220 NP

Exhibit No.:
Issue: *Rate of Return; Sioux Scrubbers*
Witness: *David Murray*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Surrebuttal Testimony*
File No.: *ER-2011-0028*
Date Testimony Prepared: *April 15, 2011*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

DAVID MURRAY

UNION ELECTRIC COMPANY
d/b/a Ameren Missouri

FILE NO. ER-2011-0028

Jefferson City, Missouri
April 2011

***** Denotes Highly Confidential Information *****

NP

TABLE OF CONTENTS

OF THE SURREBUTTAL TESTIMONY OF

DAVID MURRAY

UNION ELECTRIC COMPANY
d/b/a Ameren Missouri

FILE NO. ER-2011-0028

SURREBUTTAL TESTIMONY

OF

DAVID MURRAY

UNION ELECTRIC COMPANY
d/b/a Ameren Missouri

FILE NO. ER-2011-0028

Q. Please state your name.

A. My name is David Murray.

Q. Are you the same David Murray who previously prepared and caused to be filed in File No. ER-2011-0028 the Rate of Return (ROR) Section of the Staff's Cost of Service Report and Rebuttal Testimony related to rate of return?

A. Yes, I am.

Q. What is the purpose of your Surrebuttal testimony?

A. The purpose of my Surrebuttal Testimony is to respond to the Rebuttal Testimony of Mr. Robert B. Hevert and Mr. Jerre E. Birdsong. Mr. Hevert sponsored ROR testimony on behalf of Union Electric Company d/b/a Ameren Missouri. Mr. Birdsong sponsored Rebuttal testimony addressing financing issues as they relate to Ameren Missouri's decision to delay the Sioux Wet Flue Gas Desulfurization ("WFGD") Project.

<u>EXECUTIVE SUMMARY</u>

Q. What areas will you address in your rebuttal testimony?

A. ** ____

____

____

NP

**

Second, I will address some of the specific criticisms Mr. Hevert provided in his rebuttal testimony regarding my cost of equity analysis and the reasonableness of my overall recommendation.

Finally, I will address the rebuttal testimony of Mr. Birdsong as it relates to his characterization of a conference call Ameren Missouri had with Staff in the fall of 2008. I will also provide some overall concerns that I have with Ameren Missouri's ability to directly access the full amount of credit capacity that it might otherwise be able to if it did not share the credit facility with Ameren and its affiliates in the past and Ameren currently.

<u>ADDITIONAL DISCOVERY</u>

Q. **

**

A. **

**

Q. ** **

A. ** **

Q. ** **

A. ** **

Q. ** **

A. ** **

Q. ** . **

A. ** ____ **

Q. ** ____ ____ **

A. ** ____ **

Q. ** ____ **

A. ** ____ **

Q. ** ____ ____ **

A. ** ____ ____ **

Q. ** ____ ____ **

A. ** ____ **

Q. ** ____ ____ **

A. ** ____ **

Q. ** ____ ____ ____ **

A. ** ____ ____ ____

____
______________________________ **

Q. ** ________________________________ **

A. ** ____
____ **

Q. ** ____
____ **

A. ** ____
______ **

Q. ** ____
____ **

A. ** ____
____
__________ **

Q. ** ____
_____________________________ **

A. ** ____
____ **

Q. ** ____
______________________ **

A. ** ___ **

Q. ** ____
__________________________ **

A. ** ____ **

Q. ** ____ **

A. ** ______ **

Q. ** ____ **

A. ** ____ **

Q. ** ____ **

A. ** ____ **

Q. ** ______________________________ **

A. ** ____ **

Q. ** ____ **

A. ** ______________________________ **

Q. ** ______________________________ **

A. ** ______________________________ **

Q. ** ______________________________ **

A. ** ______________________________

______________________________ **

Q. ** ______________________________ **

---

[1] Hevert Deposition, p. 91, ll. 21-25; LaConte Deposition, p. 48, l. 6 – p. 49, l. 2; Gorman Deposition, p. 33, ll. 20-23.

A. ** ____
________ **

Q. ** ____
____ **

A. ** ____
____
____
____
____
____
____________________ **

Q. ** ____
__________ **

A. ** ___ **

Q. ** ____
____
____________________ **

A. ** ___ **

Q. ** ____
______________ **

A. ** ____
____
____________________ **

Q. ** ____________________ **

A. ** ____________________ **

SPECIFIC RESPONSE TO MR. HEVERT'S REBUTTAL TESTIMONY

Q. Did Mr. Hevert update his cost of equity estimates in his rebuttal testimony?

A. Yes.

Q. Did Mr. Hevert change his recommended return on common equity as a result of his updates?

A. No.

Q. Did Mr. Hevert's multi-stage DCF cost of equity estimates indicate that the cost of equity had decreased since he filed his direct testimony in September 2010?

A. Yes. Based on Mr. Hevert's two multi-stage DCF analyses using 90-days of stock prices, his indicated cost of equity decreased in the range of 32 to 56 basis points, yet he is still recommending a return on equity of 10.90 percent. This is not consistent with Mr. Hevert's stated intent in his direct testimony to give more weight to his multi-stage DCF analyses.[2]

Q. Is this lower cost of equity estimate based on the same proxy group Mr. Hevert used in his direct testimony?

A. No. Mr. Hevert revised his proxy group to exclude Northeast Utilities and Progress Energy due to unrelated merger announcements. Mr. Hevert also decided to include Great Plains Energy, which Staff disagrees with due to Great Plains Energy's ("GPE") continued increased financial risk caused by Aquila's legacy debt.

Q. Disagreement about Mr. Hevert's inclusion of GPE aside, what was the primary cause for the decline in Mr. Hevert's multi-stage cost of equity estimates?

A. Increases in regulated electric utility stock prices since Mr. Hevert filed his direct testimony in September 2010. This increase in regulated electric utility stock prices was due mainly to the decrease in interest rates over the same period. As interest rates decrease, the opportunity cost of not investing in regulated utility stocks increases, causing regulated utility stocks to become attractive for their yield. Schedule 5 shows that Mr. Hevert's revised proxy group stock prices increased by 7.09 percent from August 2010 through March 2011.

Q. Isn't it possible that the increases in stock prices for Mr. Hevert's proxy companies were also due to increased growth expectations?

A. It is possible, but Mr. Hevert's analysis does not show an increase in expected growth rates for the comparable companies he has in common with his original proxy group.

[2] Hevert Direct, p. 3, ll. 18-21.

The average 5-year EPS growth rates for the companies common to both his original proxy group and his revised proxy group have decreased from 5.84 percent to 5.49 percent.

Q. Did Mr. Hevert propose an alternative proxy group in his rebuttal testimony?

A. Yes. Mr. Hevert suggested a "combined proxy group" which is a proxy group that includes all companies proposed by each ROR witness.

Q. Does Staff agree with this proxy group?

A. No.

Q. What is Staff's primary concern about this proxy group?

A. This combined proxy group includes Progress and Northeast, both of which recently announced potential mergers. This combined proxy group also includes several companies from Ms. Billie Sue LaConte's proxy group. Many of these companies are inappropriate for purposes of estimating the cost of equity for regulated electric utility operations.

Q. Which companies in Ms. LaConte's proxy group cause you concern?

A. There are several companies in Ms. LaConte's proxy group that are not classified as "Regulated" utilities by the Edison Electric Institute ("EEI"). It is very important to control for the exposure to increased risk caused by companies with non-regulated operations. The companies not classified as "Regulated" utilities by EEI are: Dominion Resources, Entergy Corporation, Exelon Corporation, Integrys Energy, PPL Corporation, and Pepco Holdings. All but PPL Corporation are classified as "Mostly Regulated" companies by EEI. PPL is classified as a "Diversified" company by EEI. Although Staff considers EEI's classification system to be helpful for purposes of selecting a reasonably comparable proxy group, Staff notes that not all investment analysts agree with EEI's classifications. For example, Entergy, Exelon and Dominion Resources are all considered diversified energy companies by Goldman Sachs.[3]

Q. How did the stocks of the companies classified by EEI as "Regulated" electric utilities, "Mostly Regulated" electric utilities and "Diversified" electric utilities perform through the end of the 2010 calendar year?

A. "Regulated" electric utilities provided a total return of 15.75 percent, "Mostly Regulated" electric utilities provided a total return of 8.51 percent and "Diversified" utilities provided a total return of -5.16 percent.

Q. What is your understanding as to why "Regulated" utilities have generally outperformed "Mostly Regulated" and "Diversified" utilities?

A. This has been caused mainly by the decline in interest rates. If interest rates begin to increase due to stronger expected growth in the economy, then it is likely that "Mostly Regulated" and "Diversified" utility companies would perform better than "Regulated" utilities due to their sensitivity to economic conditions.

Q. What does this imply about the risk of electric utility companies that are not "pure play" regulated electric utilities?

A. They are riskier.

Q. Was this fact recognized by the valuation experts used to assess the value of Ameren's merchant generation operations?

A. Yes. As I discussed earlier, Ameren's asset impairment consultant, Duff & Phelps ("D&P"), estimated a cost of equity for Ameren's merchant generation operations that was over twice that of Ameren's regulated operations (** ____________ **

[3] Michael Lapides, Jaidep Malik and Neil Mehta, United States: Utilities: Diversified "A rough winter remains, downward estimate revisions still coming," December 8, 2010, Goldman Sachs.

respectively). Because Ms. Laconte's proxy group includes companies that have merchant generation operations, as well as energy marketing and retailing operations, this increases the publicly-traded parent companies' costs of equity over and above that which is appropriate for regulated electric utility operations.

Q. Is it true that some companies EEI classifies as "Regulated" utility companies may still have non-regulated operations that increase their overall risk profile, which causes an increase to the consolidated entity's cost of equity?

A. Yes. In fact, Ameren is a perfect example of such a company. Ameren is classified as a "Regulated" utility by EEI. However, one of the major causes for Ameren's increased risk profile as well as its decline in stock value is its merchant generation operations. ** ____ ** Unfortunately, this increased risk can cause a higher incurred cost of capital to its regulated utility subsidiaries as well as a decrease in the credit capacity that would normally be available to the regulated utility subsidiaries. Although Staff has limited ability to protect Ameren Missouri's credit capacity from Ameren's non-regulated operations, Staff can recommend that the Commission authorize an ROE that is more consistent with a cost of equity required for Ameren's regulated utility operations, such as Ameren Missouri.

Q. If a proxy group consists of companies that have riskier, non-regulated operations, should the proxy group's cost of equity be adjusted downward to reflect the lower business risk profile associated with regulated electric utility operations?

[4] Finance Committee of the Board, December 11, 2009, p. 9-2 (see Highly Confidential Schedule 1)

NP

A. Absolutely. However, a better option is to select a proxy group that does not include such companies. Consequently, the Commission should dismiss Ms. LaConte's cost of equity estimates due in part to her inclusion of higher-risk, diversified energy companies in her proxy group.

Q. Mr. Hevert provides his updated interpretation of the signals provided by capital market activity over the last several months (Hevert Rebuttal, p. 17, line 19 through p. 24, l. 6). Is his interpretation consistent with his updated cost of equity estimates?

A. No. Mr. Hevert evaluated a variety of different correlations over recent months attempting to convince the Commission that the regulated electric utility industry is somehow becoming similar in risk to the S&P 500. Regulated utilities outperformed the S&P 500 and diversified utilities over the 2010 calendar year, which paints a much different picture. Instead, this confirms that investors perceive regulated utilities as a "safe haven" in times of economic uncertainty and declining interest rates. As bond yields fell, the opportunity cost of not investing in regulated utility stocks increased. Either bond prices would need to fall or utility stock prices would need to increase to narrow this opportunity cost. In fact, both events occurred. Bond prices did fall and regulated utility stock prices did increase.

Q. Page 24 through page 27 of Mr. Hevert's rebuttal testimony discusses why Mr. Hevert believes the 5.20 percent First Mortgage Bond ("FMB") debt is not a good gauge for evaluating the fairness of the cost of capital in the current environment. How do you respond?

A. Although Staff simply provided this information because it was straight-forward, "observable" lower capital cost information, Mr. Hevert seems to believe that the fact that this debt was FMB debt renders it irrelevant for testing the reasonableness of cost of equity estimates. I disagree. First, while Mr. Hevert correctly indicates that FMB debt is rated higher than unsecured debt, the rating assigned to this FMB debt is more similar to the corporate credit rating Ameren Missouri could carry if it were a stand-alone entity. S&P's corporate crediting rating of 'BBB-' for Ameren Missouri is based on S&P's opinion of Ameren's consolidated credit quality, which includes the impact of the merchant generation operations on Ameren's consolidated business risk profile. Although Moody's and Fitch still consider Ameren Missouri's affiliation with Ameren's other affiliates when assigning Ameren Missouri a corporate/unsecured credit rating, they give more weight to Ameren Missouri's stand-alone financial ratios in their credit analysis of Ameren Missouri. Moody's assigns a corporate/unsecured credit rating of 'Baa2' to Ameren Missouri and Fitch assigns a corporate/unsecured credit rating of 'BBB+' to Ameren Missouri. Consequently, it is entirely appropriate to consider FMB debt yields that carry a 'BBB+' credit rating to test the reasonableness of an estimate of Ameren Missouri's cost of equity, because absent Ameren Missouri's affiliation with Ameren's other entities, it appears that Ameren Missouri could have a higher stand-alone credit rating from S&P.

Q. Notwithstanding your position above, does Empire have any unsecured debt outstanding of similar tenor, which addresses some of the concerns raised by Mr. Hevert?

A. Yes. Empire issued 30-year unsecured debt in 2005 at an annual coupon rate of 5.8 percent. Although this debt is not publicly-traded, it is traded over-the-counter, which gives an indication of current required returns on these bonds. For the week after Empire issued its 30-year FMB debt at an annual coupon rate of 5.2 percent, Empire's 5.8 percent debt traded at a yield-to-maturity in the range of 5.8 to 6.0 percent.[5] Although Staff believes Ameren Missouri's unsecured debt is considered to be of slightly higher credit quality than Empire's unsecured debt, adding a "Rule of Thumb" risk premium of 3 to 4 percent results in a cost of equity in the range of approximately 9 to 10 percent. However, based on Staff's analysis of other more mainstream cost of equity estimates, this "Rule of Thumb" risk premium should be considered a high-end estimate.

Q. Mr. Hevert provides his rebuttal of your direct testimony regarding the constant-growth DCF on pages 32 through 42 of his rebuttal testimony. How do you respond?

A. Mr. Hevert's rebuttal is an attempt to convince the Commission that, because stock prices may be impacted by equity analysts' 5-year EPS growth rate forecasts, this implies that investors use these growth rate forecasts when valuing a utility stock using the constant-growth DCF. While equity analysts' recommendations are influential to investors' decisions, this does not mean that their 5-year EPS growth forecasts are simply plugged into a constant-growth DCF to estimate a fair stock price. As Staff indicated in its direct testimony, equity analysts do not use their own 5-year EPS growth rate forecasts in this manner when performing valuation analysis for purposes of their stock recommendations. Staff has yet to see actual stock valuation analysis that assumes dividends can grow in perpetuity at this rate. Because the premise behind using equity analysts' 5-year EPS forecasts is that equity analysts' estimates are influential to the valuation of stock, it is only logical to seek to understand how these analysts incorporate their data in determining a fair price to pay for stock.

---

[5] http://cxa marketwatch.com/finra/BondCenter/BondDetail.aspx?ID=MjkxNjQxQVox

On page 34, lines 16 through 18, of his rebuttal testimony, Mr. Hevert provides his logic that because investors tend to value common equity on the basis of price/earnings ("P/E") ratios, its stands to reason that the required return on equity is a function of the long-term growth in earnings. While I agree with Mr. Hevert that investors do in fact tend to evaluate their investments based on comparison of "P/E" ratios, I do not agree that this translates into the use of long-term EPS forecasts for perpetual growth in valuation of utility stock. In fact, if an equity analyst provides a long-term EPS projection and then estimates a terminal value based on this long-term projection, the equity analyst will discount this terminal value based on the cost of equity he/she believes is appropriate for the risk of the investment. Staff provided evidence in its Rebuttal testimony that UBS Investment Bank discounts Ameren's projected cash flows and terminal value by a cost of equity of 9 percent. Considering that this cost of equity was based on the risk associated with Ameren and not specifically Ameren Missouri, Staff considers this to be a high end estimate of the cost of equity that would be appropriate for Ameren's less risky regulated operations.

Q. What does the constant-growth DCF assume?

A. It assumes that the investor's required return consists of a dividend yield and expected growth of the dividend. The expected growth of the dividend causes the expected appreciation of the stock. This is consistent with Staff's approach to estimating the cost of equity, whether in a constant-growth form or a multi-stage form.

Q. If the DCF is based on expected growth in the dividend, then why do ROR witnesses use the expected growth in EPS as a proxy for dividend growth?

A. Because 5-year EPS growth forecasts are widely available and some assume it is an indication of expected dividend growth.

Q. But is it not true that utility companies only grow their dividends very gradually?

A. Yes. Utility companies realize there may be cycles in earnings growth and therefore, they are usually conservative in their dividend growth because they realize higher EPS growth rates are not sustainable.

Q. ** ____ ____ ______________________________ **

A. ** ____ ____ ____ ____ __________________________ **

Q. On page 40, line 3, through page 42, line 9 of his rebuttal testimony, Mr. Hevert specifically addresses my analysis of actual achieved historical growth rates of a proxy group of 10 electric utility companies for the period 1968 through 1999. Mr. Hevert claims that this information is not relevant because it is based on a proxy group of companies that are not the same as those used for your current proxy group. Is this information relevant to evaluating growth rates for regulated electric utility proxy groups?

A. Yes. Although Mr. Hevert is correct that this proxy group is not the same as that which I selected for my current proxy group, this is not basis for dismissing this information. Due to consolidations and mergers in the industry, which were pronounced in the late 1990s, it is quite difficult to find companies that have comparable data over an extended period of time, i.e. over ten years. However, this does not cause this historical data to be irrelevant for purposes of testing the reasonableness of long-term growth rate projections. Mr. Hevert recognizes that the constant-growth DCF assumes that the DPS, EPS and BVPS will all grow at the same constant rate if fundamentals hold true.[6] Although these fundamentals rarely hold true in the short-term, because none of these per share indicators can consistently grow at a different rate than the other two, it tends to hold true over the long-term. Staff's analysis of 30-years of DPS, EPS and BVPS data for a proxy group of electric utilities shows that the growth rates of these per share indicators were quite similar – 3.18 percent for BVPS, 3.62 percent for EPS and 3.99 percent for DPS. This empirical evidence provides support for the assumption that these per share figures will grow at a similar rate over the long-term. This information also provides industry-specific data regarding a reasonable perpetual growth rate assumption appropriate for a multi-stage DCF analysis, rather than making theoretical assumptions that electric utilities can grow in perpetuity at the same rate as projected GDP growth. Additionally, this data does not support the presumption that investors would expect electric utilities to grow over the long-term at the same rate as equity analysts' 5-year EPS forecasts.

Q. On page 44 of his rebuttal testimony, Mr. Hevert provides his rationale as to why he does not consider it appropriate to rely on economists' 10-year projections of GDP growth for purposes of the perpetual growth rate used in a multi-stage DCF analysis. Is Mr. Hevert's rationale consistent with his decision to rely on equity analysts' 5-year EPS forecasted growth rates for his constant-growth DCF analysis?

---

[6] Hevert Direct, p. 23, l. 21, - p. 24, l. 2

A. No. Mr. Hevert's constant-growth DCF analysis assumes his proxy group's stock prices can grow in perpetuity at the same rate as equity analysts' 5-year EPS forecasts. However, when deciding on an appropriate proxy to use for his assumed perpetual GDP growth rate, he claims that because economists' forecasts only cover a ten-year period, these growth rate projections are not reliable for assumed perpetual growth. If the Commission accepts the premise that electric utilities can grow at the same rate as the growth in the overall economy, then the Commission should rely on forecasted long-term GDP growth rates provided by the Congressional Budget Office and/or Blue Chip Economic Forecasts. This provides a much more reasonable expected GDP growth rate than the 5.75 percent growth rate used by Mr. Hevert and Ms. LaConte.

Q. Mr. Hevert's concerns notwithstanding, is Staff aware of projected GDP growth rates that extend beyond ten years?

A. Yes. Such projections are provided by the Energy Information Administration ("EIA") when they publish projected energy usage through 2035. The expected compound growth rate for nominal GDP for the period 2010 through 2035 is approximately 4.60 percent. The projected growth rates for the period 2021 (the year in which my perpetual growth rate is presumed to begin) through 2035 is approximately 4.54 percent. Clearly this provides a reasonableness check to Mr. Hevert's self-calculated projected GDP growth rate of 5.75 percent.

Q. On page 45, lines 1 through 3 of his rebuttal testimony, Mr. Hevert indicates that after subtracting a current implied inflation rate of approximately 2.53 percent from the midpoint of your terminal growth rate of 3.5 percent, you project a real GDP growth rate of

0.95 percent. Did Mr. Hevert accurately portray the premise underlying your assumed perpetual growth rate?

A. No. Unlike the other ROR witnesses, I do not believe it is appropriate to assume regulated electric utility companies can grow in perpetuity at the same rate as expected long-term growth in nominal GDP. Quite frankly, experience has shown that this is not a realistic expectation. Additionally, Staff has never seen an investment analysis that makes this assumption for valuing electric utility stocks.

Q. Is it not true that Mr. Hevert discovered that it appears Goldman Sachs' basis for the 2.5 percent perpetual growth rate it uses in discounting regulated electric utilities' dividends is a projection of *real* and not *nominal* GDP growth?

A. Yes.

Q. Does Mr. Hevert suggest that Goldman Sachs should revise its DCF analysis to use a growth rate based on a higher nominal GDP growth rate rather than the 2.5 percent growth rate Goldman Sachs actually uses to value electric utility stocks?

A. Yes.

Q. Does Mr. Hevert advise investors or does Goldman Sachs?

A. Goldman Sachs advises investors. Mr. Hevert is just trying to emulate what investors actually do in practice. In this case, because Mr. Hevert does not agree with the actual perpetual growth rate used by Goldman Sachs, he suggests that they should perform their valuation differently. If Goldman Sachs were to make such a change, this would cause them to believe that most stocks are trading well below their intrinsic values causing significant changes to Goldman Sachs' current investment advice.

Q. Has it been your experience that other equity analysts use a perpetual growth rate in the 2 to 3 percent range when estimating a fair price to pay for an electric utility stock?

A. Yes.

Q. On page 46, lines 6 through 22 of his rebuttal testimony, Mr. Hevert attempts to delineate a difference between estimating the market-required cost of equity and equity analysts estimating target prices for purposes of their investment advice. What is the inherent contradiction in Mr. Hevert's testimony as it compares to the assumptions he makes in his constant-growth DCF?

A. Mr. Hevert, as well as Ms. LaConte, make a naïve assumption that investors value utility stocks by assuming that utility dividends will grow at the same rate as equity analysts 5-year EPS growth forecasts. The irony of this assumption is the very same equity analysts that provide investment advice to their clients do not value stocks by making this naïve assumption. Clearly, the assumptions and methodologies used by capital market specialists to determine a fair price to pay for utility stocks should be considered in determining the reasonableness of assumptions made by ROR witnesses who are attempting to understand the thought processes of those that practice investing.

Q. Regardless, did you not provide market-required ROE estimates from other valuation professionals?

A. Yes. As Staff has continued to test the reasonableness of its own cost of equity estimates, it continues to discover cost of equity estimates that are consistently below those estimated in utility rate case proceedings. In fact, in this case Staff discovered that UBS Investment Bank estimated a cost of equity of 9.0 percent for Ameren, ** ____

____

NP

____

____ **

Q. Again, have all of the ROR witnesses in this case indicated that the principles for estimating the cost of equity for valuation purposes are the same as for doing so in utility ratemaking?

A. Yes.

Q. Does Mr. Hevert provide testimony that contradicts the theory that electric utilities should be able to grow at the same rate as GDP in perpetuity?

A. Yes. On page 49, lines 3 through 4 of his rebuttal testimony, Mr. Hevert indicates that integrated electric utilities typically trade at a discount to the overall market, causing the implied growth rate to be lower than the market-wide rate. This observation is consistent with the information I provided from Level III of the Chartered Financial Analyst ("CFA") curriculum on page 23, line 15 through page 24, line 7 of my rebuttal testimony. An economy-wide expected growth rate is appropriately used when estimating the value or the expected return for a broad index such as the S&P 500. However, if the index is based on a sector that is viewed to have lower growth potential than the overall economy, then a negative excess corporate growth rate should be applied. Consequently, the argument should not be whether to use GDP as a perpetual growth rate for an electric utility proxy group, but how much lower than GDP growth this perpetual growth rate should be.

Q. Mr. Hevert provides rebuttal testimony concerning your CAPM methodology. Do you have any general comments regarding the CAPM?

A. Only a few. Although I did not directly rely on my CAPM estimates for purposes of my recommended allowed ROE in this case, I believe it is important to briefly discuss situations in which the CAPM may or may not provide reliable cost of equity estimates. Staff has rarely assigned much weight to its CAPM cost of equity estimate due to the fact that Staff has consistently relied on historical earned return spreads between stocks and government bonds as an estimate of the market risk premium. The problem with this assumption is that this estimated risk premium is biased high when market implied risk premiums are actually quite low (e.g. years prior to financial crisis and the late 1990s) and biased low when the market implied risk premiums are actually quite high (e.g. late 2008 and early 2009).[7]

However, in the above circumstances, it is not the CAPM that causes questionable results, it is the inputs. It has been Staff's experience that the major competitors in asset valuation, financial advisement, securities underwriting and equity research use their own proprietary models to estimate an appropriate equity risk premium for purposes of estimating a fair price to pay for assets and stock. Although Staff could attempt to develop its own quantitative methodology to estimate the market equity risk premium, because Staff is attempting to solve for the required return rather than providing its own valuation opinion, Staff believes knowledge of the actual equity risk premiums being used by influential experts in the field of valuation and investing is most relevant to the task of estimating the market cost of equity.

Q. Do you have any specific comments regarding Mr. Hevert's rebuttal testimony on the CAPM?

A. I have already addressed my concerns about Mr. Hevert's risk premium estimates as compared to mainstream estimates in my rebuttal testimony. However,

[7] Past Staff testimonies will show that Staff has equally dismissed CAPM estimates when they were too low and too high.

Mr. Hevert raises concerns about my use of Value Line betas as compared to his use of beta estimates based on shorter periods of data than the five years used by Value Line. Although Mr. Hevert's introduction of shorter-term beta estimates is thought-provoking, his analysis is a better fit for companies in a less mature industry. It is common to adjust longer-term betas for companies that are in growth-related industries or are cyclical in nature, but not for mature industries such as the regulated electric utility industry. If electric utility companies' betas have become more reactive to changes in the economy, then this implies that these utility companies have diversified into riskier merchant generation operations. The risk and the reward associated with the increased volatility associated with merchant generation operations should be placed squarely on shareholders.

Q. On page 59, line 14 through page 60, line 20 of his rebuttal testimony, Mr. Hevert first claims that you do not believe returns in other jurisdictions are relevant and then explains why an authorized ROE below those authorized by other jurisdictions is not consistent with the principles of *Hope* and *Bluefield*. How do you respond?

A. First, the testimony I provided in the Staff COS Report did not indicate that returns authorized in other jurisdictions were irrelevant. Otherwise, I would not have provided them in my testimony. I simply provided an explanation of the difference between expected, required and allowed returns. It has been my experience that these terms are used too loosely and therefore cause some to believe that they are synonymous.

Second, I believe Mr. Hevert's interpretation of *Hope* and *Bluefield* is too narrow. Mr. Hevert indicates that authorized returns in other jurisdictions are important because Ameren Missouri must compete for capital with these utilities. While I agree that Ameren Missouri competes for capital with other utilities, more importantly Ameren Missouri competes for capital against all other possible investment opportunities. It is for this reason that setting the allowed rate of return based on the cost of capital is considered to be consistent with the principles set forth in *Hope* and *Bluefield.*

Q. Mr. Hevert provides information regarding the impact that he believes your recommended ROE would have on Ameren Missouri's credit profile. How do you respond?

A. I don't agree with Mr. Hevert's use of projected debt information to assess the fairness of a recommended ROE. Mr. Hevert's use of projected debt information implies that the allowed ROE should be set to allow the company to support its planned use of leverage to fund its capital expenditures. The mix of capital used to fund capital expenditures is a function of management financing decisions, not ratemaking.

However, even with the inclusion of this assumed debt, the credit metrics fall within the benchmarks for a "Significant" financial risk profile. Combining the "Significant" financial risk profile with Ameren Missouri's "Excellent" business risk profile results in Ameren Missouri's overall risk profile being consistent with S&P's credit profile for an 'A-' corporate credit rating (see Schedule 6).

Q. What is Ameren Missouri's S&P corporate credit rating?

A. 'BBB-'.

Q. If Ameren Missouri's overall credit profile is consistent with a corporate credit rating of 'A-', why does Ameren Missouri only have a 'BBB-' corporate credit rating?

A. Because of its affiliation with Ameren's other operations. Ameren only has a "Satisfactory" business risk profile due to the significant risk associated with its merchant generation operations.[8]

[8] Standard & Poor's RatingsDirect, Ameren Corp., December 29, 2010 (see Schedule 7).

Q. If Ameren Missouri had a better credit rating based on its stand-alone risk profile, would this assist Ameren Missouri in attracting capital and improving its financial integrity?

A. Yes, which leads me to the next issue I am addressing in my surrebuttal testimony.

<u>SPECIFIC RESPONSE TO MR. BIRDSONG'S REBUTTAL TESTIMONY</u>

Q. What was the purpose of Mr. Birdsong's rebuttal testimony?

A. Mr. Birdsong provided testimony to refute the Staff's decision to disallow additional costs incurred in the Sioux WFGD Project due to Ameren Missouri's decision to delay the project for several months due to liquidity concerns at Ameren and Ameren Missouri.

Q. Did you indicate in Ameren Missouri's deposition of you on March 31, 2011 that you did not plan on filing testimony regarding the Sioux WFGD Project?

A. Yes, but that was before I read Mr. Birdsong's rebuttal testimony.

Q. What is your specific area of concern regarding Mr. Birdsong's rebuttal testimony?

A. My specific area of concern is Mr. Birdsong's testimony regarding his recollection and characterization of a conference call Ameren Missouri had with Staff on October 21, 2008. Although this conference call occurred almost two and a half years ago, Mr. Birdsong's testimony is not consistent with Staff's recollection. As a result of Ameren Missouri's Data Request No. 6 to Staff, I had a discussion with Bob Schallenberg regarding our recollections of this telephone call and his and my recollections are similar. This Ameren Missouri DR requested any notes Staff may have taken during this conference call. Although we were unable to locate any notes that may have been taken, our recollection of the discussion during this call is different than that provided by Mr. Birdsong.

Staff recalls that Ameren Missouri personnel initiated a telephone conference with Staff to discuss the possibility of requesting a financing authority for at least $1 billion of financing. Staff expressed its concern with such a large financing request due to the lack of support that Ameren Missouri had the need for this much financing. Although Staff was aware of some of the problems being caused by the unraveling financial crisis at the time, Staff does not recall this being the major emphasis underlying Ameren Missouri's request. In fact, if anything, the unraveling financial crisis caused Staff concern as to whether Ameren Missouri's debt capacity would be used for Ameren's other operations, which as Staff will explain later, can be done indirectly. Staff specifically does not recall Ameren Missouri indicating that Ameren Missouri was considering delaying the Sioux WFGD Project if it did not obtain financing authority from the Commission. Staff cannot recall an instance in which it opposed a requested financing authority when that requested authority was specifically linked to identifiable Missouri utility operational needs.

Mr. Birdsong indicates that Ameren Missouri had to abandon the strategy of pursuing financing authority from the Commission as a result of "Staff's negative reaction" during the conference call. He indicates that Ameren Missouri simply did not have time to pursue a contested financing case with the Commission.

While Mr. Birdsong is correct that Staff was concerned about Ameren Missouri's possible request for such a large financing authority, Staff does not recall Ameren Missouri proposing an alternative smaller requested financing authority. Considering the fact that Staff has not quibbled with Ameren Missouri's requests to refinance short-term debt in past financing cases, clearly this could have been done on an expedited basis. In fact, when companies provide sufficient support for upcoming capital expenditures related to capital projects related specifically to the regulated utility operations, Staff has cooperated fully with utility companies. A specific example of such a cooperative effort was with Kansas City Power & Light Company, The Empire District Electric Company and Aquila, Inc., during the construction of Iatan 2 and other related projects.

Q. Does Mr. Birdsong recall Ameren Missouri providing Staff any written details regarding its financing proposal for purposes of its conference call with Staff on October 21, 2008?

A. In response to Staff Data Request No. 444, Mr. Birdsong indicated that he does not recall providing Staff any materials outlining its proposal for purposes of the conference call.

Q. Considering Mr. Birdsong's rebuttal testimony regarding the need to preserve liquidity during the financial crisis of late 2008 and early 2009, do you have any relevant observations about how Ameren manages Ameren Missouri's credit capacity that causes a potential detriment to the financial viability of Ameren Missouri's operations?

A. Yes. As I have already indicated in my surrebuttal testimony addressing Ameren Missouri's financial integrity, Ameren's business risks from its other operations have a direct impact on Ameren Missouri's credit rating. This affects the ability of Ameren Missouri to access the commercial paper markets even during more stable capital markets. Ameren's 2008 SEC Form 10-K Filing specifically indicated the following about Moody's downgrade of Ameren Missouri's commercial paper rating:

> ...Moody's also placed UE's commercial paper rating on review for possible downgrade due to its review of **Ameren's** short-term rating as noted below...(emphasis added)
>
> ...Moody's also downgraded the commercial paper ratings of Ameren and UE to P-3 from P-2. Moody's stated that these downgrades were because of declining consolidated coverage ratios over the last several years and the expectation that ongoing cost pressures and the lack of timely regulatory recovery of some costs will prevent ratios from returning to historical levels in the near-term.

Moody's specifically stated the following when it downgraded UE's commercial paper rating:

> The downgrade of Union Electric's short-term rating for commercial paper to Prime-3 from Prime-2 is prompted by the downgrade of Ameren's short-term rating to Prime-3. Ameren and Union Electric share the same bank credit facility, with Union Electric able to borrow on a 364-day basis under the facility. The two entities also share a money pool arrangement and Union Electric is highly dependent on the parent for liquidity and financial support, as has been demonstrated by capital contributions from Ameren to Union Electric and a $50 million intercompany note payable from the utility to the parent outstanding as of June 30, 2008.[9]

Although Moody's notes Ameren Missouri's need for capital from the parent company, it is clear that the downgrade of Ameren Missouri's commercial paper rating was due to the downgrade of Ameren's commercial paper rating. This can cause a direct impact on the capitalization costs that Ameren Missouri charges to its construction projects. While companies with access to commercial paper, such as KCP&L, were able to realize weighted-average interest rates as low as 0.41 percent as of December 31, 2010, Ameren's weighted-average interest rate was 2.31 percent as of December 31, 2010. Because Ameren and Ameren Missouri have the same commercial paper rating and share the same credit facility,

[9] "Moody's Downgrades Ameren and AmerenGenco; Outlook Stable, August 13, 2008, Moody's Investor Service (see Schedule 8).

it is likely that Ameren Missouri would incur similar costs. However, Ameren Missouri did not have any short-term debt outstanding as of December 31, 2010. To the extent that Ameren Missouri includes these higher short-term rates in its capitalization of construction costs, this could be detrimental to Missouri ratepayers.

Considering the above, Staff is concerned about how Ameren manages the direct access Ameren Missouri has to short-term credit facilities. Ameren Missouri has direct access to $500 million of short-term debt under a shared $800 million credit facility it has with Ameren. However, Ameren also has direct access to $500 million under this credit facility. Therefore, Ameren can reduce Ameren Missouri's direct access to credit by $200 million if it fully draws on its access. At the time of the financial crisis, Ameren Missouri shared a credit facility not only with Ameren, but also with AmerenGenco. This credit facility had a total limit of $1.15 billion, with Ameren Missouri only allowed direct access to $500 million of this capacity.

Ameren Missouri on a stand-alone basis has a larger total asset base than Great Plains Energy, Inc. ("GPE") on a consolidated basis. However, GPE has $1.05 billion of credit capacity under two credit facilities it maintains at KCP&L ($600 million) and KCP&L Greater Missouri Operations Company ($450 million). Although GPE shares access to these credit facilities with its subsidiaries, the subsidiaries have direct access to the entire amount of their individual credit facilities. Consequently, based on this comparison, it appears that Ameren Missouri should demand at least $1 billion of direct credit capacity since it provides the asset base to support access to this liquidity. Additionally, as discussed earlier in my testimony, Ameren Missouri's stand-alone credit metrics and business risk supports a higher credit profile that would allow it to have a higher long-term credit rating and short-term credit rating, absent its affiliation with Ameren's other operations.

Q. What is S&P's current short-term debt rating for Ameren Missouri?

A. A-3, which is the equivalent to Moody's Prime-3 rating.

Q. When was Ameren Missouri's S&P short-term credit rating lowered to A-3 from its previous higher rating of A-2, which is the equivalent of Moody's Prime-2 rating?

A. On October 5, 2006, S&P downgraded Ameren and all its subsidiaries as a result of regulatory risks that were occurring in Illinois (see Schedule 9).

Q. Why would Ameren Missouri's short-term credit rating be lowered due to regulatory issues in Illinois?

A. Because S&P's rating assessment of Ameren and its subsidiaries' credit quality is based on a consolidated approach. If there are credit quality concerns at one of Ameren Missouri's affiliates and at the holding company, then Ameren Missouri's credit rating will be downgraded as well.

Q. Do these factors impact Ameren Missouri's ability to maintain adequate access to liquidity during turbulent financial markets?

A. Yes. Although it was difficult for even the most solid of companies to access commercial paper at reasonable costs in the fall of 2008, the ability to have access to these markets, even at less favorable costs, is influenced by creditors' views of a company's short-term credit quality.

Q. Considering that Ameren Missouri's financial flexibility seems to have been impaired by its affiliation with Ameren's other operations as well as by Ameren's decision to allow Ameren and its other affiliates to share credit facilities with Ameren Missouri, what can Staff do to attempt to rectify this problem?

A. Staff could make recommendations to disallow costs Ameren Missouri incurred due to its impaired credit quality caused by its affiliation with Ameren's other operations and limits placed on Ameren Missouri's direct access to credit caused by sharing of its credit capacity with Ameren and any of its affiliates.

SUMMARY AND CONCLUSIONS

Q. Please summarize the conclusions of your surrebuttal testimony.

A. Although Mr. Hevert provided a point-by-point rebuttal of my testimony, the simple fact that Ameren's own internal cost of equity estimates for Ameren Missouri are below the lowest cost of equity estimates in this case is the most telling information in this case. However, as Staff indicated earlier, the Commission need not rely on Staff's imputed cost of equity estimates from Ameren's own internal analysis. If Ameren Missouri would simply provide the specific cost of capital inputs Ameren and Lazard used to value Ameren's regulated assets, then the Commission can seek an explanation of why Ameren Missouri does not suggest to Ameren that it use Mr. Hevert's cost of equity to determine the value of equity in Ameren Missouri.

Also, the Commission should consider the impact of Ameren's management of Ameren Missouri's direct access to credit capacity under its negotiated credit facilities in determining if Staff had a justified reason to be concerned about recommending Ameren Missouri be authorized over $1 billion in financing.

Q. Does this conclude your surrebuttal 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's (nka Ameren Missouri) Tariff to Increase Its Annual Revenues for Electric Service	))))	File No. ER-2011-0028

AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

David Murray, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 33 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

David Murray

David Murray

Subscribed and sworn to before me this 15th day of April, 2011.

Nikki Senn

Notary Public

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

SCHEDULE 1

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY

SCHEDULE 2

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY

SCHEDULE 3

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY

SCHEDULE 4

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY

Union Electric Company d/b/a Ameren Missouri
File No. ER-2011-0028

Company	Ticker		Average Stock Price for August 2010	Average Stock Price for March 2011
American Electric Power	AEP		$ 35.49	$ 34.92
Cleco Corp.	CNL		$ 28.43	$ 33.22
DPL, Inc.	DPL		$ 25.49	$ 26.75
Empire District Electric	EDE		$ 19.80	$ 21.33
Great Plains Energy	GXP		$ 18.33	$ 19.55
IDACORP, Inc.	IDA		$ 35.77	$ 37.22
Pinnacle West Capital	PNW		$ 39.38	$ 42.65
Portland General	POR		$ 19.82	$ 23.50
Southern Co.	SO		$ 36.10	$ 37.57
Westar Energy	WR		$ 23.94	$ 25.87
		Average	$ 28.25	$ 30.26

Price-Weighted Capital Return 7.09%

SCHEDULE.5

STANDARD
&POOR'S

RatingsDirect®

May 27, 2009

Criteria | Corporates | General:

Criteria Methodology: Business Risk/Financial Risk Matrix Expanded

Primary Credit Analysts:
Solomon B Samson, New York (1) 212-438-7653; sol_samson@standardandpoors.com
Emmanuel Dubois-Pelerin, Paris (33) 1-4420-6673; emmanuel_dubois-pelerin@standardandpoors.com

Table Of Contents

SCHEDULE 6 - 1

Criteria | Corporates | General:

Criteria Methodology: Business Risk/Financial Risk Matrix Expanded

(Editor's Note: In the previous version of this article published on May 26, certain of the rating outcomes in the table 1 matrix were missated. A corrected version follows.)

Standard & Poor's Ratings Services is refining its methodology for corporate ratings related to its business risk/financial risk matrix, which we published as part of 2008 Corporate Ratings Criteria on April 15, 2008, on RatingsDirect at www.ratingsdirect.com and Standard & Poor's Web site at www.standardandpoors.com.

This article amends and supersedes the criteria as published in Corporate Ratings Criteria, page 21, and the articles listed in the "Related Articles" section at the end of this report.

This article is part of a broad series of measures announced last year to enhance our governance, analytics, dissemination of information, and investor education initiatives. These initiatives are aimed at augmenting our independence, strengthening the rating process, and increasing our transparency to better serve the global markets.

We introduced the business risk/financial risk matrix four years ago. The relationships depicted in the matrix represent an essential element of our corporate analytical methodology.

We are now expanding the matrix, by adding one category to both business and financial risks (see table 1). As a result, the matrix allows for greater differentiation regarding companies rated lower than investment grade (i.e., 'BB' and below).

Table 1

Business And Financial Risk Profile Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA	AA	A	A-	BBB	--
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	--	BBB-	BB+	BB	BB-	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	CCC+

These rating outcomes are shown for guidance purposes only. Actual rating should be within one notch of indicated rating outcomes.

The rating outcomes refer to issuer credit ratings. The ratings indicated in each cell of the matrix are the midpoints of a range of likely rating possibilities. This range would ordinarily span one notch above and below the indicated rating.

SCHEDULE 6 - 2

Business Risk/Financial Risk Framework

Our corporate analytical methodology organizes the analytical process according to a common framework, and it divides the task into several categories so that all salient issues are considered. The first categories involve fundamental business analysis; the financial analysis categories follow.

Our ratings analysis starts with the assessment of the business and competitive profile of the company. Two companies with identical financial metrics can be rated very differently, to the extent that their business challenges and prospects differ. The categories underlying our business and financial risk assessments are:

Business risk

- Country risk
- Industry risk
- Competitive position
- Profitability/Peer group comparisons

Financial risk

- Accounting
- Financial governance and policies/risk tolerance
- Cash flow adequacy
- Capital structure/asset protection
- Liquidity/short-term factors

We do not have any predetermined weights for these categories. The significance of specific factors varies from situation to situation.

Updated Matrix

We developed the matrix to make explicit the rating outcomes that are typical for various business risk/financial risk combinations. It illustrates the relationship of business and financial risk profiles to the issuer credit rating.

We tend to weight business risk slightly more than financial risk when differentiating among investment-grade ratings. Conversely, we place slightly more weight on financial risk for speculative-grade issuers (see table 1, again). There also is a subtle compounding effect when both business risk and financial risk are aligned at extremes (i.e., excellent/minimal and vulnerable/highly leveraged.)

The new, more granular version of the matrix represents a refinement--not any change in rating criteria or standards--and, consequently, holds no implications for any changes to existing ratings. However, the expanded matrix should enhance the transparency of the analytical process.

Financial Benchmarks

Table 2

Financial Risk Indicative Ratios (Corporates)

	FFO/Debt (%)	Debt/EBITDA (x)	Debt/Capital (%)
Minimal	greater than 60	less than 1.5	less than 25
Modest	45-60	1.5-2	25-35
Intermediate	30-45	2-3	35-45
Significant	20-30	3-4	45-50
Aggressive	12-20	4-5	50-60
Highly Leveraged	less than 12	greater than 5	greater than 60

How To Use The Matrix--And Its Limitations

The rating matrix indicative outcomes are what we typically observe--but are not meant to be precise indications or guarantees of future rating opinions. Positive and negative nuances in our analysis may lead to a notch higher or lower than the outcomes indicated in the various cells of the matrix.

In certain situations there may be specific, overarching risks that are outside the standard framework, e.g., a liquidity crisis, major litigation, or large acquisition. This often is the case regarding credits at the lowest end of the credit spectrum--i.e., the 'CCC' category and lower. These ratings, by definition, reflect some impending crisis or acute vulnerability, and the balanced approach that underlies the matrix framework just does not lend itself to such situations.

Similarly, some matrix cells are blank because the underlying combinations are highly unusual--and presumably would involve complicated factors and analysis.

The following hypothetical example illustrates how the tables can be used to better understand our rating process (see tables 1 and 2).

We believe that Company ABC has a satisfactory business risk profile, typical of a low investment-grade industrial issuer. If we believed its financial risk were intermediate, the expected rating outcome should be within one notch of 'BBB'. ABC's ratios of cash flow to debt (35%) and debt leverage (total debt to EBITDA of 2.5x) are indeed characteristic of intermediate financial risk.

It might be possible for Company ABC to be upgraded to the 'A' category by, for example, reducing its debt burden to the point that financial risk is viewed as minimal. Funds from operations (FFO) to debt of more than 60% and debt to EBITDA of only 1.5x would, in most cases, indicate minimal.

Conversely, ABC may choose to become more financially aggressive--perhaps it decides to reward shareholders by borrowing to repurchase its stock. It is possible that the company may fall into the 'BB' category if we view its financial risk as significant. FFO to debt of 20% and debt to EBITDA 4x would, in our view, typify the significant financial risk category.

Still, it is essential to realize that the financial benchmarks are guidelines, neither gospel nor guarantees. They can vary in nonstandard cases: For example, if a company's financial measures exhibit very little volatility, benchmarks may be somewhat more relaxed.

Moreover, our assessment of financial risk is not as simplistic as looking at a few ratios. It encompasses:

- a view of accounting and disclosure practices;
- a view of corporate governance, financial policies, and risk tolerance;
- the degree of capital intensity, flexibility regarding capital expenditures and other cash needs, including acquisitions and shareholder distributions; and
- various aspects of liquidity--including the risk of refinancing near-term maturities.

The matrix addresses a company's standalone credit profile, and does not take account of external influences, which would pertain in the case of government-related entities or subsidiaries that in our view may benefit or suffer from affiliation with a stronger or weaker group. The matrix refers only to local-currency ratings, rather than foreign-currency ratings, which incorporate additional transfer and convertibility risks. Finally, the matrix does not apply to project finance or corporate securitizations.

Related Articles

Industrials' Business Risk/Financial Risk Matrix--A Fundamental Perspective On Corporate Ratings, published April 7, 2005, on RatingsDirect.

SCHEDULE 6 - 6

STANDARD &POOR'S

Global Credit Portal

RatingsDirect®

December 29, 2010

Summary: Ameren Corp.

Primary Credit Analyst:
Gabe Grosberg, New York (1) 212-438-6043; gabe_grosberg@standardandpoors.com

Secondary Contact:
Todd A Shipman, CFA, New York (1) 212-438-7676; todd_shipman@standardandpoors.com

Table Of Contents

SCHEDULE 7 - 1

Summary:

Ameren Corp.

Credit Rating: BBB-/Stable/A-3

Rationale

The ratings on Ameren reflect its consolidated credit profile. The ratings also reflect Ameren's satisfactory business risk profile and significant financial risk profile. Ameren's subsidiaries include rate regulated utilities Ameren Illinois and Ameren Missouri, and merchant energy company AmerenEnergy Generating Co. (GenCo.). As of Sept. 30, 2010, Ameren had about $7.7 billion of total debt outstanding. Based on the combination of future earnings, cash flow, capital expenditures, and credit risk exposure, we view Ameren as about 75% regulated and 25% merchant generation.

The consolidated satisfactory business risk profile reflects the combination of the excellent business risk profiles of Ameren's regulated businesses offset by the fair business risk profile of Ameren's merchant energy businesses.

Ameren Missouri's excellent business risk profile reflects its recent rate cases and regulatory mechanisms that overall indicate a decreasing regulatory risk. Ameren Missouri is a rate-regulated utility that serves 1.2 million electric and 126,000 gas customers in portions of central and eastern Missouri. The company also has 10,400 megawatt (MW) of generating capacity of which 5,400 MW is base load coal and 1,200 MW is nuclear generation. In 2009 and 2010, the company received credit supportive rate case orders from the Missouri Public Service Commission that includes more than $390 million of base rate increases, a fuel adjustment clause, pension and OPEB trackers, and a cost tracker for vegetation management and infrastructure inspections. Recently, the company filed for a $12 million gas revenue increase and a $263 million electric rate increase. The commission's orders for the gas and electric rate cases are expected by April 2011 and July 2011, respectively. We expect that Ameren Missouri will continue to file rate cases on a frequent basis to reduce its regulatory lag.

Ameren Illinois' excellent business risk profile reflects its lower-risk pure transmission and distribution (T&D) operations. The company serves about 1.2 million electric customers and 813,000 gas customers in central and southern Illinois, whose rates are regulated by the Illinois Commerce Commission (ICC). Additionally, the company's electric transmission lines, which constitutes about 13% of the company's total rate base and is regulated by the Federal Energy Regulatory Commission, provides some added diversification. Overall, we view the T&D businesses as lower risk than the generation businesses that are included in many fully integrated electric utilities.

Ameren Illinois' business risk profile is also affected by its ability to manage its regulatory risk. Earlier in 2010, Standard & Poor's revised its assessment of the Illinois regulation to 'less credit supportive' from 'least credit supportive'. The change reflected our view that the Illinois legislative and regulatory environment had returned to relative stability following the disruption during the state's transition to competition. Our revised assessment was partially based on the 13 constructive rate case orders from 2008 until the early 2010. These developments clearly pointed to a decreasing regulatory risk. However, in April 2010, Ameren received a $4.7 million rate case order for its Illinois electric and gas businesses that we viewed as not conducive to credit quality. Since then, based on error corrections and a rehearing, Ameren's net rate order was increased to $44 million. Overall, we view the company's regulatory risk as rising. Should this persist, it could pressure the company's business risk profile, which could harm

SCHEDULE 7 - 2

its credit quality.

GenCo.'s business risk profile is fair. Ameren has 6,500 MW of merchant generation, of which 4,600 MW represent base load coal generation. Although GenCo. has consistently implemented a three-year hedging policy, its long-term profitability is ultimately dependent on the market price of energy. While the unregulated businesses are considerably hedged for 2011, their margins already declined in 2010 due to weak market power prices and are expected to further decline over the intermediate term based on the forward curve. While the company continues to effectively manage those areas that it can directly influence, including reducing its O&M costs and capital spending, sustained weak energy power prices or increased mandated environmental capital expenditures would pressure the merchant business over the intermediate term.

For Ameren Corp. to improve its consolidated business risk profile, it must reduce its merchant business risks by either selling its merchant assets, committing its merchant generation to long-term contracts, or by completing the necessary environment capital expenditures at its merchant business.

Ameren's significant financial risk profile reflects management's proactive 2009 and 2010 decisions to reduce its dividend, issue equity, and reduce O&M costs and capital spending. More recently, the company's financial measures have improved reflecting warmer-than-expected weather, continued cost reductions, and rate case increases. For the 12 months ended Sept. 30, 2010, adjusted funds from operations (FFO) to total debt increased to 23.9% from 21.4% at the end of 2009, adjusted debt to EBITDA improved to 3.8x from 4.3x, and adjusted debt to total capital strengthened to 53.4% from 54.1%. While Ameren's financial measures are expected to remain improved for the short term, we expect that over the intermediate term the financial measures will weaken because of increasing environmental capital expenditures and gradually weaker cash flows from the merchant generation business.

Short-term credit factors

The short-term rating on Ameren is 'A-3'. We view its liquidity as adequate under Standard & Poor's corporate liquidity methodology, which categorizes liquidity in five standard descriptors (exceptional, strong, adequate, less than adequate, and weak). Adequate liquidity supports Ameren's 'BBB-' corporate credit rating. Projected sources of liquidity--mainly operating cash flow and available bank lines--exceed projected uses, necessary capital expenditures, debt maturities, and common dividends by about 1.2x. Ameren's ability to absorb high-impact, low-probability events with limited need for refinancing, its flexibility to lower capital spending, its well established bank relationships, its general high standing in the credit markets, and prudent risk management further support our assessment of its liquidity as adequate.

As of Sept. 30, 2010, Ameren and its subsidiaries had more than $1.6 billion available on its $2.1 billion credit facilities after reducing for outstanding borrowings. The company recently entered into the existing credit facilities and they do not terminate until September 2013. The credit facilities require Ameren and its subsidiaries to maintain a maximum debt-to-capital ratio of 65% and as of Sept. 30, 2010, the company was in compliance with this financial covenant.

Ameren's current positive discretionary cash flow is expected to turn negative over the intermediate term as capital expenditures increase. Long-term maturities are manageable with $155 million due in 2011 and $199 million due in 2012. In the fourth quarter of 2010, GenCo. used cash on hand to pay down its $200 million long-term debt maturity. We fundamentally expect that Ameren will continue to meet its cash needs in a manner that is credit neutral.

Outlook

The stable outlook on Ameren reflects Standard & Poor's baseline forecast that its adjusted FFO to debt and adjusted debt to total capital will, over the intermediate term, approximate 21% and 50%, respectively. Fundamental to our forecast is the outcome of the company's rate case filings and market power prices. However, because of the business risk pressures that Ameren Illinois and GenCo. are currently facing, there is less of a cushion at the 'BBB-' corporate credit rating. A downgrade could result if the company is unable to effectively manage its regulatory risk or dark spreads continue to compress so that FFO to debt drops to below 20% on a sustained basis. An upgrade is possible if management decides to no longer support its merchant business.

Related Criteria And Research

- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009.
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008.

SCHEDULE 7 - 4

Moody's Investors Service

Rating Action: Moody's Downgrades Ameren and AmerenGenco; Outlook Stable

Global Credit Research - 13 Aug 2008

Approximately $800 million of Debt Securities Downgraded

New York, August 13, 2008 -- Moody's Investors Service downgraded the ratings of Ameren Corporation (Ameren), including its Issuer Rating, to Baa3 from Baa2, and its short-term rating for commercial paper, to Prime-3 from Prime-2; and the senior unsecured debt rating of AmerenEnergy Generating Company (AmerenGenco) to Baa3 from Baa2. The rating outlooks of Ameren and AmerenGenco are stable. Moody's also downgraded Union Electric Company's (d/b/a AmerenUE) short-term rating for commercial paper to Prime-3 from Prime-2. These rating actions conclude the review for downgrade initiated on May 21, 2008. The long-term ratings and outlooks of Central Illinois Public Service Company (d/b/a AmerenCIPS, Ba1 Issuer Rating, positive outlook); CILCORP Inc. (Ba1 Corporate Family Rating, positive outlook); Central Illinois Light Company's (d/b/a AmerenCILCO, Ba1 Issuer Rating, positive outlook), Illinois Power Company (d/b/a AmerenIP, Ba1 Issuer Rating, positive outlook), and Union Electric Company (d/b/a AmerenUE, Baa2 Issuer Rating, stable outlook) are unchanged.

"The downgrade of Ameren reflects declining consolidated coverage ratios over the last several years and Moody's expectation that ongoing cost pressures and the lack of timely regulatory recovery of some costs will prevent ratios from returning to historical levels over the near term", said Michael G. Haggarty, Vice President and Senior Credit Officer. Ameren has experienced higher operating and maintenance costs and increased capital spending requirements at both its utility and nonutility businesses. Limited rate relief, low returns, and the lack of automatic rate adjustment clauses has led to regulatory lag in recovering costs in recent years, which is reflected in its lower consolidated coverage metrics. In addition, the combination of large capital expenditures and the company's high dividend payout ratio has resulted in substantial negative free cash flow in 2007 and 2008, which is likely to continue over the next several years.

Ameren's lower rating is also prompted the downgrade of two of its major subsidiaries, Union Electric (to Baa2 on May 21, 2008) and AmerenGenco (with this rating action), which will decrease the quality of expected cash flows upstreamed to the parent company. Although Moody's maintains positive outlooks on the ratings of Ameren's Illinois utility subsidiaries, any upward movement of these ratings is likely to be modest and not significant enough to offset the lower ratings of Union Electric and AmerenGenco, which represent the bulk of the cash flows upstreamed to the parent. The downgrade also considers longer-term challenges facing Ameren, including the potential passage of carbon control legislation next year and the possible construction of a new nuclear unit at Union Electric, which just submitted a combined Construction and Operating License Application (COLA) to the Nuclear Regulatory Commission.

The downgrade of AmerenGenco reflects higher capital expenditures at this predominantly coal fired generating subsidiary, some of which are likely to be financed with additional long-term debt; and the likelihood that the company will be negatively affected over the long-term by the implementation additional environmental compliance requirements or controls on carbon emissions. The downgrade also considers its higher business and operating risk profile, as Moody's views AmerenGenco as more of a merchant generating company selling into unregulated power markets rather than a completely contracted genco selling most of its power to Ameren affiliates. Although financial metrics have improved since the expiration of these below market affiliate contracts, this improvement is not sufficient enough to offset its increased business risk profile.

The downgrade of Union Electric's short-term rating for commercial paper to Prime-3 from Prime-2 is prompted by the downgrade of Ameren's short-term rating to Prime-3. Ameren and Union Electric share the same bank credit facility, with Union Electric able to borrow on a 364-day basis under the facility. The two entities also share a money pool arrangement and Union Electric is highly dependent on the parent for liquidity and financial support, as has been demonstrated by capital contributions from Ameren to Union Electric and a $50 million intercompany note payable from the utility to the parent outstanding as of June 30, 2008.

The maintenance of a positive rating outlook of Ameren's Illinois utilities reflects the potential for modest upward movement in their ratings in the event there is a supportive outcome of their pending distribution rate cases, resulting in an improvement in some of their relatively low cash flow coverage metrics; if there is a reduction in high short-term debt levels and an extension of their bank facilities, increasing financial flexibility; or if there is a successful implementation of new power procurement policies and procedures in Illinois.

Ratings downgraded include:

Ameren's Issuer Rating, to Baa3 (stable outlook) from Baa2; and short-term rating for commercial paper, to Prime-3 from Prime-2;

AmerenGenco's senior unsecured debt, to Baa3 (stable outlook) from Baa2;

Union Electric's short-term rating for commercial paper, to Prime-3 from Prime-2.

Ameren Corporation is a public utility holding company headquartered in St. Louis, Missouri. It is the parent company of Union Electric Company (d/b/a AmerenUE), Central Illinois Public Service Company (d/b/a AmerenCIPS), CILCORP Inc., Central Illinois Light Company (d/b/a AmerenCILCO), Illinois Power Company (d/b/a AmerenIP), and AmerenEnergy Generating Company.

New York
William L. Hess
Managing Director
Infrastructure Finance Group
Moody's Investors Service
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

New York
Michael G. Haggarty
VP - Senior Credit Officer
Infrastructure Finance Group
Moody's Investors Service
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Moody's Investors Service

by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, such information is provided "as is" without warranty of any kind and MOODY'S, in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such information. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The credit ratings and financial reporting analysis observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER. Each rating or other opinion must be weighed solely as one factor in any investment decision made by or on behalf of any user of the information contained herein, and each such user must accordingly make its own study and evaluation of each security and of each issuer and guarantor of, and each provider of credit support for, each security that it may consider purchasing, holding or selling.

MOODY'S hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MOODY'S have, prior to assignment of any rating, agreed to pay to MOODY'S for appraisal and rating services rendered by it fees ranging from $1,500 to approximately $2,400,000. Moody's Corporation (MCO) and its wholly-owned credit rating agency subsidiary, Moody's Investors Service (MIS), also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually on Moody's website at www.moodys.com under the heading "Shareholder Relations - Corporate Governance - Director and Shareholder Affiliation Policy."

STANDARD
&POOR'S

Global Credit Portal
RatingsDirect®

October 5, 2006

Research Update:

Ameren And Units Downgraded Due To Potential Rate Freeze Extension In Illinois, Still On Watch

Primary Credit Analyst:
Barbara A Eiseman, New York (1) 212-438-7666;barbara_eiseman@standardandpoors.com

Table Of Contents

SCHEDULE 9 - 1

Research Update:

Ameren And Units Downgraded Due To Potential Rate Freeze Extension In Illinois, Still On Watch

Rationale

On Oct. 5, 2006, Standard & Poor's Ratings Services lowered its long-term corporate credit ratings on Ameren Corp.'s Illinois subsidiaries, Central Illinois Public Service Co. (CIPS), CILCORP Inc., Central Illinois Light Co. (CILCO), and Illinois Power Co. (IPC) to 'BBB-' from 'BBB+'. At the same time, Standard & Poor's lowered its long-term corporate credit ratings on Ameren, Union Electric Co. (UE), and Ameren Energy Generating Co. (AEGC) to 'BBB' from 'BBB+'. All ratings remain on CreditWatch with negative implications.

The rating action on CIPS, CILCORP, CILCO, and IPC (the Illinois utilities) reflects serious concern over the financial health of these companies that possible legislation mandating an electric rate freeze extension of up to three years has raised. Lower ratings on Ameren, UE, and AEGC reflect deterioration in the consolidated business profile and financial metrics, which were somewhat subpar for the previous rating level, compounded by the stress of near-term weakening of the Illinois utilities, which account for roughly 30% of Ameren's funds from operations and operating income. Also of concern is the credit exposure of power suppliers to the Illinois utilities. Under Illinois' restructuring law, generators are unable to require collateral postings from the utilities as credit quality deteriorates. Therefore, in the event of a utility insolvency, AEGC could face a liquidity crunch.

The political rhetoric in Illinois regarding a rate-freeze extension has intensified and legislation extending the freeze appears to be gathering momentum in advance of pending state elections. House Speaker Michael Madigan has asked Governor Rod Blagojevich to convene a special session of the General Assembly within a week to vote on legislation that would extend the state's current rate freeze for three years through 2009. The governor has stated that he would call a special session once the votes are in place to pass such legislation. If consensus is not reached in the near future, the governor said he would call a special session anyway.

In Standard & Poor's opinion, the active engagement of high level politically influential individuals in the debate increases the likelihood of such legislation, which, absent relief, would inevitably lead to the Illinois utilities' insolvency. In the extreme, bankruptcy filings could occur sooner rather than later. The ratings on the Illinois utilities have been lowered to 'BBB-' and remain on CreditWatch with negative implications to reflect the fact that depending on developments, credit quality would deteriorate rapidly.

We will continue to lower the ratings if, in our opinion, the likelihood of legislation extending the rate freeze increases. If rate freeze legislation is passed, Standard & Poor's will lower ratings on the Illinois utilities into the 'B' category. If the threat of legislation recedes, Standard & Poor's will re-evaluate its 'BBB-' corporate credit rating, paying special attention to the prospects for lingering political and/or regulatory uncertainties.

Ameren has indicated that it would be unwilling to support its Illinois utilities if the subsidiaries were unable to fully recover their costs. In fact, Ameren has stated that the inability to adjust rates to reflect full and timely recovery could, in the extreme, lead to its Illinois utilities filing for bankruptcy. In this regard, Ameren has taken steps to structurally separate the Illinois companies from the rest of the Ameren family. These measures include removing CIPS, CILCORP, CILCO, and IPC as borrowers under Ameren's amended credit facility and removing provisions that would treat the Illinois units as subsidiaries for purposes of cross default provisions. Moreover, beginning in 2007, Ameren's unregulated generating units will supply by law no more than 35% of the Illinois transmission and distribution utilities power needs. AEGC and AmerenEnergy Resources Generating Co., CILCO's unregulated generation subsidiary, currently supply all of CIPS' and CILCO's power requirements, respectively, through purchased power contracts that expire at the end of 2006. IPC's power needs are supplied under separate nonaffiliated contracts.

Less clear at this time is how the utilities would procure power in the event that suppliers refuse to sell to them once credit quality deteriorates, they become insolvent, or they declare bankruptcy. In California, when Pacific Gas and Electric Co. and Southern California Edison Co. defaulted, the state had to step in and act as an intermediary through its Department of Water Resources, procuring power on behalf of the insolvent utilities. California's Department of Water Resources continues today, five years after the defaults, to procure some of the utilities' power. Standard & Poor's knows of no similar plan in Illinois.

In light of the increasingly hostile political environment in Illinois, Ameren's consolidated business risk profile and the Illinois utilities business risk profiles are now regarded as weak, at '7' and '8', respectively. UE's business profile remains a satisfactory '5'.

Ratings List

Downgraded

	To	From
Ameren Corp.		
Corporate Credit Rating	BBB/Watch Neg/A-3	BBB+/Watch Neg/A-2
Senior Unsecured	BBB-/Watch Neg	BBB/Watch Neg
Preferred Stock	BBB-/Watch Neg	BBB/Watch Neg
Commercial Paper	A-3/Watch Neg	A-2/Watch Neg
AmerenEnergy Generating Co.		
Corporate Credit Rating	BBB/Watch Neg/--	BBB+/Watch Neg/--
Senior Unsecured	BBB/Watch Neg	BBB+/Watch Neg

CILCORP Inc.		
Corporate Credit Rating	BBB-/Watch Neg/--	BBB+/Watch Neg/--
Senior Unsecured	BB+/Watch Neg	BBB/Watch Neg
Central Illinois Light Co.		
Corporate Credit Rating	BBB-/Watch Neg/--	BBB+/Watch Neg/--
Senior Secured	BBB/Watch Neg	A-/Watch Neg
Preferred Stock	BB/Watch Neg	BBB-/Watch Neg
Central Illinois Public Service Co.		
Corporate Credit Rating	BBB-/Watch Neg/--	BBB+/Watch Neg/--
Senior Secured	BBB/Watch Neg	A-/Watch Neg
Senior Unsecured	BB+/Watch Neg	BBB/Watch Neg
Preferred Stock	BB/Watch Neg	BBB-/Watch Neg
Illinois Power Co.		
Corporate Credit Rating	BBB-/Watch Neg/--	BBB+/Watch Neg/--
Senior Secured	BBB-/Watch Neg	BBB+/Watch Neg
Preferred Stock	BB/Watch Neg	BBB-/Watch Neg
Union Electric Co. d/b/a AmerenUE		
Corporate Credit Rating	BBB/Watch Neg/A-3	BBB+/Watch Neg/A-2
Senior Secured	BBB/Watch Neg	BBB+/Watch Neg
Senior Unsecured	BBB-/Watch Neg	BBB/Watch Neg
Preferred Stock	BB+/Watch Neg	BBB-/Watch Neg
Commercial Paper	A-3/Watch Neg	A-2/Watch Neg

Complete ratings information is available to subscribers of RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.

SCHEDULE 9 - 4