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Witness: Gary M. Rygh
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MISSOURI PUBLIC SERVICE COMMISSION

Case No. ER-2008-0318

REBUTTAL TESTIMONY

OF

GARY M. RYGH

ON

BEHALF OF

UNION ELECTRIC COMPANY d/b/a AmerenUE

St. Louis, Missouri
October, 2008

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REBUTTAL TESTIMONY

OF

GARY M. RYGH

CASE NO. ER-2008-0318

I. INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

A. My name is Gary M. Rygh. My business address is 745 Seventh Avenue - 25th Floor, New York, New York 10019-6801.

Q. By whom and in what capacity are you employed?

A. I am employed by Barclays Capital Inc. as a Senior Vice President.

Q. Please describe Barclays Capital Inc.

A. Barclays Capital Inc. ("Barclays Capital") is the investment banking division of Barclays Bank PLC, a leading global financial institution with over $2.5 trillion of total assets. Using a distinctive business model, Barclays Capital provides large companies, institutions and government clients with solutions to their financing and risk management needs. Barclays Bank PLC is a major global financial services provider engaged in retail and commercial banking, credit cards, investment banking, wealth management and investment management services, with an extensive international presence in Europe, the United States, Africa and Asia. With over 300 years of history and expertise in banking, Barclays Bank PLC operates in over 50 countries with over 150 thousand employees.

Q. Please describe your employment history with Barclays Capital.

A. I have been employed by Barclays Capital since July of 2007. I have worked in my current position since July 2007, when I joined the Global Power and Utility Group at Lehman Brothers; our group became part of Barclays Capital on September 22, 2008. Prior to joining Barclays Capital I served in a similar role at Morgan Stanley beginning in 1998.

Q. Please describe your qualifications as well as your duties and responsibilities as a Senior Vice President.

A. I am a Senior Vice President in the Global Power and Utility Group. Our group is responsible for the corporate finance related analysis and strategic and capital markets transactions in the utility and power sectors. I have been in the utility, power and energy investment banking business for over 13 years. I have worked extensively on strategic merger and acquisition assignments, debt and equity capital markets transactions and other corporate finance related assignments in the electric, water and gas utility sectors. I have a Bachelors of Science degree in Commerce, with a concentration in Finance from the University of Virginia.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to rebut the contentions of Staff witness Lena Mantle, Noranda Aluminum, Inc. (Noranda) witness Donald Johnstone, and State of Missouri (State) witness Martin Cohen, each of whom contend that AmerenUE does not need a fuel adjustment clause (FAC). My rebuttal testimony focuses on the importance of an FAC for AmerenUE as it pertains to capital and financing related issues, which are increasingly important for AmerenUE and utilities in general given the large capital needs they face now and in the coming years. I also address how the treatment of AmerenUE's FAC request relates to the overall impact of the perceived regulatory environment for AmerenUE and the effect of that perception on AmerenUE's overall financial health, potential changes in credit quality, and access to and the cost of financial capital. These financial market and investor perceptions are important to AmerenUE and its ratepayers because it is those financial markets and investors on whom AmerenUE relies upon for investments in its rate base. All of these considerations mitigate strongly against the opposition expressed by the above-named witnesses to AmerenUE's request for an FAC. In fact, I believe these witnesses' opposition to an FAC for AmerenUE suggests that these witnesses do not fully appreciate the significance of these considerations.

Q. What items do you address in your rebuttal testimony?

A. In order to address these topics thoroughly, I will in my testimony:

- Briefly describe the current state of and outlook for the financial markets as it pertains to AmerenUE's ability to access capital on a cost competitive and reliable basis over the next several years for rate base investments.

- Discuss how investor and credit rating agency perceptions of the regulatory process can affect access to and the cost of new capital for AmerenUE. I will provide an overview of how keenly aware investors, underwriters, credit rating agencies and researchers are of the importance of balanced, mainstream rate making policy and their ability to discern key differences amongst competing issuers of capital and their associated regulators.
- Describe why investors, credit rating agencies and other market participants would view the proposed FAC as a highly valuable tool for risk management as well as reasonable and timely cost recovery.
- Discuss how inclusion of a reasonable FAC in the rate making process may affect credit rating agency analysis of AmerenUE as well as the assessments of investors that shape their views of the regulatory climate in which AmerenUE is operating.

Q. Please summarize your key conclusions and observations.

- AmerenUE and its regulators must recognize that challenges lie ahead in procuring reasonably priced capital from investors (both equity and debt), particularly given the state of the capital markets today and for the foreseeable future.
- Utilities, including AmerenUE, have extremely large capital needs and will be competing for the capital they need in difficult

capital markets. Utilities that are perceived by investors to be operating in a supportive regulatory environment, including in particular utilities with an FAC, will have a distinct advantage over utilities that are perceived to be operating in a more challenging regulatory environment.

- The Commission can, in this rate case, support AmerenUE's ability to access the capital markets on reasonable terms by approving AmerenUE's FAC request, granting AmerenUE a fair and reasonable ROE, and otherwise providing reasonable rate treatment for AmerenUE's cost of providing service, with particular attention to the challenges being faced by AmerenUE and utilities generally in the current rising cost environment.
- The lack of an FAC for AmerenUE has already contributed to an erosion of AmerenUE's credit quality. Failure to approve an FAC in this case would likely cause investors to be even more negatively predisposed to deploy capital at AmerenUE because they have trouble comprehending why a reasonable FAC for AmerenUE could not be implemented.

II. <u>CAPITAL MARKET AND FINANCING ISSUES</u>

Q. What is the current and foreseeable future environment for the capital markets in the United States that AmerenUE must have access to?

A. Both the credit and equity markets have been extremely volatile over the last eighteen months with sharply increasing risk premiums. The cost of capital has risen dramatically in many sectors and access to capital and credit has been severely limited. Investment grade utilities, while having fared comparatively well, have not been immune from broader financial market issues and turmoil. The robust credit markets that had prevailed until the summer of 2007 will likely not be experienced for some time (if ever again). AmerenUE and its regulators must recognize that challenges lie ahead in procuring reasonably priced capital from investors (both equity and debt). With the current turbulence in the financial markets not likely to subside in the near future, AmerenUE, its regulators and other concerned parties should be proactively addressing key investor and credit rating agency concerns such as regulatory lag, needed rate relief, the rising cost of procuring fuel and volatile and increasing costs to ensure access to the lowest cost capital available.

While recent government action has stemmed a complete collapse, a quick economic turnaround is unlikely. With so many momentous things happening in the U.S. financial system in such a short period, market participants could be forgiven for being dumbstruck. In the space of just a few weeks, here are just some of the things that have happened:

- The government bailed out Fannie Mae and Freddie Mac, committing up to $200 billion.
- The Treasury announced that it would buy government sponsored entities' mortgage backed securities, and the Federal Reserve announced that it would begin purchasing short-term debt of Fannie Mae, Freddie Mac and the federal home loan banks.
- The Federal Reserve announced emergency support for financial markets, including expanding collateral eligible for its Primary Dealer Credit Facility and providing non-recourse loans to banks to finance their purchase of asset-backed commercial paper from money markets mutual funds.
- Lehman Brothers Holdings filed for Chapter 11 bankruptcy, Bank of America announced that it would purchase Merrill Lynch, and Goldman Sachs and Morgan Stanley received approval from the Federal Reserve to become bank holding companies.
- The Federal Reserve threw an $85 billion lifeline to the American International Group.
- The Federal Reserve and the Treasury announced a treasury bill issuance program to provide cash to the Federal Reserve to use to purchase assets from the banking system and expand its balance sheet, something it then did aggressively.

- The Securities and Exchange Commission halted short selling of 799 financial stocks.
- The Treasury announced a guarantee program for money market funds to prevent net asset values from falling below $1 and has also announced it will begin to buy commercial paper directly from issuers.
- The Congress adopted and the President signed into law legislation that will allow the Treasury to buy from banks up to $700 billion of illiquid assets, which were "weighing down our financial institutions and threatening our economy." In response, the Dow Jones Industrial Average has since lost nearly an additional 20% of its value as investors failed to gain confidence that the legislation would prevent further economic and financial deterioration.

In short, the financial system has been rocked, the investment banking map has been redrawn, and the government and the Federal Reserve have foreshadowed a dramatic expansion of their purchases of problem assets and direct investments to stem the crisis.

Q. What appears to be the near term prospects for the U.S. capital markets and investor appetite?

A. I would make three observations. First, at the risk of stating the obvious, there is an inordinate amount of downside risk in the outlook at the moment, which greatly complicates both forecasting and investing. Most notably, it is not clear whether the financial turmoil has reached its crescendo or whether there are further major downside surprises in store.

Second, whichever of the above is the case, given the scale of the financial system dysfunction that has been revealed and the shocks that have been delivered to business and household confidence, it seems fairly clear that it will take considerable time for capital markets to return to normalcy. A sustained period of anemic or even negative growth and suppressed spirits can be expected.

Third, downside tail risks appear to have been somewhat contained. If there was any doubt about the willingness of the Federal Reserve and the Treasury to do whatever it takes to counter threats to financial stability, the cumulative actions of the past several weeks should provide some relative comfort.

As the authorities prepare to implement the myriad of announced initiatives, the question for investors is not so much "will the government act?," as it is "will the actions work?" I like the idea of policymakers taking action to "unclog" the financial system to improve the potential supply of credit, but I believe that the shocks to confidence have resulted in some of the problem being transferred to the demand side of the economy. If so, more rate cuts will be needed and the ability for AmerenUE to access credit will continue to be challenged.

Q. What is the environment like for utilities to access the short-term and longer term credit they need?

A. Utility issuers have experienced more limited market access to address their working capital and short-term funding needs due to a number of issues impacting the market for short-term credit, including:

- Flight-to-Quality – during the credit crisis investors have become more sensitive to lower-rated entities and have reduced their participation in non-A1/P1 names, the highest rated commercial paper.
- T-Bill Rally – 3-month Treasury Bills have gained significantly as investors look to the highest credit quality short-term investments, while A2/P2 commercial paper rates have increased considerably.
- The A2/P2 (lower credit quality than A1/P1) market has mostly closed, although it may be available on case-by-case basis. Risk aversion remains a key theme in the credit markets.
- Companies are more willing to draw on revolving bank lines of credit in order to avoid having to issue new commercial paper, given the current cost for A2/P2.
- In evaluating funding sources, companies are still generally focused on funding cost (commercial paper, bank credit lines) when evaluating alternatives but are beginning to worry about access to commercial paper and are looking for alternative

For longer term credit, utility issuers still have approximately $10 billion left to finance in 2008, while we expect significant new issue supply in 2009 which will put additional pressure on the cost going forward.

- The secondary trading market has been under intense pressure as well, with spreads widening significantly since August.
- The hybrid market has been even more adversely affected by the market volatility as secondary levels have been quoted at their widest spreads in recent weeks amidst limited trading volume.
- Utility new issues that have accessed the market recently have priced at higher spreads to treasuries than similar transactions priced in August. BBB rated utilities have had limited access recently and are much more challenged to issue new capital given the significant increase in cost and limited market appetite.

Q. What are some of the major trends that you expect to affect the utility industry in 2008 and beyond that will shape the environment in which AmerenUE operates?

A. The significant increase in capital expenditures in the utility sector planned over the next several years as well as the rising cost environment will create an extended era of increasing need for utilities to access external capital. Investors and credit rating agencies are highly focused on the strains created by meaningful rate increases and its effects on the utilities' ability to recover on a timely basis the capital deployed on behalf of ratepayers. The significant amount of external funding necessary will strain investor appetite for the utility sector for both debt and equity for an extended period of time.

2007 marked the first year since 1983 that the regulated utility sector has posted a pre-dividend free cash flow deficit. Our capital spending and cash flow forecasts indicate this will prevail for years to come. Based on lessons from the last major investment period (1973–1984), we believe that risks will rise for investors due to the need for external debt and equity funding, meaningful rate increases which could cause regulatory strain, and the potential for construction-related mishaps.

The regulated utility sector is entering a major capital expenditure (CapEx) cycle, driven by required transmission, infrastructure, and generation upgrades and new build needed to meet growing electricity demand requirements. In addition, the promise of more stringent environmental regulation is driving environmental CapEx spend to upgrade generation portfolios.

- We forecast $309 billion of regulated utility CapEx through 2012. This is, on average, 16%–18% greater than we forecast last year, and 55%–65% higher than we anticipated in 2006. Inflation has been a major factor.

- We expect regulated utilities will need $119 billion of external financing, split between $93 billion of debt, and $26 billion of equity, to fund their capital plans. The market to access this capital will be highly competitive, with the key differentiator amongst utilities being the perceived quality of their regulation.
- Electricity prices, as a percentage of consumer spending, could rise 7.5% per year, and approach all-time highs by 2013.
- In our opinion, successful implementation of capital plans will likely be influenced by balance sheet strength, quality of regulatory jurisdiction, timing of rate case activity, and access to low cost capital.

Both equity and fixed income investors' ever increasing aversion to risk, coupled with the anticipated amount of supply of utility related financing, will create a highly competitive market for capital. AmerenUE will be attempting to access the same investor dollars that other utilities will be competing for. The associated cost of this capital in a competitive market will be highly correlated to the perception of risk at AmerenUE, which is predominantly regulatory related.

Q. What are some of the major issues associated with the significant increases in capital expenditures? Why does this CapEx cycle have significant risks associated with access to financial capital?

A. Materials costs are up dramatically over the last five years which creates a difficult environment to forecast capital expenditures and the associated rate relief needed. Various raw commodity inputs and skilled labor are necessary to construct the various types of plant in the backlog. These commodities include steel, cement, copper, aluminum, and inputs that impact steel production such as nickel, tungsten, and iron ore. There have been various reasons for the increase in these commodity prices but they have largely been driven by international demand, as infrastructure development continues at a rapid pace in the emerging economies. Furthermore, the decline in the U.S. dollar since peaking in 2001 and 2002 has also contributed to rising costs for U.S. utilities as a significant portion of their equipment and commodity needs are sourced internationally. Moreover, costs of labor in general continue to increase, especially for skilled construction labor. Unfortunately, it may take quite some time for the U.S. to retool its craft and heavy construction labor force due to the shift to a largely service based economy since the early 1980s and the resulting lack of trade schools and apprentice programs. Most likely, this spells more inflation in labor costs to come.

Another key issue is that credit quality has deteriorated significantly since the last CapEx cycle. One key difference between the CapEx cycle today and the cycle of the late 1970s and early 1980s is that in the earlier cycle the utilities held an average credit rating of strong single A. The current average rating is BBB. The utilities did not exit the last CapEx cycle as strong as they entered it and given that the average rating is now much lower, we are concerned about where they will shake out this time. The debt portion of the $119 billion of external funding we forecast over the next five years is roughly $93 billion. In light of this burden, we examined the relative ratings of electric balance sheets over time. In 1970, just prior to the last CapEx cycle, 97% of utilities had a credit rating of single A or better, by 1980 only 76.7% did. Going into this cycle, only 30.6% are A or better.

Investors are highly focused on the utilities' need for significant external funds to finance the pending CapEx cycle. It looks like fixed income investors are going to be providing the up-front financing for the CapEx program, considering the regulatory lag on recovery and the fact that most companies are hesitant to issue equity at this stage. Hybrids and other more esoteric structures are replacing pure equity as a means to receive equity credit in a company's capital structure when these products are available and cost competitive. Our equity team anticipates that beginning in 2009, we will see an average of five to 10 formal equity offerings per year versus just two to three for the past 10 years, further increasing the competition for limited investment dollars.

With the significant rise estimated in capital expenditures over the next several years, almost every company in the utility sector is in need of external financing. With the considerable spread concession of new issues in the past several months, the market will likely continue to have a difficult time absorbing the new issue supply that is expected in the near future.

III. THE IMPORTANCE OF INVESTOR PERCEPTIONS

Q. Does investor perception of the regulatory process have an effect on the ability of AmerenUE to raise capital?

A. Investors are very cognizant that AmerenUE is operating in a highly challenging environment:

- Significant need for new capital to service customer needs ($1 billion in 2008, $750 million to nearly $1 billion per annum thereafter of CapEx);
- Rising cost environment;
- Highly volatile commodity markets;
- Need for continued rate relief to ensure the timely recovery of capital spent; and
- A difficult economic environment for ratepayers.

Most of these key challenges manifest themselves in the ratemaking process as AmerenUE requires regulatory approval to recover invested capital. Given the high degree that the form of regulation plays in the perception of risk, investors, credit rating agencies, equity and fixed income analysts as well as others have become highly educated on the ratemaking process and the differences of one regulatory body versus another. It is universally recognized that the challenges noted above and the need for continued rate increases to customers create difficulties in balancing the needs of customers with utilities and those who provide them with needed capital. A high degree of analytical thinking is being done to help investors and credit rating agencies differentiate amongst regulatory bodies to better assess what impact risk and the perception of risk has on the cost that should be charged for capital.

In a difficult economic environment with a high degree of competition for investors' dollars, AmerenUE may find itself disadvantaged as compared to its peers that enjoy regulation that is thought to expose them to less risk and volatility in recovering their expenditures and costs and earning their allowed returns.

Q. What are the key focus areas of investors as it pertains to regulation?

A. Because the majority of the forecasted capital expenditure budget will be spent by the regulated utilities like AmerenUE, having a clear understanding of the regulatory and political environment in which a utility operates will be critical to making profitable investment decisions for investors.

Regulation is a key aspect that our team focuses on here at Barclays Capital. Frequently, we publish material which provides an overview of important regulatory trends, the regulatory climate and a ranking of each of the state regulatory commissions. We attempt to evaluate some of the key factors that we consider part of a constructive regulatory environment so that when we are looking at a particular company we consider the likelihood that they will receive fair and adequate treatment of their investment. This becomes increasingly important in a CapEx cycle.

The political pressure that regulators and politicians experience from their constituencies when power prices are rising is very difficult in the face of major rate increase decisions. Electricity prices are expected to continue to rise as the price of CapEx inputs continues to rise (cooper, steel, turbines, employee costs, etc.).

Q. What are some of the major factors that you look for when you review a regulatory environment?

A. A state's political and regulatory environment and its state laws and regulatory policies can affect the credit quality and cash flow stability of the utility company operating in its jurisdiction. We use several key factors to assess whether a regulatory environment is supportive of credit quality. Chief amongst these factors include:

- Legislative policy that ensures the stability of cash flow, earnings and coverage ratios. We must be convinced that state commissions are cognizant of how their decisions affect a company's credit quality. Constructive regulators consistently aim to adopt legislative policy that results in the stability of cash flow, earnings, and coverage ratios. We analyze rate case outcomes in order to ascertain that the rates of return (ROEs) and equity ratios that are authorized in the state commission's orders are fair and reasonable, and consistent with the industry average. We believe that it is no accident that the state commissions that authorize reasonable ROEs and are aware of how their decisions will affect the credit quality of the utility, also have the highest rated utilities in the country.

- We give significant weight to regulatory rules/laws that allow the adoption and implementation of adjustment clauses for the recovery of fuel, purchased power, and environmental expenses. We examine whether the adjustment clauses permit rate adjustments that are frequent enough that there is not a significant build-up of deferral balances. The more frequent the adjustments are allowed, the less working capital that the utility has to use to finance the deferral and the more assurance investors have that the company will be able to recover prudently incurred costs on a timely basis.
- We are encouraged by regulations that allow companies to actively engage in resource planning: the pre-approval of major capital expenditure programs enables companies to add generation, improve infrastructure or purchase power. Several states have implemented resource planning programs requiring

the utilities to provide on a regular basis a forecast of resource requirements and how they plan to meet the demand growth. The regulatory commissions review and pre-approve the capital program in stages, which reduces the likelihood that large expenditures will be denied recovery when completed.

- We place a tremendous amount of value on commissions that can act quickly on a rate request from a company. The shorter the time between a rate request and a final rate order, the better for the company. We believe that the speed with which a commission acts is key to providing timely recovery and we benchmark commissions against one another.
- We value a commission that has the ability to introduce rate increases on an interim basis. The ability of a commission under law to allow a company to put rates into effect on an interim basis subject to refund is key because it allows the commission to respond quickly to a company's request if there are acute cash flow needs. In addition, interim rates provide some comfort to utility investors until a final order is issued.
- There is tremendous value attributed to state commissions that use current or forecasted costs to set base rates. The use of historical base rates can result in rates that do not reflect a company's current costs or situation. We examine whether a

state commission uses an historical/current or forecasted test year in its rate cases.

- We also favor commissions that facilitate the recovery of Construction Work in Progress (CWIP), essentially capitalized interest during the construction process. With all of the capital expenditure programs that we expect over the next few years, many coming at the regulated utility level, CWIP reduces the risk that recovery of the plant will not take place once the plant is completed.

Q. **You mentioned a number of legislative and regulatory policies that are supportive of credit quality, which as you note is even more important today given the highly challenging and competitive credit environment faces by utilities generally, and AmerenUE in particular. What can this Commission do, in this rate case, to support AmerenUE's ability to effectively compete in the credit markets to obtain the capital it needs to invest in its infrastructure at the most reasonable cost possible?**

A. It is my understanding that rates in this case will be set using an historic test year, and that CWIP cannot be recovered in Missouri. Regardless, there are things the Commission can do in this case to support AmerenUE's need to access reasonably priced capital. Stated simply, the Commission can approve an FAC on reasonable terms, grant AmerenUE a fair and reasonable ROE, particularly in view of the risks faced by AmerenUE in this rising cost environment, and otherwise provide reasonable rate treatment for other items in AmerenUE's cost of service, again particularly in consideration of the fact that costs are continuing to rise.

IV. FINANCIAL AND CREDIT CONSIDERATIONS AND FACS

Q. You noted earlier that the financial and credit considerations about which you have testified above mitigate strongly against the opposition to AmerenUE's FAC request, as expressed by Ms. Mantle, Mr. Johnstone, and Mr. Cohen. Please elaborate more specifically on the value of an FAC to investors and other financial market participants.

A. As discussed in other testimony, the volatility and rise in fuel costs recently is significant, will likely persist for some time and threatens the financial health of AmerenUE. Fuel and purchase power expenses are a substantial amount of AmerenUE's cost structure and have a significant impact on financial performance and the ability to achieve the returns allowed to AmerenUE. As noted in other testimony, the degree to which fuel costs are rising is almost unprecedented in a historical context and the regulatory lag associated with recovering fuel costs is creating substantially more financial burden on AmerenUE today and in the future than it has historically.

As also noted in other testimony, AmerenUE, while an important market participant for fuels, has increasingly declining control over the costs of the market prices for the fuels it needs. Global economic, environmental, and financial issues well beyond the control of AmerenUE are the primary reasons for the present commodity environment. AmerenUE is being asked to bear the risk for markets over which it has increasingly less control and less ability to manage its risk.

Investors and credit rating agencies are increasingly vocal that ratemaking policy needs to adapt to the new environment where substantial financial risk is being imposed on utilities that lack the regulatory authority to timely recover fuel and purchased power costs from ratepayers. The traditional means for recovery, the filing of a rate case, is considered far less than optimal by investors and credit rating agencies. The time needed to complete a rate case, the difficult political and economic environment for rate increases and the prospect of continued under-recovery make traditional rate case recovery of fuel expenses an increasingly greater threat to the financial health of AmerenUE. In addition, off-system sales prices are also becoming increasingly volatile and at the same time less correlated to key fuel price inputs for AmerenUE, providing a much less optimal off-set to rising fuel costs. Investors and credit rating agencies do not view off-system sales as a useful hedge against the potential for financial distress caused by procuring fuel for regulated operations and the associated time needed to recover these costs in a rate case. As has been stated in other testimony, the majority of utilities with which AmerenUE has to compete for capital benefit from the inclusion of an FAC in their ratemaking process. As I address earlier, that competition for capital now and in for the foreseeable future will be difficult and intense, and will be even more difficult for AmerenUE if it must compete for capital without the benefit of an FAC.

Indeed, investors, credit rating agencies and others will likely penalize AmerenUE for the risk associated with the inability to better manage the burden associated with procuring fuel for customers unless an FAC is approved for AmerenUE. In a good environment these penalties would be visible, in the current environment and the environment we expect for the foreseeable future, they could be severe. This will likely cause an increase in the cost of capital which will create a longer term and greater cost for customers. The lack of inclusion of a reasonable FAC will continue to keep AmerenUE in the minority of its peers who have these procedures in place and will also be going to the market to raise capital.

Investors will be negatively predisposed to deploying capital at AmerenUE if they believe that its regulators do not share the view that the current and likely future environment for the procurement of fuel is substantially different than what has been experienced historically. Investors are looking for responsive and mainstream regulation that balances the need for prudent fuel procurement and sensitivity to continued rate increases with the need for investors to achieve comfort in the financial viability of AmerenUE. Since fuel adjustment mechanisms are so widely in place in other jurisdictions, it will be difficult for investors to comprehend why a properly functioning fuel cost adjustment framework could not be implemented for AmerenUE.

Q. What have the credit rating agencies, the most visible of parties who grade the financial health of AmerenUE and its peers stated about AmerenUE's proposed FAC and FACs in general?

A. The credit rating agencies have been critical of AmerenUE's inability to use an FAC. In downgrading AmerenUE, Moody's recently stated:

> *The downgrade also reflects the challenging regulatory environment for electric utilities operating in the state of Missouri, as Union Electric is one of the relatively few utilities in the country operating without fuel, purchased power, and environmental cost recovery mechanisms. The lack of such automatic cost recovery provisions creates uncertainty regarding the timely recovery of the higher costs and investments being incurred and leads to significant regulatory lag.*
> – Moody's on May 21, 2008 upon downgrading AmerenUE

In November of 2007, Standard and Poor's listed the top ten credit issues facing U.S. utilities. Volatility of fuel prices, rising costs, regulatory lag, and recovery deferrals were chief among these concerns. Specifically as it pertains to FACs, Standard and Poor's stated: "*In our view, states that have fuel adjustment mechanisms to smooth out the effect on cash flow and steer utilities toward mitigating risk through hedging and supply procurement are best poised to ride* *out a turbulent journey.*" Fitch Ratings has stated with regard to FACs: "*effective and timely commodity cost-adjustment mechanisms provide utilities with greater assurance of ultimate recovery in a rising energy price environment.*"

Specifically, as it pertains to Ameren UE, Moody's has also said recently "*Ratings are constrained by significant regulatory lag for the recovery of costs and investments and a challenging regulatory environment in the state of Missouri.*" Moody's went on to state the ratings outlook for AmerenUE is stable, *assuming* the company receives adequate rate relief and cost recovery mechanisms, *including the implementation of a fuel adjustment clause.* Moody's then goes on to specifically cite the inability to implement a fuel adjustment clause as a key issue for potentially lowering the credit ratings of AmerenUE. Standard and Poor's has also listed the proposed FAC as a key factor for determining future credit quality at AmerenUE. In addition, the proposed FAC is routinely referenced in equity research material as a key driver of the financial health of AmerenUE and its ability to earn its allowed returns.

Given AmerenUE's current issuer credit ratings of Baa2/BBB-, any downgrade, especially to non-investment grade, would have severe negative consequences. Not only would the cost of capital rise dramatically, the capital that AmerenUE needs over the next several years may not be available at any price.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a AmerenUE for Authority to File Tariffs Increasing Rates for Electric Service Provided To Customers in the Company's Missouri Service Area.	))))))	Case No. ER-2008-0318

AFFIDAVIT OF GARY M. RYGH

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

Gary M. Rygh, being first duly sworn on his oath, states:

1. My name is Gary M. Rygh. I am employed by Barclays Capital Inc. as Senior Vice President.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of Union Electric Company, d/b/a AmerenUE, consisting of 27 pages, 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.

Gary M. Rygh

Subscribed and sworn to before me this 10 day of October, 2008.

Notary Public

My commission expires: 8/1/2009

MEREDITH LEMMON
Notary Public, State of New York
No. 01LE6131263
Qualified in Albany County
Commission Expires August 1, 2009