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Issue(s): Capital Structure;  
AmerenUE's Access to  
Credit Markets  
Witness: Michael G. O'Bryan  
Sponsoring Party: Union Electric Company  
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**MISSOURI PUBLIC SERVICE COMMISSION**

**Case No. ER-2008-0318**

**REBUTTAL TESTIMONY**  
**OF**  
**MICHAEL G. O'BRYAN**  
**ON**  
**BEHALF OF**  
**UNION ELECTRIC COMPANY**  
**d/b/a AmerenUE**

St. Louis, Missouri  
October, 2008

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1           A.     No. AmerenUE needs an FAC to enhance its own credit profile. In fact, as  
2 part of AmerenUE's latest downgrade, Moody's Investors Service ("Moody's") cited the lack  
3 of an FAC along with higher operating and maintenance costs, increased capital spending  
4 requirements, limited rate relief and low returns as the cause of the rating action. In addition,  
5 Standard & Poor's Rating Services ("S&P") in its most recent AmerenUE report cited a  
6 challenging Missouri regulatory climate and the lack of an FAC along with higher capital  
7 expenditures as credit weaknesses. And just two weeks ago, S&P upgraded the Ameren  
8 Illinois utilities' ratings. Given this, it is preposterous to suggest that AmerenUE needs an  
9 FAC simply because of events that occurred in Illinois in recent years. It is quite apparent  
10 that AmerenUE faces its own significant credit challenges, including credit challenges that  
11 are contributed to because of its lack of an FAC.

12           **Q.     Do the Ameren Illinois utilities significantly affect AmerenUE's credit?**

13           A.     No, not at all with respect to Moody's ratings, and not much at all with respect  
14 to S&P's ratings. While it would be naïve to suggest that the past credit issues at the Ameren  
15 Illinois utilities posed no threat and had no effect on AmerenUE's credit standing, it should  
16 be pointed out that the current effects are minimal. The political and regulatory situation in  
17 Illinois has improved greatly as the recent S&P upgrades of the Ameren Illinois utilities will  
18 attest. The recent rate relief obtained by the Ameren Illinois utilities will further improve  
19 their situation, which will make any minimal current effects the Illinois situation could have  
20 had on S&P's ratings of AmerenUE even more de minimis. While it is impossible to measure  
21 with certainty the precise effect on AmerenUE's S&P ratings due to the Ameren Illinois  
22 utilities credit standing, one can compare AmerenUE's ratings at S&P and Moody's as an  
23 estimate, given the different methodologies that the two major rating agencies use to develop

1 their ratings. S&P uses a consolidated approach; thereby incorporating all the major  
2 subsidiaries' credit profiles to come to one (with some minor tweaks) consolidated "family"  
3 rating. This approach, therefore, would incorporate all of the Illinois affiliate credit profiles  
4 and issues into AmerenUE's credit ratings. Moody's, by contrast, rates entities based upon  
5 their own individual credit profiles. This approach then would strip out much, if not all, of  
6 the Illinois effects from AmerenUE's credit ratings.

7 **Q. What can comparing AmerenUE's credit ratings tell us?**

8 **A.** As I mentioned before, it would be impossible to draw any firm conclusions  
9 based on this comparison, however it can be reasonably concluded that any effects are  
10 modest. S&P's "consolidated" issuer rating for AmerenUE is "BBB-" while Moody's  
11 "independent" senior secured issuer rating is "Baa2". This investment grade one-notch  
12 difference suggests that the core credit profile for AmerenUE is not that much different from  
13 the credit profile when taking into consideration the credit effects from the Illinois  
14 subsidiaries. Further, it would be impossible to gauge S&P's view of AmerenUE's  
15 independent credit profile given their consolidated methodology—they may view it more or  
16 less favorably than Moody's. This further reduces the significance of this investment grade  
17 one-notch difference. The following table illustrates that this one-notch difference is minor:

18 [Table on Next Page]

19

**AmerenUE's Credit Ratings  
(Standard and Poor's vs. Moody's)**

|  | Standard and Poor's<br>Long-Term<br>Issuer Ratings | Moody's<br>Long-Term<br>Obligation Ratings |     |
|--|--|--|-----|
| Utilities Rarely<br>Rated in This<br>Range | AAA  | Aaa  | P-1 |
|  | AA+  | Aa1  |     |
|  | AA   | Aa2  |     |
|  | AA-  | Aa3  | P-2 |
|  | A+   | A1   |     |
|  | A  | A2   |     |
|  | A-   | A3   | P-3 |
|  | BBB+   | Baa1                                       |     |
|  | BBB  | Baa2                                       |     |
|  | BBB- AmerenUE                                      | Baa3 AmerenUE                              |     |
| <b>Junk Bond Status</b>                    |  |  |     |

Investment Grade

1

2

**Q. What conclusions can be drawn from this?**

3

4

A. First, circumstances in Illinois and AmerenUE's Illinois affiliates are not primary drivers of AmerenUE's current credit pressures. Second, as both rating agencies have pointed out very clearly, an FAC at AmerenUE would greatly benefit its credit, and unlike affiliate issues, would have a direct and undeniable effect on its credit standing.

7

**Q. Please explain how an FAC enhances AmerenUE's credit profile.**

8

9

A. An FAC enhances cash flow which would reduce both the need for AmerenUE to borrow and the level of borrowings that the Company would need to make. Also, implementing an FAC would enhance the Company's ratings which affects access to and the cost of short and long-term capital.

12

**Q. Please discuss the current conditions of the credit and capital markets.**

13

14

A. The U.S. corporate bond market has been effectively closed for five straight weeks to all but the best rated issuers. This means issuers such as AmerenUE cannot access

1 the capital market for long-term funding. For those companies fortunate to have any access,  
2 credit spreads (the incremental cost of debt above U.S. treasury yields) have widened  
3 dramatically. One example is IBM (rated A1/A+), which issued the week of October 6<sup>th</sup> at  
4 credit spreads as high as 400 basis points. Other issuers were forced to pre-market their  
5 issuances to gauge investor interest only to withdraw their issuances from the market due to  
6 tepid demand. Banks, both foreign and domestic, are under great stress from holding bad  
7 assets, forcing write-downs and compelling them to deleverage while seeking equity capital  
8 to bolster their balance sheets. Banks are refusing to lend to one another because they are  
9 afraid of the credit risk, which causes the LIBOR rate (the rate at which banks lend to one  
10 another) to spike. This is affecting the short-term interest rates that all issuers are paying  
11 since the majority of short-term funds are priced off of the LIBOR rate. Demand is also  
12 weak in the short-term markets forcing issuers fortunate enough to have commercial paper  
13 access to risk seeking funds on a daily basis. Those issuers who do not have commercial  
14 paper access must rely solely on the banks for short-term borrowing. Banks, as mentioned,  
15 are attempting to improve their own balance sheets and are not seeking to make new loans.

16 **Q. Does AmerenUE have access to commercial paper? Why or why not?**

17 **A.** No. Given AmerenUE's low commercial paper ratings (A-3/P-3) it does not  
18 have access to this source of short-term funding. Generally, short-term ratings of at least A-  
19 2/P-2 are necessary to have any reliable access to the commercial paper market. However,  
20 current markets dictate that only A-1/P-1 rated issuers have unfettered access to this market.  
21 The table above illustrates how the Moody's short-term commercial paper ratings correspond  
22 with the long-term ratings. One can conclude from the table that upgrades at both rating  
23 agencies would enhance AmerenUE's ability to access this market.

1           **Q.    How does this affect AmerenUE's short-term funding?**

2           A.    AmerenUE must seek short-term borrowing via the bank market only, relying  
3 on its existing credit facility for day-to-day funds. Commercial paper access, enjoyed by  
4 higher-rated entities, is preferable due to its same-day access to funds and its flexibility of  
5 tenor (ranging from overnight to 270 days) which makes cash management much more  
6 efficient. Alternatively, bank lending requires a three business day notice, restricts the  
7 number of loans outstanding at any point in time and is generally much more costly.

8           **Q.    How do the current conditions of the credit and capital markets add  
9 importance to implementation of an FAC for AmerenUE ?**

10          A.    AmerenUE's \$1.15 billion credit facility has been affected by the current  
11 crisis as one of the lenders that participates in AmerenUE's bank credit facilities is in  
12 bankruptcy, which places AmerenUE's ability to access \$100 million of the \$1.15 billion in  
13 question. This credit facility matures in 2010 and will be a focus next year as negotiations  
14 with the banks will begin to replace this facility. It is safe to assume given the current  
15 banking crisis, which is greatly affecting the banks' ability and willingness to lend, that many  
16 of the banks that are currently participating in this facility will not be interested in  
17 participating in a new facility. Also, given the current stress that the banks are under, a  
18 borrower's credit profile will be scrutinized perhaps more than it has ever been. Anything  
19 that enhances the Company's credit profile can only help when the banks decide to whom  
20 they lend their limited funds given their highly stressed balance sheets. Banks are operating  
21 in an extremely risk-averse manner and there is no way to tell if or when this will end.

22          **Q.    Is the current bank and credit crisis also affecting AmerenUE's ability to  
23 raise long-term debt?**



1           A.     Yes. Bank market stress will only compound the need for companies to seek  
2 long-term funding in the capital markets to relieve and keep within the constraints of their  
3 credit facilities while maximizing and reserving liquidity. In addition to negotiating with  
4 banks for a new credit facility, the Company will itself be attempting to issue bonds in 2009  
5 as short-term debt will need to be repaid and "termed out" on a long-term basis. As  
6 mentioned earlier in this testimony, current conditions are such that only the best rated  
7 issuers are able to issue long-term debt, meaning that there is a very large and growing  
8 "backlog" of companies that need to issue long-term debt. If conditions finally improve  
9 there will very likely be a flood of issuers rushing into the capital markets which will create  
10 even more competition for debt issuances. Given these challenging and highly competitive  
11 conditions, savvy institutional investors that buy the Company's long-term debt, who are also  
12 acting in a very conservative manner, will be extremely diligent and highly selective as to  
13 whose bonds they will purchase. These investors undertake intense due diligence, scouring  
14 financial reports and credit reports of issuers looking for excuses to move on to the next  
15 opportunity or increase credit spreads and thus the interest rate on the debt. The lack of an  
16 FAC will give these investors just that excuse when examining AmerenUE. Therefore it is  
17 absolutely imperative to be mindful that AmerenUE must compete with other utilities for  
18 investment dollars and to understand the need for an FAC to enhance the Company's credit  
19 profile.

20           B.     Adjustment to the Common Equity Balance

21           Q.     Please explain the correction you are making to AmerenUE's common  
22 equity balance.

1           A.     When I prepared my supplemental direct testimony I incorrectly made an  
2 adjustment to AmerenUE's common equity balance. The adjustment of (\$145,181,525) was  
3 to account for Undistributed Earnings of Subsidiaries ("UES") of AmerenUE. This total  
4 UES balance has historically been subtracted from AmerenUE's common equity balance to  
5 remove any earnings related to unregulated subsidiaries. This adjustment is made to insure  
6 that unregulated earnings do not impact the Company's regulated capital structure.

7           **Q.     Why was it incorrect to make such an adjustment to AmerenUE's**  
8 **common equity in this case?**

9           A.     AmerenUE's total UES balance prior to the end of the first quarter of 2008  
10 contained the undistributed earnings of its wholly-owned unregulated subsidiaries. As I  
11 stated in my supplemental direct testimony these subsidiaries are no longer owned by  
12 AmerenUE. Subsequent to the date my supplemental direct testimony was filed, the  
13 AmerenUE UES month-end March 2008 accounts were corrected to a zero balance.  
14 Therefore, given the correction to the account balances, the adjustment contained in my  
15 supplemental direct testimony is no longer appropriate.

16           **Q.     What is the net effect of this correction?**

17           A.     The net effect of the correction is that it raises the Company's common equity  
18 balance to \$3,428,579,662 (52%) from \$3,283,398,137 (51%). The corrected weighted  
19 average cost of capital is shown in Schedule MGO-RE1.

20           **Q.     Does this conclude your rebuttal testimony?**

21           A.     Yes, it does.

**Union Electric Company d/b/a AmerenUE  
Weighted Average Cost of Capital**

With Fuel Adjustment Clause  
at 3/31/2008:

| CAPITAL COMPONENT | AMOUNT                 | PERCENT OF TOTAL | COST    | WEIGHTED COST |
|-------------------|------------------------|------------------|---------|---------------|
| Long-Term Debt    | \$3,001,633,545        | 45.532%          | 5.774%  | 2.629%        |
| Short-Term Debt   | \$47,612,601           | 0.722%           | 3.384%  | 0.024%        |
| Preferred Stock   | \$114,502,040          | 1.737%           | 5.189%  | 0.090%        |
| Common Equity     | \$3,428,579,662        | 52.009%          | 10.900% | 5.669%        |
| <b>TOTAL</b>      | <b>\$6,592,327,848</b> | <b>100.000%</b>  |         | <b>8.412%</b> |

Without Fuel Adjustment Clause  
at 3/31/2008:

| CAPITAL COMPONENT | AMOUNT                 | PERCENT OF TOTAL | COST    | WEIGHTED COST |
|-------------------|------------------------|------------------|---------|---------------|
| Long-Term Debt    | \$3,001,633,545        | 45.532%          | 5.774%  | 2.629%        |
| Short-Term Debt   | \$47,612,601           | 0.722%           | 3.384%  | 0.024%        |
| Preferred Stock   | \$114,502,040          | 1.737%           | 5.189%  | 0.090%        |
| Common Equity     | \$3,428,579,662        | 52.009%          | 11.150% | 5.799%        |
| <b>TOTAL</b>      | <b>\$6,592,327,848</b> | <b>100.000%</b>  |         | <b>8.542%</b> |

