

Exhibit No.:
Issue: Overall Rate of Return
Witness: Michael G. O'Bryan
Type of Exhibit: Direct Testimony
Sponsoring Party: Union Electric Company
Case No.:
Date Testimony Prepared: May 23, 2003

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. _____

DIRECT TESTIMONY

OF

MICHAEL G. O'BRYAN

ON BEHALF OF

**UNION ELECTRIC COMPANY,
d/b/a AmerenUE**

**St. Louis, Missouri
May 2003**

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Union Electric Company)
d/b/a AmerenUE for Authority to File)
Tariffs Increasing Rates for Gas Service)
Provided to Customers in the Company's)
Missouri Service Area.)

Case No. _____

AFFIDAVIT OF MICHAEL G. O'BRYAN

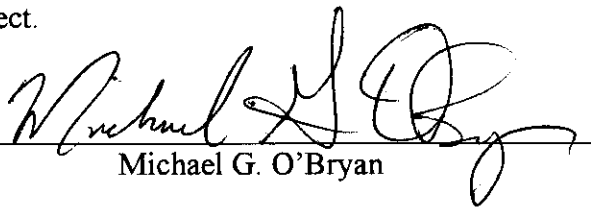
STATE OF MISSOURI)
) ss
CITY OF ST. LOUIS)

Michael G. O'Bryan, being first duly sworn on his oath, states:

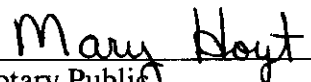
1. My name is Michael G. O'Bryan. I work in St. Louis, Missouri, and I am employed by Ameren Services Company as a Senior Capital Markets Specialist in the Corporate Finance and Development Department.

2. Attached hereto and made a part hereof for all purposes is my Direct Testimony on behalf of Union Electric Company d/b/a AmerenUE consisting of 7 pages, Appendix A and Schedules MGO-1 through MGO-4, all of which have been prepared in written form for introduction into evidence in the above-referenced docket.

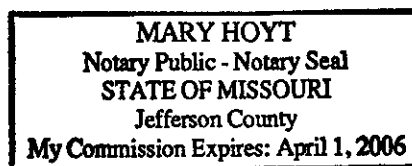
3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.


Michael G. O'Bryan

Subscribed and sworn to before me this 22nd day of May, 2003.


Notary Public

My commission expires: 4-1-2006



DIRECT TESTIMONY

OF

MICHAEL G. O'BRYAN

CASE NO. _____

Q. Please state your name and business address.

A. My name is Michael G. O'Bryan. My business address is One Ameren Plaza, 1901 Chouteau Avenue, St. Louis, Missouri 63103.

Q. By whom are you employed?

A. I am employed by Ameren Services Company.

Q. Please summarize your educational background, work experience and current duties and responsibilities.

A. My educational background, work experience and current duties and responsibilities are described on Appendix A attached hereto.

Q. What is the purpose of your direct testimony?

A. The purpose of my testimony is to recommend an overall fair rate of return for Union Electric Company d/b/a AmerenUE's ("AmerenUE" or "Company") gas utility business. I determine AmerenUE's capital structure, embedded cost of long-term debt and embedded cost of preferred stock. I also calculate the overall fair rate of return applied to rate base which is utilized in AmerenUE's filing in this case. I do so by using the fair rate of return applicable to the common equity component of AmerenUE's capital structure as developed by AmerenUE witness Kathleen McShane in her direct testimony submitted in this case.

1 **Q. Have you prepared or has there been prepared under your direction**
2 **and supervision any schedules relating to overall fair rate of return in this**
3 **proceeding?**

4 A. Yes, I am sponsoring Schedules MGO-1 through MGO-4 for that purpose.
5 These Schedules are based upon the test year twelve months ended December 31, 2002,
6 and are designated as follows:

7	Schedule MGO-1	Capital Structure
8	Schedule MGO-2	Embedded Cost of Long-Term Debt
9	Schedule MGO-3	Embedded Cost of Preferred Stock
10	Schedule MGO-4	Weighted Average Cost of Capital

11 **Q. How did you calculate the overall fair rate of return or weighted**
12 **average cost of capital for AmerenUE?**

13 A. In order to derive AmerenUE's overall fair rate of return, I multiplied the
14 relative weighting or proportion of each component of AmerenUE's capital structure by
15 the cost developed for that component. I then summed these weighted costs by
16 component to arrive at AmerenUE's overall fair rate of return or weighted average cost of
17 capital.

18 **Q. What is the primary standard for determining a fair rate of return?**

19 A. The primary standard used in the determination of a fair rate of return is
20 the cost of capital. This cost, the overall rate of return or weighted average cost of
21 capital, must produce sufficient earnings/cash flow when applied to AmerenUE's rate
22 base at book value to enable the Company to accomplish the following: maintain the
23 financial integrity of its existing invested capital; maintain its creditworthiness; and

1 attract sufficient capital on competitive terms to continue to provide a source of funds for
2 continued investment and enable the Company to meet the needs of its customers.

3 **Q. Why must AmerenUE meet these requirements?**

4 A. Beyond the fact that these three standards are mandated by the landmark
5 Bluefield and Hope U.S. Supreme Court decisions,¹ meeting these requirements is
6 necessary in order for AmerenUE to effectively meet the gas utility services requirements
7 of its customers and provide an adequate and reasonable return to its investors,
8 debtholder and equity holder alike. The assets owned by AmerenUE which are employed
9 in meeting its customers' gas utility services requirements exist and are available for this
10 purpose only because investors have entrusted their funds with AmerenUE. These
11 investors have deemed an investment in the securities issued by the Company to be sound
12 and capable of providing a competitive return.

13 AmerenUE must maintain its creditworthiness in order to continue to
14 attract capital on a competitive basis. This is important to assure future opportunities for
15 AmerenUE to replace capital and various securities which must be refinanced in the
16 future at reasonable cost. Also, the ability of AmerenUE to attract new capital on
17 competitive terms is critical in order for the Company to continue to replace and upgrade
18 facilities used to meet the gas utility services needs of its customers.

19 Further, AmerenUE's ability to attract capital is also important due to the
20 fact that AmerenUE has approximately \$521 million of debt that will mature and may
21 require refinancing during the next five years.

22 **Q. Please describe the capital structure of AmerenUE.**

¹ Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923) and Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 391 (1944).

1 A. As outlined on Schedule MGO-1, the capital structure of AmerenUE on
2 December 31, 2002 consisted of 37.645% long-term debt, 2.593% preferred stock and
3 59.762% common equity.

4 **Q. How were the balances of the components of AmerenUE's capital**
5 **structure determined?**

6 A. The balance of long-term debt, \$1,662,051,248, is the total carrying value
7 of the Company's long-term debt using the net proceeds method. The net proceeds
8 method calculates the carrying value by taking the bonds' face amount outstanding and
9 subtracting the unamortized discount, issuance expenses and any loss on reacquired debt.

10 The balance of preferred stock, \$114,502,040, is also the carrying value or
11 net proceeds amount of AmerenUE's preferred stock as found in the embedded cost
12 calculation for this component of capitalization.

13 The balance of common equity, \$2,638,521,776, represents AmerenUE's
14 stated value of common equity at December 31, 2002 adjusted to remove the effects of its
15 investments in its subsidiaries. This adjustment is necessary due to the unregulated
16 nature of these subsidiaries' businesses.

17 **Q. What is the embedded cost of AmerenUE's long-term debt?**

18 A. AmerenUE's embedded cost of long-term debt was 5.634% as of
19 December 31, 2002. Schedule MGO-2 provides the calculation of the embedded cost of
20 long-term debt. AmerenUE has about \$436.6 million principal amount of variable rate
21 environmental improvement indebtedness (in various series) outstanding under which the
22 interest rates are reset by a Dutch auction process every 7 or 35 days. The effective cost
23 used for the test year period ended December 31, 2002 for this indebtedness was derived

1 by calculating the effective interest cost and associated auction broker/dealer fees paid
2 during the test year.

3 **Q. Did you make any adjustments to AmerenUE's long-term debt**
4 **balance?**

5 A. Yes. On March 10, 2003, subsequent to the end of the test year,
6 AmerenUE issued \$184 million of 5.50% secured notes to redeem/refinance its \$104
7 million principal amount 8.25% first mortgage bonds and to refinance \$75 million of its
8 8.33% first mortgage bonds which matured on December 16, 2002. Also subsequent to
9 the end of the test year, AmerenUE issued \$114 million of 4.75% secured notes to
10 redeem/refinance \$85 million of its 8.00% first mortgage bonds and to permanently
11 finance \$25 million of short-term debt. Accordingly, the calculation of the Company's
12 cost of long-term debt and the balance of long-term debt in its capital structure reflect
13 these activities.

14 The long-term debt balance excludes two capital leases at AmerenUE.
15 These leases, a lease for nuclear fuel used at AmerenUE's Callaway Nuclear Power Plant
16 and a Chapter 100 lease for a gas-fired generating facility with the City of Bowling
17 Green, Missouri, involve the Company's electric operations only and thus are excluded
18 from the balance and cost of long-term debt calculations.

19 **Q. What is the embedded cost of AmerenUE's preferred stock?**

20 A. AmerenUE's embedded cost of preferred stock was 5.189% as of
21 December 31, 2002. Schedule MGO-3 provides the calculation of the embedded cost of
22 preferred stock. Using the net proceeds method of calculating the balance of preferred
23 stock, the balance outstanding as of December 31, 2002 was \$114,502,040.

1 **Q. Did you consider expenses associated with AmerenUE's issuance of**
2 **preferred stock in developing the embedded cost of this component of the**
3 **Company's capital structure?**

4 A. Yes, I did. I included expenses associated with the issuance of preferred
5 stock, including discount and premium, plus any loss incurred in acquiring/redeeming
6 prior series, in the embedded cost calculation. These costs are illustrated in the cost
7 calculations shown on Schedule MGO-3. Unlike similar expenses incurred in connection
8 with the issuance of long-term debt, these expenses are not amortized over the life of the
9 particular series of preferred stock due to the perpetual nature of this form of
10 capitalization. Nonetheless, for economic purposes it is reasonable to recognize these
11 costs in establishing an overall fair rate of return for the Company.

12 **Q. In what manner will AmerenUE obtain debt and preferred stock**
13 **capital in the future?**

14 A. AmerenUE expects to continue to issue its own long-term debt and
15 preferred stock securities in the external capital markets. Short-term borrowings can be
16 obtained from the capital markets, Ameren Corporation, or through Ameren
17 Corporation's Utility Money Pool, depending on the best borrowing rates available.

18 **Q. Please describe your calculation of AmerenUE's balance of common**
19 **equity.**

20 A. I derived AmerenUE's balance of common equity, \$2,638,521,776, by
21 adjusting the Company's stated value of common equity at December 31, 2002 of
22 \$2,631,348,425 by amounts representing the acquisition costs and undistributed earnings

Direct Testimony of
Michael G. O'Bryan

1 (\$7,173,351 net total) associated with AmerenUE's investment in two subsidiaries, Union
2 Electric Development Corp. and Electric Energy, Inc.

3 **Q. What is the cost of common equity for AmerenUE?**

4 A. In her direct testimony in this case, Ms. McShane develops and supports a
5 fair return on common equity for AmerenUE's gas utility operations in the range of
6 11.5% – 13.5% with a recommended cost of equity for AmerenUE of 12.25%. For
7 purposes of determining the overall fair rate of return for AmerenUE in this proceeding, I
8 use Ms. McShane's recommendation, 12.25%, as the Company's cost of common equity.

9 **Q. What is the overall fair rate of return for AmerenUE for this**
10 **proceeding?**

11 A. As shown on Schedule MGO-4, as of December 31, 2002, the overall fair
12 rate of return for AmerenUE is 9.577%. I derived this result by using the capital structure
13 and embedded costs of long-term debt and preferred stock discussed above, and shown
14 on the various Schedules attached, along with the cost of common equity for AmerenUE
15 developed by Ms. McShane in her testimony.

16 **Q. Does this conclude your direct testimony?**

17 A. Yes, it does.

QUALIFICATIONS OF MICHAEL G. O'BRYAN

My name is Michael G. O'Bryan, and my business address is One Ameren Plaza, 1901 Chouteau Avenue, St. Louis, Missouri 63103. I hold the position of Senior Capital Markets Specialist in Corporate Finance and Development for Ameren Services Company.

In my current position, I am involved in Ameren's corporate financing, cost of capital, financial analysis and modeling activities as well as monitoring capital markets and bank credit markets to stay current on rates, structures and opportunities. I communicate regularly with investment bankers and debt capital markets personnel to obtain market intelligence. I also closely follow the actions of the rating agencies for trends and changes in ratings methodology largely for internal ratings maintenance purposes.

Prior to accepting my current position at Ameren Services, I was employed by A.G. Edwards in St. Louis, Missouri as a Vice President in Investment Banking. I focused on business development and transaction execution with both investor-owned utilities and public power entities. I was also involved in structuring and analyzing fixed-income transactions for clients.

Upon graduation from undergraduate studies, I took a position at A.G. Edwards in Investment Banking as a Research Assistant and then Analyst, focusing on the investor-owned utilities sector. I was responsible for transaction support and marketing as well as general financial analysis of clients, capital markets transactions and merger and acquisitions. I later was promoted to Senior Analyst where I focused to a greater degree on business development and the execution of clients' transactions. I then moved into Debt Capital Markets concentrating solely on fixed-income execution and business development for clients in several different industries.

I graduated *cum laude* with a Bachelor of Science in Business Administration with a concentration in Finance from the University of Missouri – Columbia in 1992. I later earned an MBA from Saint Louis University’s John Cook School of Business in 1998.

Union Electric Company d/b/a AmerenUE
Case No.
Capital Structure

as at end of test year 12/31/2002:

CAPITAL COMPONENT	AMOUNT	PERCENT OF TOTAL
Long-Term Debt	\$1,662,051,248	37.645%
Preferred Stock	\$114,502,040	2.593%
Common Equity	\$2,638,521,776	59.762%
TOTAL	\$4,415,075,064	100.000%

Union Electric Company d/b/a AmerenUE
Case No.
Embedded Cost of Long-Term Debt

At December 31, 2002

SERIES C1	COUPON C2	ISSUED C3	MATURITY C4	PRINCIPAL C5	FACE AMOUNT OUTSTANDING C6	UNAMORTIZED BALANCES			CARRYING VALUE C10	ANNUALIZED COUPON INT. C11	ANNUALIZED AMORTIZATION			ANNUALIZED INT. EXP. C15	EMBEDDED COST C16
						DISC/(PREM) C7	ISSUE EXP. C8	LOSS C9			DISC/(PREM) C12	ISSUE EXP C13	LOSS C14		
First Mortgage Bonds	7.650%	28-Jan-92	15-Jul-03	\$100,000,000	\$100,000,000		\$70,236			\$7,650,000		\$70,236			
First Mortgage Bonds	7.375%	15-Dec-92	15-Dec-04	\$85,000,000	\$85,000,000	\$60,210	\$127,050			\$6,268,750	\$24,084	\$50,820			
First Mortgage Bonds	6.875%	01-Feb-93	01-Aug-04	\$188,000,000	\$188,000,000	\$251,000	\$244,325			\$12,925,000	\$120,480	\$117,276			
First Mortgage Bonds	6.750%	01-May-93	01-May-08	\$148,000,000	\$148,000,000	\$244,300	\$473,340			\$9,990,000	\$41,880	\$81,144			
First Mortgage Bonds	7.150%	01-Aug-93	01-Aug-23	\$75,000,000	\$75,000,000	\$591,514	\$583,924			\$5,362,500	\$28,056	\$27,696			
First Mortgage Bonds	5.450%	15-Oct-93	01-Oct-28	\$44,000,000	\$44,000,000	\$256,095	\$470,295			\$2,398,000	\$9,756	\$17,916			
First Mortgage Bonds	7.000%	15-Jan-94	15-Jan-24	\$100,000,000	\$100,000,000	\$136,752	\$667,443			\$7,000,000	\$6,336	\$30,924			
First Mortgage Bonds, Series AA	5.250%	22-Aug-02	01-Sep-12	\$173,000,000	\$173,000,000	\$202,410	\$1,374,500			\$9,082,500	\$20,241	\$137,450			
First Mortgage Bonds, Series BB	5.500%	10-Mar-03	15-Mar-34	\$184,000,000	\$184,000,000	\$2,055,280	\$1,860,000			\$10,120,000	\$66,299	\$60,000			
First Mortgage Bonds, Series CC	4.750%	09-Apr-03	01-Apr-15	\$114,000,000	\$114,000,000	\$184,680	\$1,048,000			\$5,415,000	\$15,390	\$87,333			
Subordinated Debentures	7.690%	16-Dec-96	15-Dec-36	\$65,500,000	\$65,500,000	\$494,316	\$100,602			\$5,036,950	\$14,328	\$2,916			
Environmental Improvement, Series 1991	1.895%	01-Dec-91	01-Dec-20	\$42,585,000	\$42,585,000		\$296,540			\$906,986		\$16,056			
Environmental Improvement, Series 1992	1.850%	01-Dec-92	01-Dec-22	\$47,500,000	\$47,500,000		\$325,306			\$878,750		\$15,888			
Environmental Improvement, Series 1998 ABC	1.788%	04-Sep-98	01-Sep-33	\$160,000,000	\$160,000,000		\$1,497,424			\$2,860,800		\$48,036			
Environmental Improvement, Series 2000 ABC	1.801%	09-Mar-00	01-Mar-35	\$186,500,000	\$186,500,000		\$1,385,410			\$3,358,865		\$42,276			
TOTAL LONG-TERM DEBT				\$1,713,085,000	\$1,713,085,000	\$4,476,557	\$10,524,395	\$36,032,800	\$1,662,051,248	\$89,154,101	\$346,850	\$805,967	\$3,340,404	\$93,647,322	5.634%

Carrying Value = Face Amount Outstanding less Unamortized Discount, Issuance Expenses, and Loss on Reacquired Debt

$$C10 = C6 - C7 - C8 - C9$$

Annualized Interest Expense = Annual Coupon Interest plus Annual Amortization of Discount, Issuance Expenses, and Loss on Reacquired Debt

$$C15 = C11 + C12 + C13 + C14$$

Embedded Cost = Annualized Interest Expense divided by Carrying Value

$$C16 = C15 / C10$$

Union Electric Company d/b/a AmerenUE
Case No.
Embedded Cost of Preferred Stock

at December 31, 2002

SERIES, TYPE, PAR C1	DIVIDEND C2	ISSUED C3	MATURITY C4	SHARES OUTSTANDING C5	PAR ISSUED/ OUTSTANDING C6	PREMIUM C7	ISSUANCE EXPENSE/DISCOUNT C8	NET PROCEEDS C9	ANNUAL DIVIDEND C10	EMBEDDED COST C11
\$4.50 Series, Perpetual, \$100 par	\$4.500	01-May-41	-	213,595	\$21,359,500	(\$825,000)	\$440,294	\$21,744,206	\$961,178	
\$5.50 Series, Perpetual, \$100 par	\$5.500	01-Oct-41	-	14,000	\$1,400,000			\$1,400,000	\$77,000	
\$3.70 Series, Perpetual, \$100 par	\$3.700	01-Oct-45	-	40,000	\$4,000,000	(\$70,000)	\$69,396	\$4,000,604	\$148,000	
\$3.50 Series, Perpetual, \$100 par	\$3.500	01-May-46	-	130,000	\$13,000,000	(\$910,000)	\$252,772	\$13,657,228	\$455,000	
\$4.30 Series, Perpetual, \$100 par	\$4.300	01-Jul-46	-	40,000	\$4,000,000			\$4,000,000	\$172,000	
\$4.75 Series, Perpetual, \$100 par	\$4.750	01-Oct-49	-	20,000	\$2,000,000			\$2,000,000	\$95,000	
\$4.00 Series, Perpetual, \$100 par	\$4.000	01-Nov-49	-	150,000	\$15,000,000	(\$384,000)	\$326,896	\$15,057,104	\$600,000	
\$4.56 Series, Perpetual, \$100 par	\$4.560	01-Nov-63	-	200,000	\$20,000,000	(\$266,000)	\$297,633	\$19,968,367	\$912,000	
\$7.64 Series, Perpetual, \$100 par	\$7.640	01-Jan-93	-	330,000	\$33,000,000		\$325,469	\$32,674,531	\$2,521,200	
TOTAL PREFERRED STOCK					\$113,759,500	#####	\$1,712,460	\$114,502,040	\$5,941,378	5.189%

issuance expenses, discount/premium, and any loss incurred in acquiring/redeeming prior series are not amortized due to the perpetual nature of the company's preferred stock

Net Proceeds = Par Value Outstanding plus Premium less Issuance Expense and Discount

$$C9 = C6 + C7 - C8$$

Embedded Cost = Annual Dividend divided by Net Proceeds

$$C11 = C10 / C9$$

Union Electric Company d/b/a AmerenUE
Case No.
Weighted Average Cost of Capital

as at end of test year 12/31/2002:

CAPITAL COMPONENT	AMOUNT	PERCENT OF TOTAL	COST	WEIGHTED COST
Long-Term Debt	\$1,662,051,248	37.645%	5.634%	2.121%
Preferred Stock	\$114,502,040	2.593%	5.189%	0.135%
Common Equity	\$2,638,521,776	59.762%	12.250%	7.321%
TOTAL	\$4,415,075,064	100.000%		9.577%