate for the utilities' gas delivery services operations.

[52] Further, total CWIP, CWIP accruing AFUDC, and utility loans and borrowings from the money pool are needed to calculate net balances of short-term debt.

The cost of capital for CILCO's, CIPS' and IP's electric delivery services operations would be 7.75%, 7.94%, and 8.69%, respectively. Those cost of capital recommendations reflect Staff witness Freetly's updated 10.32% cost of equity estimate for the utilities' electric gas delivery services

Q. Has the Commission rejected selective updates to cost of capital components previously?

A. Yes. In the Ameren utilities' 2006 electric delivery services rate case, the Commission noted the risks inherent in selective updates to capital structure components, rejected the Ameren utilities' proposed selective updates to interest rates and endorsed measuring all the costs of capital at or over the same period. Specifically, the Commission's Order states:

> …the Commission favors measuring all of the costs of capital at or over the same period. Such an approach contributes to a test year revenue requirement that matches the cost of providing services and, in the Commission's view is fair to both consumers and the utility investors. The Commission becomes wary when a party proposes updates to certain components of the cost of capital without providing updates to all components. Allowing selective updates could serve to encourage utilities to only provide updates if the cost of components increased. Absent sufficient justification, this would be unfair to ratepayers…
>
> Ameren proposed to revise its variable rate and short-term interest rates… Ameren did not provide any updates for other components of its cost of capital. The Commission finds this to be problematic. First, the Commission favors a consistent period for measuring costs of capital… Second, Ameren only provided updates for one component of its cost of capital and only did so because the cost increased. Allowing Ameren to include its selective update here would be unfair to ratepayers. Finally, Ameren provided these

> updates during the responsive phase of the proceeding, giving other parties little time to evaluate the proposal…[53]

RATE OF RETURN ON RATE BASE

Q. What is the rate of return on rate base you recommend for CILCO?

A. I continue to recommend a 7.95% rate of return on rate base for CILCO's gas delivery services. I recommend a 7.93% rate of return on rate base for CILCO's electric delivery services, as shown on Schedule 16.01. My recommendations incorporate the rates of return on common equity Ms. Freetly recommends for CILCO's gas and electric delivery services. Those rates of return do not incorporate the April 2008 updates to the costs of variable rate debt and common equity I described previously.

Q. What is the rate of return on rate base you recommend for CIPS?

A. I continue to recommend an 8.15% rate of return on rate base for CIPS' gas delivery services and an 8.13% rate of return on rate base for CIPS' electric delivery services. My recommendations incorporate Ms. Freetly's rates of return on common equity recommendation for CIPS' gas and electric delivery services. Those rates of return do not incorporate the April 2008 updates to the costs of variable rate debt and common equity I described previously.

Q. What is the rate of return on rate base you recommend for IP?

[53] Order, Docket Nos. 06-0070/0071/0072 Cons. (11/21/06), pp. 109-110.

A. I continue to recommend an 8.70% rate of return on rate base for IP's gas delivery services and an 8.68% rate of return on rate base for IP's electric delivery services. My recommendations incorporate Ms. Freetly's rate of return on common equity recommendation for IP's gas and electric delivery services. Those rates of return do not incorporate the April 2008 updates to the costs of variable rate debt and common equity I described previously.

Q. Does this question conclude your prepared rebuttal testimony?

A. Yes, it does.

CENTRAL ILLINOIS LIGHT COMPANY

JUNE 30, 2007 COST OF CAPITAL SUMMARY

STAFF PROPOSAL FOR CILCO ELECTRIC

Capital Component	Balance	Percent of Total Capitalization	Cost	Weighted Cost
Short-Term Debt	$82,500,351	17.29%	4.04%	0.70%
Long-Term Debt	141,064,706	29.54%	6.65%	1.96%
Preferred Stock	36,450,058	7.63%	5.34%	0.41%
Common Equity	217,459,214	45.54%	10.68%	4.86%
Total	$477,474,329	100.00%		**7.93%**