## MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. EF-2003-0514, Union Electric Company d/b/a AmerenUE

FROM: Lena Mantle, Energy Department
Greg Meyer, Auditing Department
David Murray, Financial Analysis Department
Dan Redel, Internal Accounting

| /s/ David Murray 06/19/03 | /s/ Steven Dottheim 06/19/03 |
|---|---|
| Project Coordinator / Date | General Counsel's Office / Date |

SUBJECT: Staff Recommendation to not approve the Application of Union Electric Company d/b/a AmerenUE for authority to issue and sell up to $1,500,000,000 aggregate principal amount of additional long-term indebtedness as filed, but to approve the Application with the following suggested changes/conditions

DATE: June 19, 2003

**Union Electric Company d/b/a AmerenUE**

1. (a) **Type of Issue:** First mortgage bonds or other forms of secured indebtedness, and promissory notes or other forms of unsecured indebtedness (including subordinated deferrable interest debentures).

   (b) **Amount:** Up to $1,050,000,000 principal amount.

   (c) **Rate:** Fixed or variable rate not to exceed the greater of (i) 9 percent, or (ii) a rate that is consistent with similar securities of comparable credit quality and maturities issued by other issuers. The actual rate will be determined at the time of issuance of the new securities.

   (d) **Other Provisions:** The price to be paid to Applicant for the various series of the New Indebtedness (as defined in the Application) will not be less than 95% nor more than 105% thereof; the terms of maturity for the various series of the New Indebtedness will not exceed 40 years.

2. **Proposed Date of Transaction:** Anytime after the effective date of the order or orders.

3. (a) **Statement of Purpose of the Issue:** The Application states: "Applicant proposes to use the proceeds from the issuance and sale of the New Indebtedness to refund, discharge, or retire its outstanding indebtedness and preferred stock, whether at maturity or otherwise, as described in Exhibit 2 hereto (which has been designated as

"Proprietary" under the Commission's standard protective order being sought in this proceeding) and to pay related redemption premiums and expenses."

(b) **From a financial perspective, does Staff deem this purpose reasonable?:**

Yes _X_ No

4. **Type of Transaction:** Public offering and/or private placement.

5. **Copies of executed instruments defining terms of the proposed securities:**

___ (a) If such instruments have been previously filed with the Commission, a reference to the Case Number in which the instruments were furnished.

_X_ (b) If such instruments have not been executed at the time of filing, a statement of the general terms and conditions to be contained in the instruments, which are proposed to be executed.

___ (c) If no such instruments are either executed or to be executed, a statement of how the securities are to be sold.

6. **Certified copy of resolution of the directors of applicant, or other legal documents authorizing the issuance of the securities reviewed:**

Yes _X_ No

7. **Pro-forma Balance Sheet and Income Statement reviewed:**

Yes _X_ No

8. **Capital expenditure schedule reviewed:**

Yes No _X_

9. **Journal entries are required to be filed by the Company to allow for the Fee Schedule to be applied:**

Yes _X_ No

10. **Recommendation of the Staff:**

___ Grant by session order (see Comments).

_X_ Conditional Approval granted pending receipt of definite terms of issuance (see Comments), but only for refinancing, refunding, discharging, and/or retiring of existing securities.

___ Require additional and/or revised data before approval can be granted (see Comments).

___ Formal hearing required (see Comments).

___ Recommend dismissal (see Comments).

**COMMENTS:**

Union Electric Company d/b/a AmerenUE (Union Electric, AmerenUE, Company or Applicant) is a public utility engaged in providing electric and gas utility services in portions of Missouri under the jurisdiction of this Commission. Applicant is a subsidiary of Ameren Corporation, which is a registered public utility holding company under the Public Utility Holding Company Act of 1935 (PUHCA).

On May 22, 2003, AmerenUE filed an Application with the Missouri Public Service Commission (Commission) requesting approval for authority to issue debt securities in an amount up to $1.5 billion aggregate principal amount of New Indebtedness in one or more combination of the following forms: first mortgage bonds or other forms of secured indebtedness, and promissory notes or other forms of unsecured indebtedness (including subordinated deferrable interest debentures). In its Application, AmerenUE stated the following:

> The various series of the New Indebtedness will be offered to the public or privately placed or a combination of both through commercial or investment banking firms or groups of firms selected through negotiation and/or competitive bidding. Sales of the series of the New Indebtedness could be through underwriters or dealers, directly to a limited number of purchasers or to a single purchaser, or through agents designated by Applicant. Compensation to be paid for underwriting or privately placing the New Indebtedness will be determined based on prevailing financial market conditions.

The Applicant further states that it:

> ...proposes to issue the New Indebtedness under existing authority from the Securities and Exchange Commission or under new authority to be obtained in the

form of a "shelf-registration" filed with that agency for such securities issued in public transactions.

Although the original Application requests approval for the issuance of $1.5 billion of long-term debt, Staff expressed to AmerenUE its concerns about recommending the Commission approve the Application as filed because **

** Staff recommends that the Company only be allowed to issue up to $1.05 billion versus the $1.5 billion originally requested in the Application. By reducing the amount to $1.05 billion, the Commission will only be approving an amount reasonably required to refinance, refunding, discharging and/or retiring of existing securities. It is Staff's understanding that the Company is agreeable to this condition. In response to Staff Data Information Request 3801, AmerenUE indicated that:

> AmerenUE incurs short-term debt generally as a result of net cash provided by its operations being insufficient to cover all of the Company's cash requirements. One primary cause of this is the financing of capital expenditures.

Based on AmerenUE's response to Staff Data Information Request 3805, in which AmerenUE indicated that it had paid common dividends to its parent company, Ameren Corporation, totaling $450 million since September 30, 2001, the Staff would note that it appears that a cause of AmerenUE's need for either internal loans or outside capital for capital expenditures is this payment of dividends to Ameren. Staff intends to conduct a review of Missouri utilities' policies and procedures regarding both inter-company loans and dividend payments to their parents. AmerenUE will be part of that review.

Staff notes that the use of short-term debt to initially finance capital expenditures results in avoidance of the fees that would normally be charged on long-term debt pursuant to Section 386.200.2, RSMo 2000. However, in reviewing a Report and Order issued by the Missouri Public Service Commission on May 14, 1982, for consolidated Case Nos. TF-82-2, EF-82-30, EF-82-70, EF-82-72, EF-82-84, EF-82-113, TF-82-130 and TF-82-131, Staff found that the Commission had made the determination that if long-term debt is used to refinance outstanding short-term debt, regardless of its use, the fee schedule required by Section 386.300.2, RSMo 2000 does not apply. However, it appears from this Report and Order that the Commission determined that if the issuance of long-term debt was for purposes of buying stock, the fee schedule should be applied to the amount of long-term debt issued to do so. Therefore, Staff recommends that the fee schedule be applied to the amount of long-term debt used to buy the preferred stock outstanding of ** ** It is Staff's understanding that the Company is agreeable to this condition.

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The Applicant also stated in its Application that it "...proposes to use the proceeds from the issuance and sale of the New Indebtedness to refund, discharge, or retire its outstanding indebtedness and preferred stock, whether at maturity or otherwise..." and "...to pay related redemption premium and expenses." The Applicant may seek to extend the existing maturity of outstanding indebtedness by refinancing at or after maturity or through early redemption prior to maturity. AmerenUE also states that the New Indebtedness will only be issued for purposes of "...refinancing/redeeming outstanding indebtedness prior to its stated maturity only if, in its judgment, such issuance is expected to result in interest savings or reduce interest rate volatility or uncertainty."

Although the Company has expressed its intent to use the funds for refinancing, refunding, discharging, and/or retiring purposes, the Application also indicates that it is possible that the "...Applicant may not be able to immediately utilize the proceeds of an issuance of a series of the New Indebtedness to retire or redeem outstanding debt. In such event, the proceeds from the issuance of the series of New Indebtedness will be added to Applicant's general funds and temporarily utilized. When the timing constraints are satisfied, such funds will be used for the purposes specified herein." Although AmerenUE makes this representation in its Application, Staff finds that it is prudent to condition the approval of the Application on the funds being used for refinancing, refunding, discharging and/or retiring purposes only. If the Company were to use the funds for purposes other than the stated purpose, then this would render the pro forma financial statements submitted with the Application inaccurate. Staff recommends that approval of this Application be conditioned upon the use of the funds for refinancing, refunding, discharging and/or retiring of the specific issuances of long-term debt, preferred stock, short-term debt and the nuclear fuel lease listed in response to Staff Data Information Request 3804 and in the revised Exhibit 2 that the Company will file with the Commission after the filing of this recommendation.

AmerenUE provided to Staff and agreed to file with the Commission in response to the Staff's recommendation revised pro forma financial statements contemplating the reduced amount of $1.05 billion. Assuming AmerenUE issued the entire $1.05 billion of long-term debt as of March 31, 2003, this financing would cause the Company's consolidated capital structure to become more heavily weighted in long-term debt. The actual and pro forma capital structure ratios are as follows (See also Attachment A):

| | As of March 31, 2003 | ** ________ ** |
|---|---|---|
| Common Equity | 51.72% | ** ** |
| Preferred Stock | 2.23% | ** ** |
| Long-term Debt | 39.48% | ** ** |
| Short-term Debt | 6.57% | ** ** |

Although the Company's long-term debt to total capital ratio would increase by ** ** basis points to ** ** percent from 39.48 percent, the total debt (inclusive of short-term debt) to total capital ratio increases by a lesser ** ** basis points. The pro forma common equity ratio decreases by ** ** basis points to ** ** percent from 51.72 percent mainly because of reduced retained earnings related to higher interest expenses. The Pre-Tax Interest Coverage ratios as of March 31, 2003, on an actual and pro forma basis are 6.52 times and ** ** times, respectively. The Funds Flow Interest Coverage ratios as of March 31, 2003 on an actual and pro forma basis are 7.39 times and ** ** times, respectively. The Funds from Operations to Total Debt ratios as of March 31, 2003 on an actual and pro forma basis are 32.16 percent and ** ** percent, respectively. The total debt to total capital ratios as of March 31, 2003 on an actual and pro forma basis are 46.05 percent and ** ** percent, respectively (see Attachment B).

The ratios calculated for the period ending March 31, 2003 are within or above the ranges set by the industry average and defined by Standard & Poor's Corporation for an AA rated utility, which is considered to be high grade, high quality debt. The same would be true on a pro forma basis even considering the fact that there has been a slight deterioration in coverage ratios. The slight deterioration in the coverage ratios can be attributed to the fact that long-term debt would be used to retire short-term debt and preferred stock. Preferred stock dividends are not included in interest expense. Therefore, the retiring of preferred stock with long-term debt results in a higher interest expense. The retiring of lower interest rate short-term debt with higher rate long-term debt results in a higher interest expense as well. However, this slight deterioration should be offset somewhat by the removal of variable interest rate short-term debt that can cause liquidity concerns.

AmerenUE's current credit rating should not be negatively affected by this transaction if the funds are used for refinancing, refunding, retiring and/or discharging of existing securities. However, AmerenUE's current Standard & Poor's credit rating is impacted by the financial condition of its affiliated companies. This fact is noted in the following portions of Standard & Poor's Rationale concerning AmerenUE's A- credit rating contained in an April 7, 2003, Standard & Poor's Rating's Direct Research report:

> The ratings on Union Electric are based on the consolidated credit profile of the entire Ameren family of companies, which includes regulated utilities Union Electric and Central Illinois Public Service Co. (CIPS, doing business as AmerenCIPS); recently acquired CILCORP Inc. and its utility subsidiary, Central Illinois Light Co. (CILCO, doing business as AmerenCILCO); its unregulated generation unit, AmerenEnergy Generating Co. (AEGC); and other diversified businesses.
>
> Standard & Poor's views all Ameren operating companies as core to the company's business strategy. Because there are no regulatory mechanisms or other structural barriers in Missouri or Illinois that sufficiently restrict access by the parent to the cash flow of the utilities, Standard & Poor's considers the default risk of Union Electric, CIPS, and CILCO as being the same as that of Ameren.
>
> Ameren's credit quality reflects an average business profile and weakening consolidated financial measures primarily due to the assumption of about $850

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> million of debt in conjunction with the CILCORP acquisition. A recent electric rate reduction in Missouri, lower forward energy prices, financing requirements for installation of combustion turbines, and higher operating expenses have also pressured cash flow and capital structure balance. Ameren supported an 'A-' credit profile by issuing substantial amounts of common equity and equity-like securities and by sharply reducing expenses. In this regard, pretax interest coverage and funds from operation (FFO) interest coverage should remain solid, at levels hovering around 3.75x and 4.75x, respectively. On conversion of the company's $345 million adjustable conversion-rate equity security units (ACES) in 2005, total debt to capital should fall below 44% from nearly 50% currently, and FFO to total debt should reach 26% from 24%. Meanwhile, internal cash flow should cover the bulk of the construction outlays.

Standard & Poor's went on to provide the following Outlook for AmerenUE:

> The outlook is stable. Ratings stability for Union Electric mirrors that of parent Ameren and reflects expectations for gradual improvement of post-acquisition financial parameters, as well as effective cost cutting measures, favorable competitive standing, efficient coal and nuclear operations, and diverse service area. The risk of Ameren's unregulated generating fleet is substantially tempered by the long-term contracts with affiliated regulated utilities.

As can be derived from the above comments from Standard & Poor's, Ameren's business activities outside of its Union Electric subsidiary can affect Union Electric's credit rating and resulting cost of debt. Therefore, while Staff believes that the pro forma credit metrics for Union Electric alone are consistent with at least an A rated utility or better, Union Electric's Standard & Poor's credit rating is based on the consolidated credit profile of Ameren, which includes all of its affiliates and/or subsidiaries and can be negatively impacted by these entities.

The proposed transaction, assuming the funds are used only for refinancing, retiring, refunding and/or discharging existing securities, should not have a negative impact on AmerenUE's credit ratings, and therefore, its ability to attract capital.

The Staff has verified that the Company has filed its annual report and is not delinquent on any assessment. The Commission's Energy Department Staff has reviewed this filing and is unaware of any issue currently pending before the Commission that affects or is affected by this filing. The following open cases involving this Company before the Commission at this time are: Case Nos. EC-2002-1, EO-96-14, EC-2003-0378, EO-2002-351, EE-2003-0365, EO-2003-0271, EM-96-149, and EO-2003-464.

Staff believes certain conditions should be placed on AmerenUE to ensure the funds are used in a manner that does not sacrifice its financial integrity and to protect the ratepayers of Missouri from any adverse impact of its proposal.

## RECOMMENDATIONS

Staff recommends that the Commission approve the Application submitted by AmerenUE in this case subject to the following conditions:

1. That the Company be authorized to issue the reduced amount of $1.05 billion in debt securities and that the Company shall not be authorized to use any portion of the $1.05 billion amount in debt securities for any purpose other than refinancing, refunding, discharging and/or retiring of existing AmerenUE securities as outlined in AmerenUE's response to Staff Data Information Request 3804 and in the revised Exhibit 2 that the Company will file with the Commission after the filing of this recommendation.

2. That the fee schedule be applied to the amount of long-term debt used to buy the ** ** of preferred stock currently outstanding, as required by Section 386.300.2, RSMo 2000.

3. That the Company shall be required to file with the Commission all final terms and conditions on this financing including, but not limited to, the aggregate principal amount to be sold or borrowed, price information, estimated expenses, portion subject to the fee schedule and loan or indenture agreement concerning each issuance.

4. That the interest rate for this debt issuance is not to exceed the greater of (i) 9 percent or (ii) a rate that is consistent with similar securities of comparable credit quality and maturities issued by other issuers.

5. That the Company shall file with the Commission any information concerning communication with credit rating agencies concerning this issuance(s).

6. That the Company's total borrowings, including all instruments, shall, at no time, exceed its regulated rate base.

7. That nothing in the Commission's order shall be considered a finding by the Commission of the value of these transactions for rate making purposes, and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions and their results in cost of capital, in any later proceeding.

8. That the Company shall file with the Commission any information concerning use of the funds from the issuance(s) with regard to redemption of any outstanding long-term debt, including Net Present Value calculations indicating the amount of interest cost savings.

9. That the Commission's order in this proceeding shall remain effective for a three-year term from the effective date of the order, with the Applicant authorized to request an extension of

such term by filing an application at least ninety (90) days prior to the expiration of the three-year term.

10. That all future funds acquired through issuance of securities under this application shall be used exclusively for the benefit of AmerenUE regulated operations, and not for the other operations of Ameren Corporation or any of its affiliates or non-regulated activities.

11. That the amount of any and all other benefits that accrue to the funds acquired through issuance of securities under this application shall be used exclusively for the benefit of AmerenUE regulated operations, and not for the other operations of Ameren Corporation or any of its affiliates or non-regulated activities.

12. That Ameren Corporation and AmerenUE shall make available to the Staff sufficient documentation to ensure that the funds, and the amount of any and all other benefits that accrue to the funds, acquired through issuance of securities under this application shall be used exclusively for the benefit of AmerenUE regulated operations, and not for the other operations of Ameren Corporation or any of its affiliates or non-regulated activities.

Attachments: A Pro Forma Capitalization
B Pro Forma Financial Ratios

**Attachments 1 and 2**

**are deemed**

**Proprietary**

**in their entirety.**