# ILLINOIS COMMERCE COMMISSION

## DOCKET 01-___

## PREPARED JOINT DIRECT TESTIMONY OF

## BRENDA FREEMAN AND TOM BRAMSCHREIBER

Q1: Please state your names and business addresses.

A1: Brenda Freeman and my business address is 300 Liberty Street, Peoria, Illinois 61602.

Tom Bramschreiber and my business address is 1901 Butterfield Road, Suite 650, Downers Grove, Illinois 60515.

Q2: Ms. Freeman, by whom are you employed and in what position?

A2: I am presently employed as a Finance Team Member on the Finance and Administration Team of Central Illinois Light Company ("CILCO").

Q3: Mr. Bramschreiber, by whom are you employed and in what position.

A3: I am presently employed as a Project Director with AES Great Plains Inc., the business unit of AES where CILCO resides.

Q4: Ms. Freeman, please describe your educational background and business experience.

A4: I hold a Bachelor of Science degree in Accounting and a Masters of Business Administration degree from Bradley University. I have been employed by CILCO since 1991. My work experience at CILCO includes positions in accounting, tax, treasury, and investments and finance. I have worked on the Finance and Administration Team since 1999.

Q5: Mr. Bramschreiber, please describe your educational background and business experience.

A5: I hold a Bachelor of Science degree in Finance from Bowling Green State University and a Masters of Business Administration degree in Finance from DePaul University. I have been employed by AES, in various business units, since 1999. From 1994 to 1998, I was employed by MidCon Corp., a subsidiary of Occidental Petroleum and later KN Energy, where I held various positions in retail and wholesale energy marketing, supply procurement, and product development and planning. From 1984 to 1994, I was employed by The Peoples Gas, Light & Coke Company, a subsidiary of Peoples Energy, in various gas supply planning and regulatory affairs positions.

Q6: In addition to your joint direct testimony, CILCO Appendix N, are you sponsoring any other exhibits?

A6: Yes, we are sponsoring the following five exhibits, which were prepared under our direction and control: CILCO Appendix N-2 (Treasury Bond Yields and CILCO Historical Returns), CILCO Appendix N-3 (Financial Projections Under A No Customer Switching Scenario), CILCO Appendix N-4 (Financial Projections Under A Customer Switching Scenario - - As Filed Delivery Services Rates), CILCO Appendix N-5 (Financial Projections Under A Customer Switching Scenario - - Existing Delivery Services Rates), and CILCO Appendix N-6 (Financial Projections Under A Customer Hyper-Switching Scenario - - Existing Delivery Services Rates).

Q7: What is the purpose of your joint direct testimony in this proceeding?

A7: The purpose of our joint direct testimony is to present projections of CILCO's earned rates of return on common equity ("ROE"), for the years 2002 through 2004, calculated in accordance with Section 16-111(d) of the Illinois Public Utilities Act ("Act"). As required by Section 16-111(g)(vi) of the Act, we will demonstrate that CILCO's earned rate of return on common equity, as a result of the transfer of CILCO's generation assets to Central Illinois Generation, Inc. ("CIGI"), a wholly owned non-utility subsidiary of CILCO, will not produce a strong likelihood of the need for a rate increase under Section 16-111(d) of the Act.

Q8: Please describe the requirements for an electric base rate increase under Section 16-111(d) of the Act.

A8: It is our understanding that Section 16-111(d) of the Act permits an electric utility to request an increase in its base rates during the mandatory transition period, which extends through 2004, if its two-year average return on common equity falls below the average return on 30-year U.S. Treasury bonds for the same two year period. The calculation of earned rate of return on common equity specified in Section 16-111(d) states:

> . . . . an electric utility may request an increase in its base rates if the electric utility demonstrates that the 2-year average of its earned rate of return on common equity, calculated as its net income applicable to common stock divided by the average of its beginning and ending balances of common equity using data reported in the electric utility's Form 1 report to the Federal Energy Regulatory Commission but adjusted to remove the effects of accelerated depreciation or amortization or other transition or mitigation measures implemented by the electric utility pursuant to subsection (g) of this Section, is below the 2-year average for the same 2 years of the monthly average yields of 30-year U.S. Treasury

> bonds published by the Board of Governors of the Federal Reserve System in its weekly H.15 Statistical Release or successor publication.

This is a historical calculation of the two-year average earned ROE as reported in the electric utility's Form 1 report to the Federal Energy Regulatory Commission ("FERC") and compared to the historical yields of 30-year U.S. Treasury bonds over the same two-year period.

Q9: Please describe the operational and financial projection requirements under Section 16-111(g)(vi) of the Act.

A9: It is our understanding that CILCO must show that the proposed transfer of generation assets under Section 16-111(g)(vi) of the Act (i) will not render the electric utility unable to provide its tariffed services in a safe and reliable manner, and (ii) that there is not a strong likelihood that consummation of the proposed transaction will result in the electric utility being entitled to request an increase in its electric base rates during the mandatory transition period pursuant to Section 16-111(d).

CILCO witness Robert Sprowls and Robert G. Ferlmann address the former requirement. With respect to the latter requirement, we have prepared projections of CILCO's two-year average returns on common equity through 2004, both with and without the proposed transfer, assuming no retail load loss to alternative generation providers ("No Customer Switching"). The results, when compared to projected average monthly yields of 30-year U.S. Treasury bonds, indicate that there is not a strong likelihood of the utility qualifying to request an increase in electric base rates during the mandatory transition period. In addition, although we believe the level of customer switching that may occur is not a function of whether or not the generation assets are transferred, we have prepared various projections of CILCO's two-year average returns on common equity through 2004, both with and without the proposed transfer, assuming an increasing level of annual retail load loss to alternative generation providers ("With Customer Switching"). These results, when compared to projected average monthly yields of 30-year U.S. Treasury bonds, also indicate that there is not a strong likelihood of the utility qualifying to request an increase in electric base rates during the mandatory transition period.

Q10: What were the average monthly yields of 30-year U.S. Treasury bonds for the most recent two calendar years?

A10: The average monthly yields of 30-year U.S. Treasury bonds for the twenty-four month period ending December 31, 2000, was 5.90%. This data is shown on Page 1 of CILCO Appendix N-2.

Q11: What are the projected average monthly yields of 30-year U.S. Treasury bonds which CILCO compared its financial projections?

A11: For conservative comparison purposes, CILCO relied on the current spot yield for 30-year U.S. Treasury bonds and the historical variability of bond yields. The spot yield for 30-year U.S. Treasury bonds on November 15, 2001, was 5.22%. To estimate historical variability of bond yields, CILCO calculated the standard deviation of two-year average monthly returns over the last decade to be 0.84%. The standard deviation is a statistical measure of how widely values are dispersed from the average value or mean.

Adding two statistical standard deviations, or 168 basis points, to the current spot bond yield of 5.22% produces a probability of approximately 95% that 30-year U.S. Treasury bond yields will be no higher than 6.90%. For conservative comparison purposes, CILCO has assumed 6.90% to be the projected average annual monthly yield of 30-year U.S. Treasury bonds. This data is shown on Page 2 of CILCO Appendix N-2. Treasury bond yields approaching such levels have not occurred since 1997.

Q12: What have CILCO's historical two-year average earned rates of return on common equity been?

A12: As reported in CILCO's FERC Form 1 report, the unadjusted two-year average rates of return on common equity have ranged from 8.74% to 14.14% over the last decade. The unadjusted two-year average return on common equity has exceeded the two-year average 30-year U.S. Treasury bond yield by a minimum of 300 basis points in every corresponding period, with an average difference of almost 500 basis points. The positive correlation between CILCO's earned rate of return on common equity and 30-year U.S. Treasury bond yields is shown on Page 3 of CILCO Appendix N-2.

Q13: What assumptions were used in developing CILCO's projected rate of return on common equity assuming no retail load loss to alternative generation providers?

A13: The key No Customer Switching assumptions which underlie the financial projections are set forth on Pages 1 - 3 of CILCO Appendix N-3.

Q14: What are the results of the comparison of the projected earned rates of return on common equity to the projected Treasury bond yields assuming no retail load loss to alternative generation providers?

A14: As shown on Page 8 of CILCO Appendix N-3, the projected earned rates of return on common equity through the mandatory transition period indicate that the transfer of generation assets will not affect CILCO's returns such that there is a strong likelihood that CILCO would be entitled to seek an increase in its electric base rates. In both No Customer Switching scenarios, the projected earned rates of return on common equity are well above the projected average annual monthly yields of 30-year U.S. Treasury bonds. This is shown on Page 4 of CILCO Appendix N-3, which assumes no transfer of generation assets, and on Page 8 of CILCO Appendix N-3, which assumes the transfer of generation assets.

Q15: What assumptions were used in developing CILCO's projected rate of return on common equity assuming retail load loss to alternative generation providers?

A15: The key With Customer Switching assumptions which underlie the financial projections are set forth on Pages 1 - 3 of CILCO Appendix N-4. To date, CILCO has not experienced any retail load loss to alternative generation providers. For purposes of this filing, however, we have developed financial projections assuming an increasing level of annual retail load loss to alternative generation providers (5% in 2002, 10% in 2003, and 15% in 2004).

As previously stated, we believe that the level of customer switching that may occur is not a function of whether or not the generation assets are transferred. As noted on the Illinois Commerce Commission's Website, customers may choose who supplies the generation portion of their electric service for a variety of reasons.

> Those [reasons] may include how or where the electricity is produced, economic or environmental support, the lowest price or total cost or the best combination of prices, services and incentives.

None of these reasons are affected or altered by the transfer of generation assets during the mandatory transition period. Commission approved bundled and delivery service rates do not change as a result of the transfer of generation assets. In terms of switching decisions, customers are indifferent to the transfer of generation assets.

Moreover, any financial impact to CILCO arising from customer switching, positive or negative, would occur regardless of the transfer of generation assets (i.e., difference between bundled service rates and delivery service rates plus any wholesale revenue from freed-up energy sales). CILCO is proposing to transfer substantially all of its generation assets to CIGI, a wholly owned non-utility subsidiary of CILCO. For purposes of calculating the earned rate of return on common equity under Section 16-111(d) of the Act, the earnings or losses of subsidiary companies are included in FERC Form 1 and are therefore reflected in the earned rate of return on common equity calculation. In essence, the net income and common equity of CILCO, as reported in FERC Form 1, will not be affected by the proposed transfer of generation assets.

Q16: What are the results of the comparison of the projected earned returns on common equity to the projected Treasury bond yields assuming an increasing level of annual load loss to alternative generation providers?

A16: As shown on Page 8 of CILCO Appendix N-4, the projected earned rates of return on common equity through the mandatory transition period indicate that the transfer of generation assets, even with an increasing level of annual load loss to alternative generation providers, will not affect CILCO's returns such that there is a strong likelihood that CILCO would be entitled to seek an increase in its electric base rates. In both With Customer Switching scenarios, the projected earned rates of return on common equity are well above the projected average annual monthly yields of 30-year U.S. Treasury bonds. This is shown on Page 4 of CILCO Appendix N-4, which assumes no transfer of generation assets, and on Page 8 of CILCO Appendix N-4, which assumes the transfer of generation assets.

Q17: Have you developed any other financial projections?

A17: Yes. The With Customer Switching financial projections shown in CILCO Exhibit N-4 incorporate delivery services revenues reflective of CILCO's recently filed tariffs in consolidated ICC Docket Nos. 01-0637, 01-0465, and 01-0530 ("As Filed Delivery Services Rates"). We have modified CILCO Exhibit N-4 to incorporate delivery services revenues reflective of CILCO's previously approved tariffs in consolidated ICC Docket Nos. 99-0119 and 99-0131 ("Existing Delivery Services Rates"). The financial projections shown in CILCO Exhibit N-5 are reflective of the previously approved delivery services rates.

In addition, we have further modified the With Customer Switching financial projections to reflect "hyper-switching". We believe that the level of switching reflected in the With Customer Switching financial projections are aggressive given existing bundled service rates (i.e., 5% in 2002, 10% in 2003, and 15% in 2004). Nonetheless, we have modified CILCO Exhibit N-5 to reflect even further annual loss of retail load to alternative generation providers (i.e., 10% in 2002, 20% in 2003, and 30% in 2004). The financial projections shown in CILCO Exhibit N-6 are reflective of the previously approved delivery services rates and an assumed *doubling* of annual retail load loss to alternative generation providers.

Q18: What is your conclusion?

A18: Based upon the projected earned rates of return on common equity under the various scenarios described above, the consummation of the proposed transaction will not result in CILCO being entitled to request an increase in its base rates during the mandatory transition period pursuant to Section 16-111(d) of the Act. Even under the most extreme "hyper-switching" scenario, CILCO's projected rate of return on common equity is at least two standard deviations above current 30-year U.S. Treasury bond yields. This indicates that there is not a strong likelihood that CILCO will qualify to request an increase in base rates during the mandatory transition period.

Q19: Does this conclude your joint direct testimony?

A19: Yes.

## STATE OF ILLINOIS

## ILLINOIS COMMERCE COMMISSION

| | | |
|---|---|---|
| Central Illinois Light Company | ) | |
| | ) | |
| Notice of transfer of generation assets to a | ) | |
| subsidiary and entry into various agreements | ) | Docket No. 01-________ |
| pursuant to Section 16-111(g) of the Illinois | ) | |
| Public Utilities Act. | ) | |

## AFFIDAVIT OF TOM BRAMSCHREIBER

Tom Bramschreiber, being first duly sworn on oath, deposes and states as follows:

1. I prepared and am familiar with the contents of Appendix N to CILCO's Notice of Transfer of Assets, which bears the title "Prepared Joint Direct Testimony of Brenda Freeman and Tom Bramschreiber." My answers to the questions appearing in said appendix are true and correct to the best of my knowledge and belief.

2. CILCO Appendices N-2, N-3, N-4, N-5 and N-6 were prepared under my direction and control and accurately portray what they purport to portray.

3. Further Affiant sayeth naught.

Tom Bramschreiber

Tom Bramschreiber

SUBSCRIBED AND SWORN TO BEFORE ME
THIS 21st DAY OF NOVEMBER, 2001

NOTARY PUBLIC

OFFICIAL SEAL
FRANK P LUCAFO
NOTARY PUBLIC, STATE OF ILLINOIS
MY COMMISSION EXPIRES:06/22/06

**STATE OF ILLINOIS**

**ILLINOIS COMMERCE COMMISSION**

| | | |
|---|---|---|
| Central Illinois Light Company | ) | |
| | ) | |
| Notice of transfer of generation assets to a subsidiary and entry into various agreements pursuant to Section 16-111(g) of the Illinois Public Utilities Act. | ) ) ) ) | Docket No. 01-_________ |

## AFFIDAVIT OF BRENDA FREEMAN

Brenda Freeman, being first duly sworn on oath, deposes and states as follows:

1. I prepared and am familiar with the contents of Appendix N to CILCO's Notice of Transfer of Assets, which bears the title "Prepared Joint Direct Testimony of Brenda Freeman and Tom Bramschreiber." My answers to the questions appearing in said appendix are true and correct to the best of my knowledge and belief.

2. CILCO Appendices N-2, N-3, N-4, N-5 and N-6 were prepared under my direction and control and accurately portray what they purport to portray.

3. Further Affiant sayeth naught.

Brenda Freeman

Brenda Freeman

SUBSCRIBED AND SWORN TO BEFORE ME
THIS 21st DAY OF NOVEMBER, 2001

Dana K. McNeil

NOTARY PUBLIC

"OFFICIAL SEAL"
DANA K. MCNEIL
COMMISSION EXPIRES 07/21/05

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# Average Yields 30-Year U.S. Treasury Bonds

## Published By Board of Governors of the Federal Reserve System

Source: http://www.federalreserve.gov/releases/H15/data/m/tcm30y.txt

| | 1999 | 2000 | 2001 |
|---|---|---|---|
| January | 5.16% | 6.63% | 5.54% |
| February | 5.37% | 6.23% | 5.45% |
| March | 5.58% | 6.05% | 5.34% |
| April | 5.55% | 5.85% | 5.65% |
| May | 5.81% | 6.15% | 5.78% |
| June | 6.04% | 5.93% | 5.67% |
| July | 5.98% | 5.85% | 5.61% |
| August | 6.07% | 5.72% | 5.48% |
| September | 6.07% | 5.83% | 5.48% |
| October | 6.26% | 5.80% | 5.32% |
| November | 6.15% | 5.78% | |
| December | 6.35% | 5.49% | |
| Two-Year Average Return | | **5.90%**<br>1999-2000 | **5.80%**<br>Last 24 Months |

# Average Yields 30-Year U.S. Treasury Bonds

**Published By Board of Governors of the Federal Reserve System**

Source: http://www.federalreserve.gov/releases/H15/data/m/tcm30y.txt

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| January | 8.26% | 8.27% | 7.58% | 7.34% | 6.29% | 7.85% | 6.05% | 6.83% | 5.81% | 5.16% | 6.63% | 5.54% |
| February | 8.50% | 8.03% | 7.85% | 7.09% | 6.49% | 7.61% | 6.24% | 6.69% | 5.89% | 5.37% | 6.23% | 5.45% |
| March | 8.56% | 8.29% | 7.97% | 6.82% | 6.91% | 7.45% | 6.60% | 6.93% | 5.95% | 5.58% | 6.05% | 5.34% |
| April | 8.76% | 8.21% | 7.96% | 6.85% | 7.27% | 7.36% | 6.79% | 7.09% | 5.92% | 5.55% | 5.85% | 5.65% |
| May | 8.73% | 8.27% | 7.89% | 6.92% | 7.41% | 6.95% | 6.93% | 6.94% | 5.93% | 5.81% | 6.15% | 5.78% |
| June | 8.46% | 8.47% | 7.84% | 6.81% | 7.40% | 6.57% | 7.06% | 6.77% | 5.70% | 6.04% | 5.93% | 5.67% |
| July | 8.50% | 8.45% | 7.60% | 6.63% | 7.58% | 6.72% | 7.03% | 6.51% | 5.68% | 5.98% | 5.85% | 5.61% |
| August | 8.86% | 8.14% | 7.39% | 6.32% | 7.49% | 6.86% | 6.84% | 6.58% | 5.54% | 6.07% | 5.72% | 5.48% |
| September | 9.03% | 7.95% | 7.34% | 6.00% | 7.71% | 6.55% | 7.03% | 6.50% | 5.20% | 6.07% | 5.83% | 5.48% |
| October | 8.86% | 7.93% | 7.53% | 5.94% | 7.94% | 6.37% | 6.81% | 6.33% | 5.01% | 6.26% | 5.80% | 5.32% |
| November | 8.54% | 7.92% | 7.61% | 6.21% | 8.08% | 6.26% | 6.48% | 6.11% | 5.25% | 6.15% | 5.78% | |
| December | 8.24% | 7.70% | 7.44% | 6.25% | 7.87% | 6.06% | 6.55% | 5.99% | 5.06% | 6.35% | 5.49% | |
| Two-Year Average Return | | 8.37% | 7.90% | 7.13% | 6.98% | 7.13% | 6.79% | 6.65% | 6.09% | 5.72% | 5.90% | |

| | |
|---|---|
| Standard Deviation Two-Year Average Return | 0.84% |
| Spot Yield on November 15, 2001 | 5.22% |
| Spot Yield Plus Two Standard Deviations | **6.90%** |

# Central Illinois Light Company (CILCO)
## Return on Equity Versus 30-Year U.S. Treasury Bond Yields

| | | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **FERC Form 1 Data (NO Adjustments)** | | | | | | | | | | | | | |
| Net Income | *pg. 117, line 72* | 44,431 | 40,966 | 44,231 | 35,636 | 37,678 | 32,487 | 42,398 | 45,129 | 53,467 | 44,235 | 19,250 | 47,777 |
| Less: Preferred Dividends | *pg. 118, line 29* | (4,441) | (4,441) | (4,441) | (4,441) | (4,043) | (2,980) | (3,299) | (3,188) | (3,216) | (3,194) | (3,188) | (2,977) |
| Net Income Available to Common | | 39,990 | 36,525 | 39,790 | 31,195 | 33,635 | 29,507 | 39,099 | 41,940 | 50,252 | 41,041 | 16,061 | 44,800 |
| Stockholders Equity | *pg. 112, line 14* | 344,600 | 349,486 | 343,307 | 342,715 | 360,427 | 373,907 | 392,597 | 388,411 | 398,863 | 386,252 | 400,286 | 393,171 |
| Less: Preferred Stock | *pg. 112, line 3* | 64,620 | 64,620 | 64,620 | 64,620 | 66,120 | 66,120 | 66,120 | 66,120 | 66,120 | 66,120 | 66,120 | 41,120 |
| Common Equity | | 279,979 | 284,865 | 278,686 | 278,094 | 294,307 | 307,787 | 326,477 | 322,291 | 332,743 | 320,132 | 334,166 | 352,051 |
| Average Common Equity | | | 282,422 | 281,776 | 278,390 | 286,201 | 301,047 | 317,132 | 324,384 | 327,517 | 326,438 | 327,149 | 343,109 |
| Return on Equity | | | 12.93% | 14.12% | 11.21% | 11.75% | 9.80% | 12.33% | 12.93% | 15.34% | 12.57% | 4.91% | 13.06% |
| Two-Year Average Return on Equity | | | | 13.53% | 12.67% | 11.48% | 10.78% | 11.07% | 12.63% | 14.14% | 13.96% | 8.74% | 8.99% |
| **30-Year U.S. Treasury Bond Yields** | | | | | | | | | | | | | |
| Two-Year Average T-Bond Yield | | | | 8.37% | 7.90% | 7.13% | 6.98% | 7.13% | 6.79% | 6.65% | 6.09% | 5.72% | 5.90% |
| **Difference** | | | | | | | | | | | | | |
| ROE Over T-Bonds | | | | 5.15% | 4.76% | 4.35% | 3.79% | 3.94% | 5.84% | 7.48% | 7.86% | 3.02% | 3.08% |

| **Statistics** | | |
|---|---|---|
| Average Difference | 4.93% | Average difference ROE over T-bonds. |
| Standard Deviation | 1.69% | Standard Deviation of average difference ROE over T-bonds. |
| Correlation Coefficient | 0.48 | Positive correlation (i.e., ROE and T-bond returns move together) |
| Plus 2 Standard Deviations | **8.31%** | 95% Confidence Interval that the two-year average ROE will be above the two-year |
| Minus 2 Standard Deviations | **1.55%** | T-bond yield by these amounts (i.e., ROE over T-bonds by 1.55% to 8.31%). |

Appendix N-3 contains confidential forecasted returns on common equity required by 220 ILCS 5/16-111(g). As a result, Appendix N-3 is being filed separately under seal.

Appendix N-4 contains confidential forecasted returns on common equity required by 220 ILCS 5/16-111(g). As a result, Appendix N-3 is being filed separately under seal.

Appendix N-5 contains confidential forecasted returns on common equity required by 220 ILCS 5/16-111(g). As a result, Appendix N-5 is being filed separately under seal.

Appendix N-6 contains confidential forecasted returns on common equity required by 220 ILCS 5/16-111(g). As a result, Appendix N-6 is being filed separately under seal.