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Issues:	Cost of Capital
Witness:	Lee R. Nickloy
Sponsoring Party:	Union Electric Co.
Type of Exhibit:	Direct Testimony
Case No.:	ER-2010-____
Date Testimony Prepared:	July 24, 2009

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2010-____

DIRECT TESTIMONY

OF

LEE R. NICKLOY

ON

BEHALF OF

UNION ELECTRIC COMPANY
d/b/a AmerenUE

St. Louis, Missouri
July, 2009

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DIRECT TESTIMONY

OF

LEE R. NICKLOY

CASE NO. ER-2010-____

I. INTRODUCTION

Q. Please state your name and business address.

A. Lee R. Nickloy, Ameren Services Company ("Ameren Services"), One Ameren Plaza, 1901 Chouteau Avenue, St. Louis, Missouri.

Q. What is your position with Ameren Services?

A. I am Assistant Treasurer and Director, Corporate Finance.

Q. Please describe your educational background and employment experience.

A. I graduated Magna Cum Laude with a Bachelor of Science degree from Christian Brothers University in Memphis, Tennessee in 1989. I earned a triple concentration in the Economics/Finance, Management, and Marketing programs of study. Upon graduation I was employed by Shell Oil Company in their Chicago, Illinois refined products division. In 1992, I was promoted to Financial Analyst and transferred to the company's U.S. headquarters in Houston, Texas. In 1994, I accepted the position of Assistant Treasurer with Enjet, Inc., a privately held crude oil refining and products trading company based in Houston with operations in the U.S. Gulf Coast region and internationally. I was promoted to Treasurer later that same year and was responsible for financing the company's operational and trading activities. I negotiated all financing facilities, issued debt, was responsible for banking relationships and cash management, and directed the company's trading activities to maximize profitability given certain capital constraints. In late 1995, I became Manager of Counterparty Risk for TransCanada Energy USA Inc. In this position I managed the company's counterparty risk exposure for a broad range of energy trading and marketing businesses and natural gas processing assets. This responsibility entailed assessment of the financial condition and capitalization of the company's counterparties and trading partners. I conducted financial due diligence for the company's new business and asset acquisition group. In this position I also negotiated and managed the company's domestic bank financing facilities and parental guarantees. I left that company in 1998 to accept a position with Ameren.

Q. What are your responsibilities in your current position with Ameren Services?

A. In my current position, I am responsible for capital raising and financing activities, banking and cash management, short-term liquidity and borrowing facilities among other responsibilities.

II. PURPOSE AND SCOPE OF TESTIMONY

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

A. The purpose of my testimony is to describe changes in the cost and availability of bank facility liquidity and long-term debt capital since September 2008 - the beginning of the current distressed state of the financial markets (exacerbated to great degree by the bankruptcy of Lehman Brothers) - and the importance of those financing/borrowing resources to Union Electric Company d/b/a AmerenUE ("AmerenUE" or "Company"). Further, I will also describe how AmerenUE's cash flow profile can increase the Company's exposure to these higher borrowing and capital costs and pose greater risk to the Company's ability to fund its short-term needs and finance its long-term requirements at reasonable cost, and how AmerenUE's ability to maintain and implement various cost recovery and tracking mechanisms is made even more critical given the more challenging and more expensive environment for raising capital.

III. BANK AND CAPITAL MARKETS ENVIRONMENT

Q. Please describe these two markets and the forms of capital they offer.

A. For a company like AmerenUE, the *bank market* is the most cost-effective source of committed *short-term* liquidity. By that I mean, a source of short-term borrowing capacity to provide cash for the day-to-day funding of the Company's operations and other cash needs. The form of this borrowing – or *liquidity* - resource is typically a committed revolving bank credit facility under which AmerenUE may borrow on a short-term basis – typically 30 days. These facilities are provided by a group of bank lenders (such as JPMorgan Chase, Barclays Bank, UBS, U.S. Bank, Commerce Bank and UMB Bank to name several) which lend by funding borrowing requests under the facility on a pro-rata basis. These short-term borrowings are very often priced at a pre-defined spread (in the underlying credit agreement) over LIBOR,[1] which is a widely used benchmark short-term interest rate.

For example, AmerenUE often needs to fund large cash requirements such as payments to equipment suppliers for components purchased for construction projects, payments to suppliers of coal, funding of payroll, making of tax payments, etc. On a given day, payments such as these or other large payments may need to be made, but the Company's incoming cash receipts and surplus cash balances may be insufficient to

[1] "LIBOR" stands for the London Interbank Offered Rate.

provide the necessary funding. In those instances, AmerenUE could borrow under its bank facility to obtain the funds it needed to make the payments. (As an aside to this example, AmerenUE can go through periods of time where its cash requirements persistently exceed its cash receipts, thus driving an external financing need which can also be met through bank facility borrowings. This condition is an instance of having "negative free cash flow.")

By contrast, AmerenUE accesses the *capital markets* as a source of permanent, *long-term* debt capital. This form of capital, in appropriate relative amounts with equity capital, finances the rate base assets AmerenUE utilizes to provide utility services for its customers. This financial market matches companies with a need for debt capital (such as a utility like AmerenUE) with institutional and other investors with funds to invest (such as insurance companies and pension funds). This form of borrowing is evidenced by bonds (e.g. first mortgage bonds) issued under an indenture. Debt issued in this market is typically priced by adding a credit spread based on the debt ratings and other credit characteristics of the borrower to the yield or interest rate on a U.S. Treasury security of comparable maturity to the debt being issued, each as determined at the time the debt is sold/issued to the investors.

Q. What has happened in these markets since September 2008?

A. Although exhibiting different dynamics, in general terms, bank lenders and investors have become much more risk averse and are demanding higher returns for investing their capital. To a borrower like AmerenUE, this means higher borrowing costs. At more distressed times in this period, capital wasn't even being made available. Given Ameren's activity in the financial markets during this time and ongoing dialogue with various banks and financial institutions, we have observed a number of factors and drivers causing these market conditions. I will leave it to others to debate the underlying causes and philosophize as to where blame for inappropriate or reckless behavior may lie, but for an entity which requires frequent access to bank liquidity and long-term debt capital at reasonable cost, AmerenUE must certainly be concerned with the effects and consequences.

In terms of the bank market, we note a number of key themes which highlight the deterioration in this market and the condition of many financial institutions. These include:

1) limited bank capital driven by asset write-downs, erosion of equity base and limited access to capital which reduces the banks' ability to lend and increases their return requirements;
2) a changing lender landscape evidenced by bank consolidations, market exits and government ownership and oversight;
3) rising default rates which increase bank losses and reduces capital base;
4) shorter bank facility maturity dates given reduced capital reserve requirements; and
5) higher lending costs as capital availability becomes more limited and uncertainty over further losses remains.

The various government support initiatives have certainly provided some relief to the lending environment and the financial condition of many of these institutions.

However, lending costs are clearly higher and bank liquidity has become more difficult and expensive to obtain.

Conditions in the debt capital markets have also been challenging. We have observed an "ebb and flow" to this with periods of more positive market tone evidenced by great investor interest in new issue transactions, lower new issuance premiums required for a given borrower versus the secondary market trading level of that issuer's outstanding bonds, greater flexibility around issuance maturity and the market's ability to absorb heavy levels of new debt issuance. This contrasts with periods of more negative market tone with many investors not participating in new issuance transactions and a much more challenging environment in terms of available maturities, wider credit spreads and greater levels of price concession for a new debt offering versus an issuer's existing debt securities. However, notwithstanding some recent periods of positive tone in the debt capital markets, credit spreads and related borrowing costs undoubtedly have been materially elevated versus those in recent years.

Another factor present in the debt capital markets is increasing interest rates in the form of higher yields on U.S. Treasury securities. Certainly a driver of this is the significant amount of new debt issuance by the U.S. government. Without an offsetting reduction in credit spreads, higher Treasury yields will cause interest rates on new debt issuances to increase.

Q. How would you characterize the current tone or condition of these financial markets?

A. At the time of this writing, I would characterize the bank market as being generally open and available to investment grade utilities such as AmerenUE, though on a much more expensive basis and offering limited/shortened maturities. The debt capital markets are improving and credit spreads are tightening versus being very elevated earlier, however concern remains around the direction of Treasury yields which could continue to increase and cause bond yields to be higher. I discuss this in more detail later in this testimony.

Though it is the case that these markets are more accessible and supportive than last fall, these markets are not anywhere near as attractive for issuers as they have been over recent years leading up to last September. It is important to note that conditions in these markets can rapidly change. We have observed periods since last September where the capital markets might be open on one day, but effectively closed the next.

Q. How has the cost of bank liquidity changed?

A. We experienced firsthand in the recent renewal of our bank liquidity facilities significantly higher cost for these facilities. The table below illustrates these higher costs comparing fee and spread levels under the prior $1.15 billion credit agreement (originally arranged in July 2005 and amended and restated in July 2006) under which AmerenUE is a borrower and the recent renewal and extension of this facility. The fees compared include 1) up-front fees which are paid to participating lenders at the time the facility is put in place to provide an incentive to enter into the facility, 2) facility fees which are paid during the term of the facility and compensate the lenders for maintaining a commitment to the borrowers to lend, and 3) the borrowing spread (over LIBOR) which is incurred in connection with each borrowing under the facility. Note, 100 basis points (bps) equals 1%.

TABLE 1 - Comparison of Bank Facility Fees

Fee	Prior Facility	Renewed/Extended Facility
up-front fees (1)	8 bps	150 - 200 bps
Facility fee (2)	15 bps	100 bps
borrowing spread (2)(3)	50 - 60 bps	325 bps

(1) for overall facility
(2) based on current AmerenUE debt ratings
(3) over LIBOR

So, by way of example, a one month LIBOR borrowing under the prior facility would have carried an average interest rate of 0.84% - assuming 1-month LIBOR equals 0.29% and adding the midpoint, 0.55%, of the borrowing spread indicated in the table above. The same borrowing under the pricing in the renewed facility would carry an interest rate of 3.54% - LIBOR of 0.29% plus the indicated borrowing spread of 3.25%. That's a cost differential of 2.70%, or 270 basis points. To put that in dollar terms, at March 31, 2009, AmerenUE had total short-term debt outstanding of $297 million. Multiplying this amount of short-term debt by the 270 basis point interest rate differential represents over $8 million of incremental interest cost on an annualized basis.

Q. To what extent have the available maturities of bank facilities become more limited?

A. When AmerenUE's $1.15 billion facility was originally arranged in July 2005, it had a final maturity of July 2010, thus providing 5 years of overall facility maturity. This was a common maturity at the time. The current renewal/extension of this facility extends the maturity date just one year, from July 2010 to July 2011, which means AmerenUE has access to the facility for up to two years. This was the longest maturity available to AmerenUE at the time this facility was renewed.

Q. How has the cost of long-term debt capital changed?

A. As mentioned earlier, the interest rate on new long-term debt issuance is typically determined by the yield on a U.S. Treasury security of comparable maturity plus a credit spread determined by investors. Since the beginning of 2009, the yield on the 10-year Treasury has increased by as much as nearly 175 basis points (1.75%) and the yield on the 30-year Treasury has increased by as much as 200 basis points (2.00%). See Schedules LRN-E1 and LRN-E2, which show these trends.

Although credit spreads have been improving recently, since September 2008, these spreads have risen dramatically. For example, AmerenUE issued new long-term debt on two occasions in 2008 - $250 million in April with a coupon[2] of 6.00% and credit spread of 250 basis points, and $450 million in June with a coupon of 6.70% and credit spread of 253 basis points. By contrast, AmerenUE issued $350 million of new long-term debt in March 2009 at a coupon of 8.45% with a credit spread of 482.5 basis points. That's a spread differential of about 230 basis points in 2009 versus 2008.

Of course what is important is the overall coupon level, or interest rate, achieved when issuing long-term debt. Going forward, the direction of Treasury yields is uncertain, along with other conditions in the capital markets, investor sentiment, etc. which could reverse recent improvement in credit spreads and cause these to increase once again. AmerenUE can control neither of these factors. This all leaves AmerenUE faced with the questions of whether the capital markets remain open to issuers like

[2] The coupon is the interest rate for the debt.

AmerenUE and whether those markets will provide capital at the times and in the amounts needed.

IV. AMERENUE'S CASH FLOW PROFILE

Q. How is AmerenUE exposed to the higher costs and risk of accessing this form of capital and liquidity?

A. Weaker cash inflows, relative to its cash outflows, can drive greater financing needs in two ways. First, as illustrated above, in the short-term, if cash expenditures exceed cash receipts AmerenUE must incur short-term debt to fund the differential. As explained above, this form of capital or liquidity is much more expensive than before. Second, weaker cash inflows reduce the amount of internally generated capital (cash) available to finance utility assets and capital investment (capex). Given this capex must be financed in some manner, AmerenUE will typically temporarily fund it with short-term debt and then, once the outstanding balance is of sufficient size, "term-out" this short-term debt with new long-term debt issued in the capital markets. Less cash available means the incurrence of greater amounts of higher cost short-term debt which results in a greater and more frequent need to access potentially even more expensive debt capital and, in what has proven true at times, a highly uncertain market environment. With stronger cash inflows, this risk is reduced – less short-term debt is required to fund AmerenUE's operations and more cash/capital is available to fund capex.

To put this in perspective, over the past several years AmerenUE has experienced persistent negative free cash flow and has had to borrow on both a short- and long-term basis to fund the resultant cash need. The financing need during 2008 was especially acute; during last year AmerenUE's outstanding balance of short-term debt increased by $261 million, the Company depleted $185 million of cash on hand as of the beginning of the year and it issued $700 million of new long-term debt. Of this new long-term debt, approximately $377 million refinanced long-term debt which matured or was redeemed, but otherwise AmerenUE generated a $769 million financing need during the year.

Q. Can this risk be reduced or partially mitigated?

A. As AmerenUE witness Warner L. Baxter summarizes and describes in his direct testimony, AmerenUE is seeking to maintain and implement a number of cost recovery mechanisms which will have the effect of improving the Company's cash flows by better matching (in time and amount) the incurrence of various costs with the recovery of such costs and reducing regulatory lag. These measures include such regulatory mechanisms as the fuel adjustment clause, the vegetation management and infrastructure inspection tracker, the pension/OPEB[3] tracker, and the proposed environmental cost recovery mechanism and storm cost recovery tracker, among others. By reducing regulatory lag and improving AmerenUE's cash inflows, these measures will reduce the Company's borrowing requirements and will reduce interest costs.

Q. Are there other benefits?

A. Yes, if AmerenUE can reduce its borrowing needs through strengthened cash flow generation, its liquidity and financial condition will be improved. This will enhance the Company's creditworthiness and make it easier and less expensive when the Company does need to access the debt capital markets to raise the capital it needs, lower

[3] "OPEB" stands for Other Post-Employment Benefits.

the cost of such capital and enhance AmerenUE's access to this capital in times of market disruption.

Q. Please summarize your testimony and conclusions.

A. As we have directly observed in recent months, the market for debt capital and liquidity has become much more expensive and uncertain. The bank and capital markets have become more tenuous and difficult to navigate even for an investment grade regulated utility. AmerenUE is proposing to maintain and implement various regulatory mechanisms in this case which will have the effect of reducing regulatory lag and allowing the Company to more timely recover its costs. These measures will improve the cash flow profile of AmerenUE by strengthening cash inflows and reducing the reliance the Company places on short- and long-term to debt to fund its day-to-day operations and to finance capex. The Company and its customers can readily benefit from this through reduced borrowing needs, lower borrowing costs and a reduced need to access challenging markets for this capital.

Q. Does this conclude your direct testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a AmerenUE for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area.	)))))	Case No. ER-2010-

AFFIDAVIT OF LEE R. NICKLOY

STATE OF MISSOURI)
) **ss**
CITY OF ST. LOUIS)

Lee R. Nickloy, being first duly sworn on his oath, states:

1. My name is Lee R. Nickloy. I work in the City of St. Louis, Missouri, and I am employed by Ameren Services Company as Assistant Treasurer and Director, Corporate Finance.

2. Attached hereto and made a part hereof for all purposes is my Direct Testimony on behalf of Union Electric Company d/b/a AmerenUE consisting of 12 pages, and Schedules LRN-E1 — LRN-E2, all of which have been prepared in written form for introduction into evidence in the above-referenced docket.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.

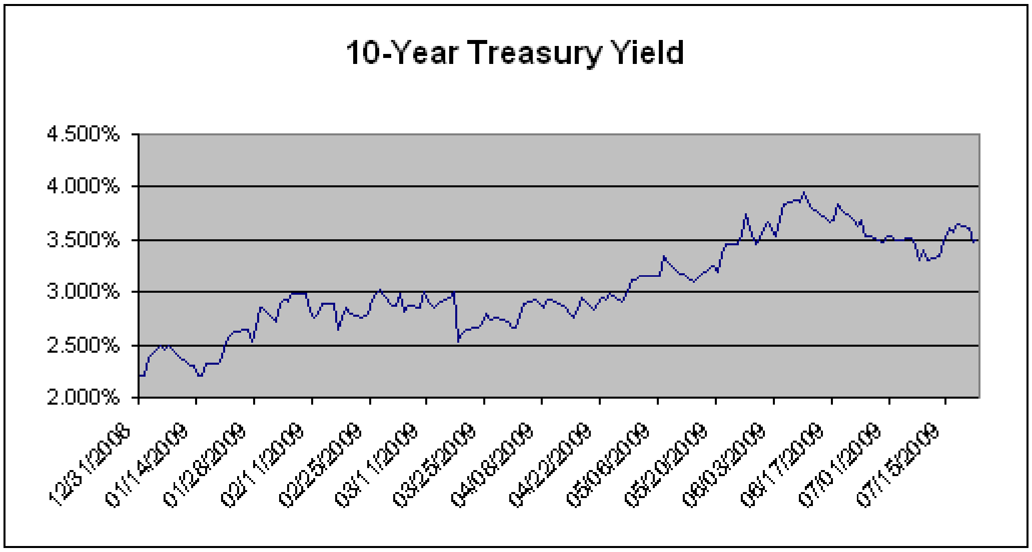
Lee R. Nickloy

Subscribed and sworn to before me this 24th day of July, 2009.

Amanda Tesdall
Notary Public

My commission expires:

Amanda Tesdall - Notary Public
Notary Seal, State of
Missouri - St. Louis County
Commission #07158667
My Commission Expires 7/29/2011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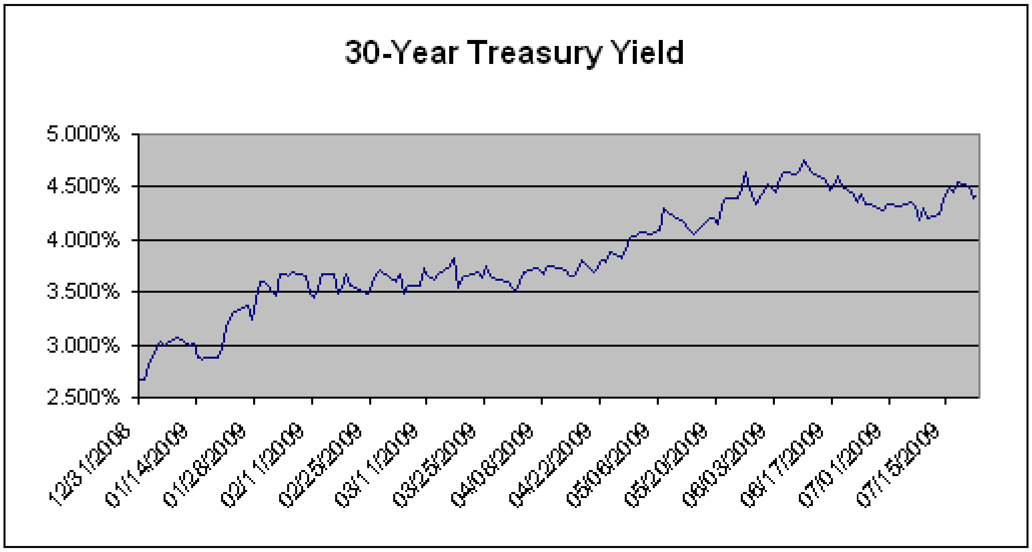
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