Merchant Power Generator
Capital Structure, Debt and Equity Cost Assumptions

I. Capital Structure

We assume a 50/50 capital structure for a financially healthy merchant generation firm.

II. Debt Cost

Consistent with the 50/50 capital structure, we assume the merchant generator would have a BBB credit rating. We believe the debt component of total capital could rise to 55% and still be consistent with a BBB credit rating.

Yields on Moody's Baa corporate bonds as of December 13, 2006 were 6.16%.[1] Base debt cost of 6.5% to account for initial expenses and uncertainty. Range of debt costs from 5% to 8%.

III. Equity Cost – CAPM build up

The CAPM is used to derive the equity cost as follows.

CAPM Input	Value as of December 13, 2006
Risk-Free Rate (R_f) [2]	4.73%
Equity Beta ß	In range of 0.8 to 1.2 (assumed average of 1.0)
Historic Long-Term Equity Premium (R_m - R_f)	7.10% [3]
Cost of Equity k_e = R_f + ß * (R_m - R_f)	11.83%

Based on above use base equity cost of 12%. Range of 10% to 14%.

Further research will be conducted on equity beta.

[1] Federal Reserve Statistical Release. Selected Interest Rates. http://www.federalreserve.gov/releases/h15/update/.

[2] Ibid.

[3] The source for the equity risk premium is the Ibbotson Associates *Stocks, Bonds, Bills and Inflation 2006 Yearbook*. It reflects the Long Horizon Equity Risk Premium from 1926 to 2005.