REBUTTAL TESTIMONY

of

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Finance Department
Financial Analysis Division
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 and business address.

A. My name is Janis Freetly. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. Are you the same Janis Freetly who previously testified in this proceeding?

A. Yes, I am.

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

A. The purpose of my rebuttal testimony is to respond to the rebuttal testimony of Ameren witness Kathleen C. McShane. (AmerenCILCO Ex. 22.0, AmerenCIPS Ex. 22.0, AmerenIP Ex. 22.0) In addition, I will respond to the direct testimony of Christopher C. Thomas on behalf of the Citizens Utility Board (CUB Exhibit 1.0) and the direct testimony of Michael Gorman on behalf of Illinois Industrial Energy Consumers (IIEC Exhibit 2.0). I also present my analysis of Staff's rebuttal revenue requirements on the Companies' risk.

Cost of Equity Recommendation

Q. What is your estimate of the Companies' required rate of return on common equity for the natural gas distribution operations?

A. Based on my analysis, in my judgment, the investor required rate of return on common equity for the natural gas distribution operations equals 10.72% for CILCO, CIPS and IP.

Q. What is your estimate of the Companies' required rate of return on common equity for the electric delivery service operations?

A. Based on my analysis, in my judgment, the investor required rate of return on common equity for the electric delivery service operations equals 10.68% for CILCO, CIPS and IP.

Q. Did you make any changes to your cost of equity analysis?

A. Yes, my cost of equity recommendation reflects Staff's revenue requirement recommendations put forth in rebuttal testimony. Specifically, I calculated the same benchmark ratios discussed in my direct testimony using Staff's proposed revenue requirement from rebuttal testimony. I then compared the values for the financial guideline ratios that result from Staff's proposed rebuttal revenue requirement to those for the Electric and Gas samples and to Moody's guidelines for electric utilities with medium business risk. Due to a slightly higher risk adjustment for CILCO Electric, my cost of equity recommendation decreased to 10.68% from 10.73% for CILCO Electric.

Q. Please summarize the results of your analysis of the financial strength of the electric delivery service operations of the Ameren Companies relative to the Electric sample.

A. Staff’s recommended revenue requirement for CILCO Electric results in a funds from operations (“FFO”) to interest coverage ratio of 6.0X and a FFO to total debt coverage ratio of 28%, which fall within the upper end of the guideline range for an A credit rating. Together, those ratios are consistent with an A1 credit rating. Staff’s recommended revenue requirement for CIPS Electric results in a FFO to interest coverage ratio of 6.1X and a FFO to total debt coverage ratio of 30% which lies on the border between the guideline ranges for the Aa and A credit ratings. Together, those ratios are consistent with an Aa3/A1 credit rating. Staff’s recommended revenue requirement for IP Electric results in a FFO to interest coverage ratio of 5.8X, which lies at the upper end of the guideline range for an A credit rating and a FFO to total debt coverage ratio of 32% which falls within the guideline range of an Aa credit rating. Together, those ratios are consistent with an A1 credit rating. The financial guideline ratios from Moody’s for electric utilities with medium levels of business risk are shown below in Table 1. In summary, I conclude that Staff’s revenue requirement recommendations, including my cost of equity recommendations, are indicative of a level of financial strength that is commensurate with an Aa3/A1 credit rating for CIPS and A1 credit ratings for CILCO and IP.

Table 1 – Moody's Guideline Ratios

	Aa	A	Baa
Financial Guideline Ratios			
FFO/IC	> 6.0X	3.5-6.0X	2.7-5.0X
FFO/Debt	> 30%	22-30%	13-25%
Electric Sample			
FFO/IC			4.0X
FFO/Debt			18%
Staff Proposal – CILCO E			
FFO/IC		6.0X	
FFO/Debt		28%	
Staff Proposal – CIPS E			
FFO/IC	6.1X		
FFO/Debt	30%		
Staff Proposal – IP E			
FFO/IC		5.8X	
FFO/Debt	32%		

In comparison, the Electric sample's FFO to interest coverage ratio of 4.0X and the FFO to total debt ratio of 18% fall within the guideline range for a Baa credit rating, which indicates that the Electric sample has lower financial strength and therefore higher risk than the Companies' electric delivery service operations. Financial theory posits that investors require higher returns to accept greater exposure to risk. Conversely, the investor-required rate of return is lower for investments with less exposure to risk. Thus, in my judgment, given the difference between the forward-looking financial ratios of the Companies' electric delivery service operations and the financial ratios of the Electric sample, the sample's average cost of common equity needs to be adjusted to determine the final estimate of the Companies' costs of common equity for electric delivery service operations.

Q. How did you estimate the components of and calculate the coverage ratios implied by your capital component cost recommendations and capital structure?

A. I followed the same methodology described on lines 524 through 540 of my direct testimony filed in this proceeding to estimate the components of and calculate the coverage ratios.[1]

Q. How did you establish the adjustments you used to determine the cost of equity for the Companies?

A. The 30 basis point adjustment for CILCO Electric, CIPS Electric and IP Electric equals the spread between Baa1 rated and A1 rated 30-year utility debt yields.[2] The spreads for 30-year utility debt yields as of February 13, 2008, were presented on Schedule 5.10. Although the CIPS Electric financial ratios fall just above the border between the Aa and A ratings (i.e., Aa3/A1), those ratios are very close to the CIPS Electric financial ratios resulting from the revenue

[1] ICC Staff Exhibit 5.0, p. 28 and Schedules 5.08 and 5.09.
[2] Ibid.

requirement Staff presented in its direct testimony. Therefore, I did not revise the adjustment to the cost of common equity for CIPS Electric that I had recommended in my direct testimony.

Q. Did you adjust the Gas sample's cost of common equity?

A. No. For the Ameren Companies' gas utility operations, the financial ratios implied by the capital component costs and capital structure are consistent with those for the Gas sample. Therefore, I did not adjust the cost of common equity of the Gas sample. The financial guideline ratios for the gas operations of CILCO, CIPS and IP are shown below in Table 2.

Table 2 –Guideline Ratios for Gas Utilities

	Baa
Financial Guideline Ratios	
FFO/IC	2.7-5.0X
FFO/Debt	13-25%
Gas Sample	
FFO/IC	4.8X
FFO/Debt	21%
Staff Proposal – CILCO G	
FFO/IC	4.6X
FFO/Debt	21%
Staff Proposal – CIPS G	
FFO/IC	4.1X
FFO/Debt	19%
Staff Proposal – IP G	
FFO/IC	4.5X
FFO/Debt	23%

Q. Does your cost of common equity recommendation for the natural gas distribution operations of the Ameren Illinois Companies take into account Rider VBA?

A. No. As discussed in my direct testimony, my cost of common equity recommendation does not account for the lower risk associated with the revenue decoupling mechanism (Rider VBA) that the Companies are proposing in this case. Should the Commission approve Rider VBA, I recommend that the return on common equity for the gas operations of CILCO, CIPS and IP be reduced 10 basis points to recognize the reduction in risk associated with the use of a gas decoupling mechanism.[3]

Q. Have you updated your cost of equity analysis for the Ameren Illinois utilities in the event the Commission accepts Ameren witness O'Bryan's position to update the cost of long-term debt to reflect the recent refinancing of IP's auction rate bonds?

Yes. My updated analysis indicates that the cost of common equity for the natural gas distribution operations of CILCO, CIPS and IP is 10.73%.

Q. What is your updated cost of common equity estimate for the electric delivery service operations of CILCO, CIPS and IP?

A. My updated analysis indicates that the cost of common equity for the electric delivery service operations of CILCO, CIPS and IP is 10.32%.

Q. How did you measure the updated investor-required rate of return on common equity for the Companies?

A. I applied the same models in the same manner described in my direct testimony except that I updated the inputs to reflect data as of April 30, 2008. The results of this analysis, including the sources and dates of the underlying data, are presented in Schedules 17.03 to 17.07.

[3] ICC Staff Exhibit 5.0, pp. 30-33, lines 556-622.

Q. Please describe the results of the relative financial strength analysis of the Ameren utilities.

A. Staff's recommended revenue requirement for CILCO Electric results in a funds from operations ("FFO") to interest coverage ratio of 6.0X, which lies on the border between the guideline ranges for the Aa and A credit ratings and a FFO to total debt coverage ratio of 28%, which falls within the benchmark range of an A credit rating. Together, those ratios are consistent with an A1 credit rating. Staff's recommended revenue requirement for CIPS Electric results in a FFO to interest coverage ratio of 6.1X, which lies within the guideline range for an Aa credit rating and a FFO to total debt coverage ratio of 30% which lies on the border between the guideline ranges for the Aa and A credit ratings. Together, those ratios are consistent with an Aa3/A1 credit rating. Staff's recommended revenue requirement for IP's electric delivery service operations results in a FFO to interest coverage ratio of 5.5X which lies at the upper end of the guideline range for an A rating, and a FFO to total debt ratio of 32% which falls within the guideline range of an Aa credit rating. Together, those ratios are consistent with an A1 credit rating. Schedule 17.08-E demonstrates how the FFO ratios for the electric delivery service operations of CILCO, CIPS and IP were calculated. The Electric sample's lower average FFO ratios indicate that its risk is higher than that of the Companies' electric delivery service operations. Since the investor-required rate of return on common equity is lower for investments with less exposure to risk, a downward adjustment to the cost of equity for the Electric sample is necessary when applying that return to the electric delivery service operations of the Ameren Illinois utilities. The 48 basis point adjustment to the cost of equity for CILCO, CIPS and IP's electric delivery service operations equals the spread between Baa1 rated and A1 rated utility debt yields.[4,5] The spreads for 30-year utility debt yields as of April 30, 2008, are presented on Schedule 17.09.

Q. Did you adjust the Gas sample's updated cost of common equity?

A. No. For the Gas utilities, the financial ratios implied by the capital component costs and capital structure are consistent with those for the Gas sample. Therefore, I did not adjust the updated cost of common equity of the Gas sample. Schedule 17.08-G demonstrates how the FFO ratios for the natural gas distribution operations of CILCO, CIPS and IP were calculated.

Response to Ms. McShane

Q. Ms. McShane is concerned with your regression betas because they have been consistently lower than Value Line betas. Please respond.

A. Since the Value Line methodology is not inherently superior to Staff's methodology, one could just as persuasively argue that Value Line betas should be disregarded since they have been consistently higher than regression betas. Value Line and regression betas are estimates of the unobservable true beta, which measures investors' expectations of the quantity of non-diversifiable risk inherent in a security. Consequently, which beta estimates are more accurate is

[4] Reuters Corporate Spreads for Utilities, www.bondsonline.com, April 30, 2008.
[5] Although CIPS Electric's forward-looking financial strength is consistent with an Aa3/A1 credit rating, I used the yield spread for A1 rated debt for the adjustment to CIPS Electric's cost of common equity for the reason described at lines 78-83 of my rebuttal testimony.

unknown. Different beta estimation methodologies can produce different betas when those methodologies employ different samples of stock return data. The methodology I used to calculate the regression betas for my sample, which Staff has regularly used and the Commission has consistently approved,[6] employs the same monthly frequency of stock price data as the widely accepted Merrill Lynch methodology.

Q. Mr. O'Bryan claims that you used the rating agency benchmark ratios to develop credit ratings for CILCO, CIPS and IP.[7] He also states that the rating agencies are the final arbiters of credit ratings.[8] Please respond.

A. I did not attempt to determine my own credit ratings for the Ameren Illinois Utilities nor am I suggesting that simply because the Ameren Companies' metrics fall within the guideline ranges that the implied rating will result. Rather, I performed the ratio analysis in order to compare the financial strength of the Companies, based on the FFO to interest coverage and FFO to total debt ratios (collectively "FFO ratios"), to those of my Electric and Gas samples. I translated the resulting ratios into implied credit ratings only to have a metric on which to base an adjustment to the cost of equity. Corporate debt yields are published by credit rating, not financial ratio. Ratio analysis is necessary to evaluate the riskiness of the Ameren Companies versus proxy samples.

[6] Order, Docket No. 02-0837, October 17, 2003, pp. 37-38; Order, Docket Nos. 02-0798/03-0008/03-0009 Cons., October 22, 2003, p. 85; Order, Docket No. 00-0340, February 15, 2001, p. 25; and Order, Docket No. 03-0403, April 13, 2004, p. 42.
[7] Ameren Exhibit 23.0, pp. 12-13.
[8] Ameren Exhibit 23.0, p. 12, lines 14-15.

Credit ratings agencies do not develop separate credit ratings for a company's business segments. Therefore, if I had been developing credit ratings for the Ameren Illinois Utilities, I would have performed a single financial strength analysis for each company that would have reflected the combined financial strength of each company's business segments, including electric transmission. Further, Staff would have recommended downward adjustments to the Companies' variable rate debt to reflect the lower cost associated with the "predicted credit rating."

Q. Why did you not use the current credit ratings of CILCO, CIPS and IP for comparison to your Electric sample?

A. First, credit ratings reflect the risk of a company's entire operations, not just those operations subject to the Commission's rate jurisdiction. Second, credit ratings also could reflect a company's affiliation with other companies. Third, credit ratings reflect the credit ratings agency's forecast. Since those forecasts are not published, they cannot be compared to Staff's (or any other party's) revenue requirement recommendation. Finally, credit rating agencies are taking a "wait and see" approach to the credit ratings for the Ameren Illinois Companies. That is, they have made it clear that there will be no credit rating upgrades until they have had a chance to observe how the new power procurement process will work and whether its results will be accepted without further legislative intervention. In other words, the credit rating agencies have severed the connection between credit rating and financial strength for the time being. For all these reasons, the Companies' credit ratings should not be relied upon absent investigation of the underlying standalone, going forward financial strength of the Companies.

Response to Mr. Thomas

Q. In his discussion of the proper growth rate to use in a DCF analysis, CUB witness Thomas cites several studies and concludes that "[a]nalysts tend to be optimistic about future growth and produce forecasts that are upwardly biased."[9] Do you agree with his implication that those studies can be applied to utility growth rates?

A. No. The studies he cites tend to report generalized findings and do not specifically suggest that growth rates for utilities are overstated relative to achieved growth. In contrast, a study by Chan, Karceski, and Lakonishok indicates that analyst growth rate estimates for utilities are <u>not</u> overstated. The authors of that study sorted by growth rate all domestic firms with available IBES long-term growth rate estimates, forming value-weighted portfolios in each quintile after each year, and found that the growth rates for portfolios of companies falling in the highest quintiles (i.e., having the highest growth rates) tend to be overstated relative to the growth achieved over the five years post ranking.[10] However, that study also indicates that the growth rates for portfolios of companies falling in the lowest quintile show no such tendency. That study further notes that the bottom quintile portfolios predominantly comprise firms in mature industries, with approximately 25% of those firms being utilities. Thus,

[9] CUB Exhibit 1.0, pp. 28-30.
[10] Chan, Karceski, and Lakonishok, "The Level and Persistence of Growth Rates," *Journal of Finance*, April 2003, pp. 671-676.

utility growth rates do not appear to be upwardly biased estimators of achieved growth five years ex post.

Q. Mr. Thomas argues that "[i]f we accept that (1) current stock prices reflect all available information, and (2) empirical research has found a pattern of upwardly biased analyst growth rate forecasts, then it is reasonable to conclude that the Commission cannot rely on analysts' growth forecasts alone."[11] Do you agree?

A. The appropriate answer depends on the benchmark used to determine if analyst growth rates are too high. It is true that if analysts' growth rates overstate investor <u>expectations</u> of future growth, use of those analysts' growth rates will produce an overstated cost of equity. However, the financial literature that Mr. Thomas cites relates to whether or not analysts' growth estimates are too high relative to <u>achieved</u> growth, as measured after the fact. That is, they are ex post assessments of analyst growth rates' ability to accurately predict future growth, not assessments of analyst growth rates' value as estimates of investors' ex ante expectations. Given that investors' growth expectations are forecasts of the future, they may differ significantly from the ex post achieved growth. A cost of equity witness only attempts to estimate what the investors' true growth expectations are. To the extent that analyst growth rates reflect the investors' true growth expectations, use of analyst growth rates <u>will</u> provide an accurate estimate of the cost of equity, if properly applied in a correctly specified DCF model, whether or not the predicted growth is ultimately realized.

[11] CUB Exhibit 1.0, p. 30, lines 712-715.

Mr. Thomas' argument, within the context of his discussion of the financial literature he cites, incorrectly implies that analyst growth rates should be judged on their ability to accurately predict future growth, rather than on their value as proxies for investors' ex ante expectations. As noted above, with regard to analyst growth rates' ability to accurately predict future achieved growth, I believe Mr. Thomas' implication that the findings of the generalized studies he cites apply specifically to utilities is, at best, dubious. Nevertheless, the more significant question is whether or not analyst growth rates accurately portray investor expectations of future growth. Mr. Thomas has presented no evidence to demonstrate that analyst growth rates are poor proxies for investor growth expectations.

The above notwithstanding, Mr. Thomas presents no reason to reject analysts' growth rates altogether. Indeed, Mr. Thomas' argument is not that analyst growth rates should be disregarded entirely if they are upwardly biased, but that they should not be used exclusively in that case. Nevertheless, despite presenting analyst earnings per share ("EPS") growth rates from four separate sources, Mr. Thomas ignored them when performing his DCF analysis.[12] Instead, Mr. Thomas elected to rely solely on a "b x r" growth rate estimate derived from historical data. That approach produces a growth rate of 4.21% for his electric sample, which is 39% lower than the lowest (i.e., 6.91%) of his four analyst EPS growth rates (Value Line) and 52.5% lower than the highest (i.e., 8.86%) of his four analyst EPS growth rates (Reuters) noted in his testimony.

[12] CUB Exhibit 1.0, p. 39.

Mr. Thomas' "b x r" approach produces a growth rate of 4.69% for his gas sample. Obviously, if, as his argument suggests, Mr. Thomas were to have given any weight to any of those analyst growth rates (i.e., if he had not disregarded them entirely) in his DCF analysis, the resulting costs of equity would have been higher than his recommendations of 8.955% for gas and 9.046% for electric.

Q. Mr. Thomas argues that "[i]n circumstances where the dividend payout ratio is expected to change, using this fundamental growth formula [b x r] to estimate expected future growth is superior to analysts' forecast."[13] Do you agree?

A. No. Mr. Thomas notes that Value Line's EPS and dividends per share ("DPS") growth expectations differ and, thus, concludes that neither correctly measures investor expectations. His solution is to reject both and use a growth rate that is almost a full percentage point less than either the EPS or DPS growth projection. First, Mr. Thomas inappropriately extrapolates from a single source to suggest that investors, generally, are expecting dividend payout ratios to change. Second, the difference between the Value Line dividend growth rates and earnings growth rates is not very large; thus, they do not indicate changes in dividend payout ratios beyond normal year-to-year fluctuations. It is unrealistic to expect dividend payout ratios to remain absolutely constant in the near term. Third, Value Line's growth normalization technique for calculating forecasted growth rates is too mechanistic to ensure proper normalization. Specifically, it

[13] CUB Exhibit 1.0, p. 33, lines 799-801.

takes a simple three-year average of the base line data, such as EPS and DPS, to approximate the results of normal operations. However, if that three-year base is abnormally high, the growth rate indicated by the forecasted EPS or DPS will be lower than appropriate. Conversely, if that three-year base is abnormally low, the growth rate indicated by forecasted EPS or DPS will be greater than appropriate.

Even if one were to agree that the divergence of DPS and EPS growth disqualifies either for use in a DCF analysis, his solution is inappropriate. When DPS grows more slowly than EPS, sustainable growth must be higher than DPS growth, not lower. The b x r growth rate formula is:

$$g = (1 - DPS/EPS) \times ROE$$

That formula shows that the b x r sustainable growth rate is bounded by 0% on the low end (when the company pays all earnings out in dividends) and the ROE on the high end (when the company pays no dividends). That is, if DPS growth exceeds EPS growth over an extended period, the fraction DPS/EPS in the above equation will approach 1 and sustainable growth will approach 0%.[14] Conversely, if EPS growth exceeds DPS growth over an extended period, the fraction DPS/EPS will approach zero and sustainable growth will approach the ROE. According to Mr. Thomas' Value Line data the latter example applies; that

[14] For the purpose of this example, DPS is assumed to be less than EPS because a DPS greater than EPS indicates a liquidation of the company, a condition which cannot be sustained over an extended period of time. Also, ROE is assumed to be constant and thus, sustainable growth occurs when the fraction DPS/EPS reaches its long-run steady state. At this point, DPS and EPS will grow at the same rate.

is, EPS growth exceeds DPS growth. Therefore, even if one assumes that the difference in the Value Line growth projections for DPS and EPS is sufficient for rejecting them both, which I dispute, the long-term steady state growth rate is higher than the DPS growth rate rather than lower as Mr. Thomas has estimated.

Q. Do you have any other concerns with the b x r growth rate that Mr. Thomas used in his DCF cost of equity analysis?

A. Yes. Mr. Thomas used historical dividend payout ratios and returns on equity to derive his b x r growth estimate, which he then added to the current dividend yield of each company in his samples to derive his cost of equity estimates. It is inconsistent to apply a growth rate that reflects historical dividend payout ratios with dividend yields that reflect current dividend payout ratios. First, growth rates derived from historical data are inconsistent with the prospective nature of the cost of common equity. While a historical perspective has value in forecasting the future, one cannot reasonably forecast the future by looking solely to the past, as Mr. Thomas does. That is, the same historical data Mr. Thomas used is also available to security analysts who also incorporate current information to improve their forecasts of future growth relative to the use of historical data alone.

Second, Value Line earnings per share and dividend per share growth data indicate that the average dividend payout ratio for his sample is expected to fall from 2004-2006 to 2010-2012. This indicates that the retention ratios (i.e., retention ratio = 1 - dividend payout ratio) were lower during the period from which Mr. Thomas derived his b x r growth rate (2002-2006) than expected going forward, all else equal. Conversely, it indicates that Value Line projects lower dividend payouts going forward, which would produce a lower dividend yield, all else equal. Thus, Mr. Thomas combines the lower growth rates from 2002-2006 with the lower current dividend yields, which understates the cost of equity.

In addition, numerous studies have shown that analyst growth rate estimates are the best proxy for investor expectations. A text by Michael Erhardt summarizes the research, stating:

> There are many studies showing analysts' forecasts are better predictors of actual growth rates than are predictors based solely on historical information. Also, the results of valuation models, such as the dividend growth model, are typically more accurate when the growth rate comes from analyst forecasts. Therefore, you should use analyst forecasts as an estimate of your company's expected dividend growth rate, if such forecasts are available.[15]

Q. Mr. Thomas concludes that the quarterly DCF model is not appropriate for rate setting purposes because utility companies recover their approved cost of equity over an entire year while their investors receive dividend payments on a quarterly basis.[16] Do you agree?

A. No. Mr. Thomas has raised a working capital issue, not a cost of common equity issue. His argument implicitly assumes that working capital is not correctly measured. A working capital allowance compensates a utility for any delay between the time it expends cash to provide service and the time it receives cash

[15] Erhardt, Michael, The Search for Value, 1994, p. 39, citing Chatfield, Hein and Moyer (1990), VanderWeide and Carleton (1987-1988), and Brown and Rozeff (1978, 1979-1980).
[16] CUB Exhibit 1.0, pp. 41-44.

from its customer for that service.[17] If a utility is authorized an appropriate working capital allowance, by definition, it will receive cash to pay for all costs of service as they come due. Consequently, if one assumes an appropriate working capital allowance is authorized, Mr. Thomas' argument is invalid because the working capital allowance will eliminate any surplus or deficit in earnings created by the timing of the utility's cash collections and disbursements. Since utility companies pay cash flows (i.e., dividends) over the course of a year and not all at the end of the year, use of a quarterly DCF model is not only appropriate for rate setting purposes, it is necessary for a utility to recover its true cost of common equity. In fact, the Commission has explicitly rejected the use of an annual DCF model in previous proceedings.[18]

Q. Mr. Thomas claims that a paper by Gregory L. Nagel et al. ("the Nagel paper") "rejects the version of the CAPM traditionally used by the Commission."[19] Please respond.

A. The Nagel paper did not evaluate and, thus, did not reject the version of the CAPM traditionally used by the Commission. Specifically, the Nagel paper does not apply to Staff's CAPM because it does not evaluate a CAPM that utilizes adjusted betas. Rather, the Nagel paper found that a CAPM using raw betas was less accurate in predicting realized rates of return than a naïve model that assumes the same cost of equity, equal to the risk-free rate plus a risk premium,

[17] Hahne and Aliff, Accounting for Public Utilities, Mathew Bender, 1991, p. 5-2.

[18] Order, Docket No. 94-0065, January 9, 1995, p. 93 citing Order, Docket No. 87-0032 et al., January 20, 1988, p. 36 and Order, Docket No. 83-0537, p. 34.

[19] CUB Exhibit 1.0, p. 8, lines 145-146.

applies to all stocks (i.e., all betas equal 1.0).[20] Ironically, after asserting that the CAPM can only be used if the Commission "carefully selects the appropriate beta," Mr. Thomas recommended use of raw betas in the CAPM analysis he presented as a check of his DCF analysis, despite his own sources' explicit rejection of such an approach.

Q. Mr. Thomas claims that betas should not be adjusted for reversion to a market mean of 1.0.[21] Please comment.

A. The beta parameter is generally derived from historical data, but, in theory, should be a forward-looking number. Thus, I adjusted the raw (i.e., historical) betas for the companies in my samples to improve the accuracy of my beta estimates. The Armitage text Mr. Thomas cites with regard to this argument notes that studies have shown that such adjustments result in appreciably better forecasts, finding that the reduction in both bias and inefficiency is greater the further away from one the beta in question is.[22] Armitage states that the observed flatness of the Securities Market Line is due to two factors: 1) error in the estimation of true betas (i.e., the further above (or below) the mean an observed beta is, the more likely it is that the estimate error is positive (or negative)) and 2) regression toward the mean (i.e., moderation in risk over time).[23]

[20] Gregory L. Nagle, David R. Peterson, and Robert S. Prati, The Effect of Risk Factors on Cost of Equity Estimation, Quarterly Journal of Business and Economics, Vol. 46 No. 1, p. 67.
[21] CUB Exhibit 1.0, pp. 13-18.
[22] Armitage, S., The Cost of Capital: Intermediate Theory, 2005, pp. 284-285.
[23] Armitage, S., The Cost of Capital: Intermediate Theory, 2005, p. 283.

Q. Mr. Thomas claims that the assumption of a mean reversion makes little sense for utilities with betas below 1.0, citing a study by Gombola and Kahl.[24] Do you agree with Mr. Thomas' conclusion that use of an adjusted beta for utilities with betas below 1.0 is wrong?

A. Mr. Thomas cites the Gombola and Kahl article and notes that they suggest that utility betas actually revert to a utility average beta rather than the market mean of 1.0. However, the derivation of the true industry mean beta is problematic. Not only is any estimate of the true industry portfolio beta mean dubious, as betas change over time, but, as noted above, the farther below the market mean a raw beta is, the more likely its estimate error is to be negative. Thus, the average of a portfolio of low betas, each of which is likely to be biased downward, will, itself, likely be biased downward. Regardless, as noted previously, Mr. Thomas' proposal to ignore beta reversion altogether and use an unadjusted beta was explicitly rejected in the Nagel paper he cites.

Q. Mr. Thomas presents academic research indicating that the proper expected common equity market risk premium for determining the investor-required rate of return is between 3 and 5%. Do you agree?

A. No. The research cited by Mr. Thomas represents various academics' opinions of the common equity risk premium investors should expect, which is not necessarily the same as what the investors truly are expecting. Since the relationship between the returns of the stock market and U.S. Treasury bonds is not stable over time, current returns provide the best indication of what investors

[24] CUB Exhibit 1.0, pp. 18-22.

are expecting going forward. Hence, my estimate of the common equity risk premium, derived by subtracting the current yield on long-term U.S. Treasury bonds from the required return on the S&P 500 provides the actual difference between returns on risk-free and risky securities that exists in today's market.

Response to Mr. Gorman

Q. Please evaluate Mr. Gorman's cost of common equity analyses.

A. Mr. Gorman used four models to estimate the cost of common equity for the Ameren Illinois Utilities: (1) a constant-growth DCF model; (2) a two-stage growth DCF model; (3) a Risk Premium model; and (4) a CAPM. He applied these models to a proxy group of electric utilities that he developed and to Ms. McShane's electric sample. Mr. Gorman improperly relied on historical data to implement all four of his models. As stated in my direct testimony, the Commission has consistently ruled against use of historical data in cost of equity models.[25]

Q. Are there any problems with Mr. Gorman's DCF analyses?

A. Yes. For his stock price, Mr. Gorman used the average of weekly high and low stock prices over a 13-week period ended February 22, 2008. Mr. Gorman states "an average stock price is less susceptible to market price variations than is a spot price."[26] However, only the most recent stock price can reflect the most current information available to the market. Hence, average stock prices reflect information that may no longer be relevant to investors. Since the investor-

[25] ICC Staff Exhibit 5.0, pp. 36-40.
[26] IIEC Exhibit 2.0, p. 17.

required rate of return is a forward-looking concept, the most recently available market information should be relied on.

Q. Please describe Mr. Gorman's Bond Yield plus Rick Premium model.

A. Mr. Gorman's Bond Yield plus Risk Premium model is based on two estimates of an equity risk premium over the period 1986 through June 2007. First, he estimated the difference between the regulatory commission-authorized rate of return on common equity for electric utilities and U.S. Treasury Bonds. His estimated equity risk premium of authorized electric utility common equity returns over U.S. Treasury bond yields ranged from 4.4% to 5.9%. He then added the projected 30-year U.S. Treasury bond yield of 4.6% and estimated the cost of equity for the Ameren Illinois Utilities in the range of 9.0% to 10.5%, with a midpoint of 9.8%.

Mr. Gorman's second equity risk premium is based on the difference between the regulatory commission-authorized rate of return on common equity for electric utilities and contemporary A-rated utility bond yields. The equity risk premium estimate based on the spread between authorized electric utility common equity return and Moody's A-rated utility bond yields ranged from 3.0% to 4.4% over the period 1986 through June 2007. He then added the current 13-week average yield on Baa rated utility bonds of 6.7%, which produced a cost of equity in the range of 9.8% to 10.9%, with a midpoint of 10.2%.

Q. Is Mr. Gorman's Bond Yield plus Rick Premium model appropriate for estimating the cost of equity of the Ameren Illinois Utilities?

A. No. Mr. Gorman utilized historical data to estimate the risk premium in this model, which, as stated above, is improper. Like interest rates and stock prices, risk premiums are volatile. It is not appropriate to estimate the cost of common equity by adding the current cost of debt to a risk premium based on the spread between bonds and stocks experienced in the past. The relative risks of debt and equity change over time. In addition, the results of his analysis are highly susceptible to the time period used. Current risk premiums should be matched with current interest rates to estimate the expected risk premium in establishing the investor-required rate of return on common equity.[27]

Q. How did Mr. Gorman calculate the market risk premium for his CAPM analysis?

A. Mr. Gorman derived two market premium estimates. First, he estimated the expected return on the S&P 500 by adding an expected inflation rate of 2.3% to the 9.1% long-term historical arithmetic average real return on the market over the period 1926-2006. He then subtracted the projected yield on U.S. Treasury bonds of 4.6% to determine the 7.0% market premium.

He also provided a historical estimate of the market risk premium by calculating the difference between the arithmetic average of the achieved total return on the S&P 500 of 12.3% and the total return on long-term Treasury bonds of 5.8% over the period 1926-2006, or 6.5%.

Q. Do you agree with Mr. Gorman's estimates of the market risk premium?

[27] Eugene Brigham, Dilip Shome and Steve Vinson, *The Risk Premium Approach to Measuring a Utility's Cost of Equity*, Financial Management, Spring 1985.

A. No. Both of his market risk premium estimates were derived based on historical returns on the S&P 500. As stated in my direct testimony, the past relationship between two investments, such as common equity and debt, is unlikely to remain constant.[28] Historical earned returns are questionable estimates of the required rate of return that are susceptible to manipulation and could result in a distorted cost of common equity estimate. The Commission has consistently rejected use of historical data in determining the market risk premium in setting the investor-required rate of return on common equity, and should do so once again in this proceeding.[29]

Q. Does this conclude your prepared rebuttal testimony?

A. Yes, it does.

[28] ICC Staff Exhibit 5.0, p. 38.
[29] ICC Staff Exhibit 5.0, p. 39.

Central Illinois Light Company
Central Illinois Public Service
Illinois Power Company

Ratios

Components

Funds Available to Shareholders = (Weighted Cost of Equity + Weighted Cost of Preferred Stock) x Rate Base

Non-Cash Items = Depreciation & Amortization + Deferred Taxes and Investment Tax Credits

Funds From Operations = Funds Available to Shareholders + Non-Cash Items

Interest = (Weighted Cost of Short-term Debt + Weighted Cost of TFTN + Weighted Cost of Long-term Debt) x Rate Base

Total Debt = (Short-term Debt Ratio + TFTN Ratio + Long-term Debt Ratio) x Rate Base

Ratios

Funds From Operations / Interest Coverage = (Funds From Operations + Interest) ÷ Interest

Funds From Operations / Debt = Funds From Operations ÷ Total Debt

Central Illinois Light Company

Electric Utility

Components

Staff's Proposed Rate Base =	$228,980
Funds Available to Shareholders =	(4.86% + 0.41%) x $228,980 = $12,069
Non-Cash Items =	$18,244
Funds From Operations =	$12,069 + $18,244 = $30,313
Interest =	(0.70% + 1.96%) x $228,980 = $6,097
Total Debt =	(17.29% + 29.54%) x $228,980 = $107,231

Ratios

Funds From Operations / Interest Coverage =	($30,313 + $6,097) ÷ $6,097 = **6.0X**
Funds From Operations / Debt =	$30,313 ÷ $107,231 = **28%**

Central Illinois Public Service

Electric Utility

Components

Staff's Proposed Rate Base = $440,637

Funds Available to Shareholders = (5.02% + 0.23%) x $440,637 = $23,145

Non-Cash Items = $48,372 + -$6,764 = $41,608

Funds From Operations = $23,145 + $41,608 = $64,753

Interest = (0.28% + 2.60%) x $440,637 = $12,688

Total Debt = (7.03% + 41.43%) x $440,637 = $213,533

Ratios

Funds From Operations / Interest Coverage = ($64,753 + $12,688) ÷ $12,688 = **6.1X**

Funds From Operations / Debt = $64,753 ÷ $213,533 = **30%**

Illinois Power Company

Electric Utility

Components

Staff's Proposed Rate Base = $1,234,032

Funds Available to Shareholders = (5.51% + 0.11%) x $1,234,032 = $69,379

Non-Cash Items = $78,372 + $34,585 = $112,957

Funds From Operations = $69,379 + $112,957 = $182,336

Interest = (0.16% + 0.40% + 2.50%) x $1,234,032 = $37,717

Total Debt = (3.96% + 8.22% + 34.01%) x $1,234,032 = $569,999

Ratios

Funds From Operations / Interest Coverage = ($182,336 + $37,717) ÷ $37,717 = **5.8X**

Funds From Operations / Debt = $182,336 ÷ $569,999 = **32%**

Central Illinois Light Company

Gas Utility

Components

Staff's Proposed Rate Base = $171,354

Funds Available to Shareholders = (4.88% + 0.41%) x $171,354 = $9,063

Non-Cash Items = $7,525

Funds From Operations = $9,063 + $7,525 = $16,588

Interest = (0.70% + 1.96%) X $171,354 = $4,563

Total Debt = (17.29% + 29.54%) x $171,354 = $80,245

Ratios

Funds From Operations / Interest Coverage = ($16,588 + $4,563) ÷ $4,563 = **4.6X**

Funds From Operations / Debt = $16,588 ÷ $80,245 = **21%**

Central Illinois Public Service

Gas Utility

Components

Staff's Proposed Rate Base = $175,352

Funds Available to Shareholders = (5.04% + 0.23%) x $175,352 = $9,244

Non-Cash Items = $7,702 + -$1,097 = $6,605

Funds From Operations = $9,244 + $6,605 = $15,849

Interest = (0.28% + 2.60%) x $175,352 = $5,049

Total Debt = (7.03% + 41.43%) x $175,352 = $84,976

Ratios

Funds From Operations / Interest Coverage = ($15,849 + $5,049) ÷ $5,049 = **4.1X**

Funds From Operations / Debt = $15,849 ÷ $84,976 = **19%**

Illinois Power Company

Gas Utility

Components

Staff's Proposed Rate Base = $475,825

Funds Available to Shareholders = (5.53% + 0.11%) x $475,825 = $26,849

Non-Cash Items = $24,063 + $484 = $24,547

Funds From Operations = $26,849 + $24,547 = $51,396

Interest = (0.16% + 0.40% + 2.50%) x $475,825 = $14,543

Total Debt = (3.96% + 8.22% + 34.01%) x $475,825 = $219,784

Ratios

Funds From Operations / Interest Coverage = ($51,396 + $14,543) ÷ $14,543 = **4.5X**

Funds From Operations / Debt = $51,396 ÷ $219,784 = **23%**

Central Illinois Light Company
Central Illinois Public Service
Illinois Power Company

Gas Sample

Growth Rate Estimates

Company	Growth Rates Stage 1[1]	Stage 2[2]	Stage 3[3]
AGL Resources	4.75%	4.83%	4.91%
Atmos Energy	5.83%	5.37%	4.91%
Nicor Inc.	5.67%	5.29%	4.91%
New Jersey Resources	7.33%	6.12%	4.91%
Northwest Natural Gas	6.20%	5.56%	4.91%
Piedmont Natural Gas	6.00%	5.46%	4.91%
South Jersey Industries	7.88%	6.40%	4.91%
WGL Holdings	6.33%	5.62%	4.91%

[1] Zacks 3-5 year earnings per share growth rate estimate (Zacks Investment Research, Inc.)
[2] Equals the average of Stage 1 and Stage 3 growth rates.
[3] The implied 20-year forward U.S. Treasury rate in ten years ($_{20}f_{10}$), based on the 10- and 30-year U.S. Treasury rates as of April 30, 2008. (The Federal Reserve Board, Federal Reserve Statistical Release: Selected Interest Rates, H.15 Daily Update, http://www.federalreserve.gov/releases/H15/update/, May 1, 2008.)

Central Illinois Light Company
Central Illinois Public Service
Illinois Power Company

Electric Sample

Growth Rate Estimates

	Growth Rates		
Company	Stage 1[1]	Stage 2[2]	Stage 3[3]
American Electric Power	5.40%	5.16%	4.91%
Consolidated Edison	3.17%	4.04%	4.91%
Entergy	13.25%	9.08%	4.91%
IDACORP	6.00%	5.46%	4.91%
NSTAR	6.20%	5.56%	4.91%
Northeast Utilities	10.00%	7.46%	4.91%
Pinnacle West Capital Corp.	6.67%	5.79%	4.91%
Progress Energy	4.57%	4.74%	4.91%
Southern Co.	4.71%	4.81%	4.91%
Westar Energy	5.00%	4.96%	4.91%
Wisconsin Energy	9.40%	7.16%	4.91%
Xcel Energy	5.20%	5.06%	4.91%

[1] Zacks 3-5 year earnings per share growth rate estimate (Zacks Investment Research, Inc.)
[2] Equals the average of Stage 1 and Stage 3 growth rates.
[3] The implied 20-year forward U.S. Treasury rate in ten years (${}_{20}f_{10}$), based on the 10- and 30-year U.S. Treasury rates as of April 30, 2008. (The Federal Reserve Board, Federal Reserve Statistical Release: Selected Interest Rates, H.15 Daily Update, http://www.federalreserve.gov/releases/H15/update/, May 1, 2008.)

Central Illinois Light Company
Central Illinois Public Service
Illinois Power Company

Gas Sample

Prices and Dividends

	Company	Current Dividend $D_{0,1}$	$D_{0,2}$	$D_{0,3}$	$D_{0,4}$	Next Dividend (D1) Payment Date	4/30/2008 Stock Price
1	AGL Resources	$ 0.410	$ 0.410	$ 0.410	$ 0.420	6/1/2008	$ 34.00
2	Atmos Energy	0.320	0.320	0.325	0.325	6/10/2008	$ 27.68
3	Nicor Inc.	0.465	0.465	0.465	0.465	8/1/2008	$ 35.12
4	New Jersey Resources	0.253	0.253	0.267	0.280	7/1/2008	$ 31.85
5	Northwest Natural Gas	0.355	0.375	0.375	0.375	8/15/2008	$ 44.87
6	Piedmont Natural Gas	0.250	0.250	0.250	0.260	7/15/2008	$ 26.29
7	South Jersey Industries	0.245	0.245	0.270	0.270	7/2/2008	$ 36.51
8	WGL Holdings	0.343	0.343	0.343	0.355	8/1/2008	$ 32.80

Central Illinois Light Company
Central Illinois Public Service
Illinois Power Company

Electric Sample

Prices and Dividends

	Company	Current Dividend $D_{0,1}$	Current Dividend $D_{0,2}$	Current Dividend $D_{0,3}$	Current Dividend $D_{0,4}$	Next Dividend (D1) Payment Date	4/30/2008 Stock Price
1	American Electric Power	$ 0.390	$ 0.390	$ 0.410	$ 0.410	6/10/2008	$ 44.63
2	Consolidated Edison	0.580	0.580	0.580	0.585	6/15/2008	$ 41.60
3	Entergy	0.540	0.750	0.750	0.750	6/2/2008	$ 114.86
4	IDACORP	0.300	0.300	0.300	0.300	5/30/2008	$ 32.44
5	NSTAR	0.325	0.325	0.350	0.350	8/1/2008	$ 32.21
6	Northeast Utilities	0.188	0.200	0.200	0.200	6/30/2008	$ 26.32
7	Pinnacle West Capital Corp.	0.525	0.525	0.525	0.525	9/2/2008	$ 33.94
8	Progress Energy	0.610	0.610	0.615	0.615	8/1/2008	$ 41.99
9	Southern Co.	0.403	0.403	0.403	0.403	6/6/2008	$ 37.23
10	Westar Energy	0.270	0.270	0.270	0.290	7/1/2008	$ 23.19
11	Wisconsin Energy	0.250	0.250	0.250	0.270	6/1/2008	$ 47.46
12	Xcel Energy	0.230	0.230	0.230	0.230	7/20/2008	$ 20.80

Central Illinois Light Company
Central Illinois Public Service
Illinois Power Company

Gas Sample

Expected Quarterly Dividends

Company	$D_{1,1}$	$D_{1,2}$	$D_{1,3}$	$D_{1,4}$
AGL Resources	$ 0.420	$ 0.420	$ 0.420	$ 0.440
Atmos Energy	0.325	0.325	0.344	0.344
Nicor Inc.	0.465	0.491	0.491	0.491
NJ Resources	0.280	0.280	0.287	0.301
Northwest Natural Gas	0.375	0.398	0.398	0.398
Piedmont Natural Gas	0.260	0.260	0.260	0.276
South Jersey Industries	0.270	0.270	0.291	0.291
WGL Holdings	0.355	0.355	0.355	0.377

Central Illinois Light Company
Central Illinois Public Service
Illinois Power Company

Electric Sample

Expected Quarterly Dividends

Company	$D_{1,1}$	$D_{1,2}$	$D_{1,3}$	$D_{1,4}$
American Electric Power	$ 0.410	$ 0.410	$ 0.432	$ 0.432
Consolidated Edison	0.585	0.585	0.585	0.604
Entergy	0.750	0.849	0.849	0.849
IDACORP	0.300	0.318	0.318	0.318
NSTAR	0.350	0.350	0.372	0.372
Northeast Utilities	0.200	0.220	0.220	0.220
Pinnacle West Capital Corp.	0.560	0.560	0.560	0.560
Progress Energy	0.615	0.615	0.643	0.643
Southern Co.	0.420	0.420	0.420	0.420
Westar Energy	0.290	0.290	0.290	0.305
Wisconsin Energy	0.270	0.270	0.270	0.295
Xcel Energy	0.242	0.242	0.242	0.242

Central Illinois Light Company
Central Illinois Public Service
Illinois Power Company

Gas Sample

DCF Cost of Common Equity Estimates

Company	Estimate
AGL Resources	10.13%
Atmos Energy	10.25%
Nicor Inc.	10.87%
NJ Resources	9.20%
Northwest Natural Gas	8.77%
Piedmont Natural Gas	9.35%
South Jersey Industries	8.69%
WGL Holdings	9.84%
Average	9.64%

Central Illinois Light Company
Central Illinois Public Service
Illinois Power Company

Electric Sample

DCF Cost of Common Equity Estimates

Company	Estimate
American Electric Power	8.96%
Consolidated Edison	10.32%
Entergy	9.60%
IDACORP	9.21%
NSTAR	9.89%
Northeast Utilities	9.38%
Pinnacle West Capital Corp.	12.32%
Progress Energy	11.03%
Southern Co.	9.61%
Westar Energy	10.23%
Wisconsin Energy	8.09%
Xcel Energy	9.82%
Average	9.87%

Docket Nos. 07-0585 - 07-0590 (Cons.)
ICC Staff Exhibit 5.0
Schedule 17.07

Central Illinois Light Company
Central Illinois Public Service
Illinois Power Company

Risk Premium Analysis

Interest Rates as of April 30, 2008

U.S. Treasury Bills		U.S. Treasury Bonds	
Discount Rate	Effective Yield	Equivalent Yield	Effective Yield
1.15%	1.17%	4.49%	4.54%

Risk Premium Cost of Equity Estimates*
Gas Sample

Risk-Free Rate		Beta		Risk Premium		Cost of Common Equity
4.54%	+	0.80	*	(13.63% - 4.54%)	=	11.81%

Risk Premium Cost of Equity Estimates*
Electric Sample

Risk-Free Rate		Beta		Risk Premium		Cost of Common Equity
4.54%	+	0.79	*	(13.63% - 4.54%)	=	11.72%

*Risk-Free Rate Proxy is the U.S. Treasury Bond Yield.

Central Illinois Light Company

Electric Utility

Components

Staff's Proposed Rate Base = $228,980

Funds Available to Shareholders = (4.70% + 0.41%) x $228,980 = $11,694

Non-Cash Items = $18,244

Funds From Operations = $11,694 + $18,244 = $29,938

Interest = (0.68% + 1.96%) x $228,980 = $6,048

Total Debt = (17.29% + 29.54%) x $228,980 = $107,231

Ratios

Funds From Operations / Interest Coverage = ($29,938 + $6,048) ÷ $6,048 = **6.0X**

Funds From Operations / Debt = $29,938 ÷ $107,231 = **28%**

Central Illinois Public Service

Electric Utility

Components

Staff's Proposed Rate Base = $440,637

Funds Available to Shareholders = (4.85% + 0.23%) x $440,637 = $22,400

Non-Cash Items = $48,372 + -$6,764 = $41,608

Funds From Operations = $22,400 + $41,608 = $64,008

Interest = (0.28% + 2.59%) x $440,637 = $12,606

Total Debt = (7.03% + 41.43%) x $440,637 = $213,533

Ratios

Funds From Operations / Interest Coverage = ($64,008 + $12,606) ÷ $12,606 = **6.1X**

Funds From Operations / Debt = $64,008 ÷ $213,533 = **30%**

Illinois Power Company

Electric Utility

Components

Staff's Proposed Rate Base = $1,234,032

Funds Available to Shareholders = (5.33% + 0.11%) x $1,234,032 = $67,087

Non-Cash Items = $78,372 + $34,585 = $112,957

Funds From Operations = $67,087 + $112,957 = $180,044

Interest = (0.15% + 0.40% + 2.70%) x $1,234,032 = $40,142

Total Debt = (3.96% + 8.22% + 34.01%) x $1,234,032 = $569,999

Ratios

Funds From Operations / Interest Coverage = ($180,044 + $40,142) ÷ $40,142 = **5.5X**

Funds From Operations / Debt = $180,044 ÷ $569,999 = **32%**

Central Illinois Light Company

Gas Utility

Components

Staff's Proposed Rate Base = $171,354

Funds Available to Shareholders = (4.89% + 0.41%) x $171,354 = $9,071

Non-Cash Items = $7,525

Funds From Operations = $9,071 + $7,525 = $16,596

Interest = (0.68% + 1.96%) X $171,354 = $4,526

Total Debt = (17.29% + 29.54%) x $171,354 = $80,245

Ratios

Funds From Operations / Interest Coverage = ($16,596 + $4,526) ÷ $4,526 = **4.7X**

Funds From Operations / Debt = $16,596 ÷ $80,245 = **21%**

Central Illinois Public Service

Gas Utility

Components

Staff's Proposed Rate Base = $175,352

Funds Available to Shareholders = (5.04% + 0.23%) x $175,352 = $9,252

Non-Cash Items = $7,702 + -$1,097 = $6,605

Funds From Operations = $9,252 + $6,605 = $15,857

Interest = (0.28% + 2.59%) x $175,352 = $5,016

Total Debt = (7.03% + 41.43%) x $175,352 = $84,976

Ratios

Funds From Operations / Interest Coverage = ($15,857 + $5,016) ÷ $5,016 = **4.2X**

Funds From Operations / Debt = $15,857 ÷ $84,976 = **19%**

Illinois Power Company

Gas Utility

Components

Staff's Proposed Rate Base = $475,825

Funds Available to Shareholders = (5.54% + 0.11%) x $475,825 = $26,874

Non-Cash Items = $24,063 + $484 = $24,547

Funds From Operations = $26,874 + $24,547 = $51,421

Interest = (0.15% + 0.40% + 2.70%) x $475,825 = $15,478

Total Debt = (3.96% + 8.22% + 34.01%) x $475,825 = $219,784

Ratios

Funds From Operations / Interest Coverage = ($51,421 + $15,478) ÷ $15,478 = **4.3X**

Funds From Operations / Debt = $51,421 ÷ $219,784 = **23%**

Central Illinois Light Company
Central Illinois Public Service
Illinois Power Company

Reuters Corporate Spreads for Utilities

April 30, 3008

Ratings	30-year
Aaa/AAA	104
Aa1/AA+	155
Aa2/AA	155
Aa3/AA-	180
A1/A+	168
A2/A	191
A3/A-	202
Baa1/BBB+	216
Baa2/BBB	238
Baa3/BBB-	243
Ba1/BB+	325
Ba2/BB	390
Ba3/BB-	410