



# IS Utility Credit Rating Stability Increasingly Vulnerable?

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# Standard & Poor's Role in the Capital Markets

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- **To Provide Investors, Traders And Counterparties...**
  - An Independent, Objective And Forward Looking Opinion Of Creditworthiness
  - A Global Benchmark For Investors To Compare Credit Risk Among Peers

# What A Credit Rating Is...

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- **A Credit Rating Represents An Opinion Regarding ...**
  - The Likelihood That An Issuer Will Default On Its Financial Obligations
  - The Capacity And Willingness Of An Issuer Or Obligor To Make Timely Payments In Accordance With The Terms Of The Obligations
- **It Is One Of Many Tools That May Be Used By Investors To Make Investment Decisions**

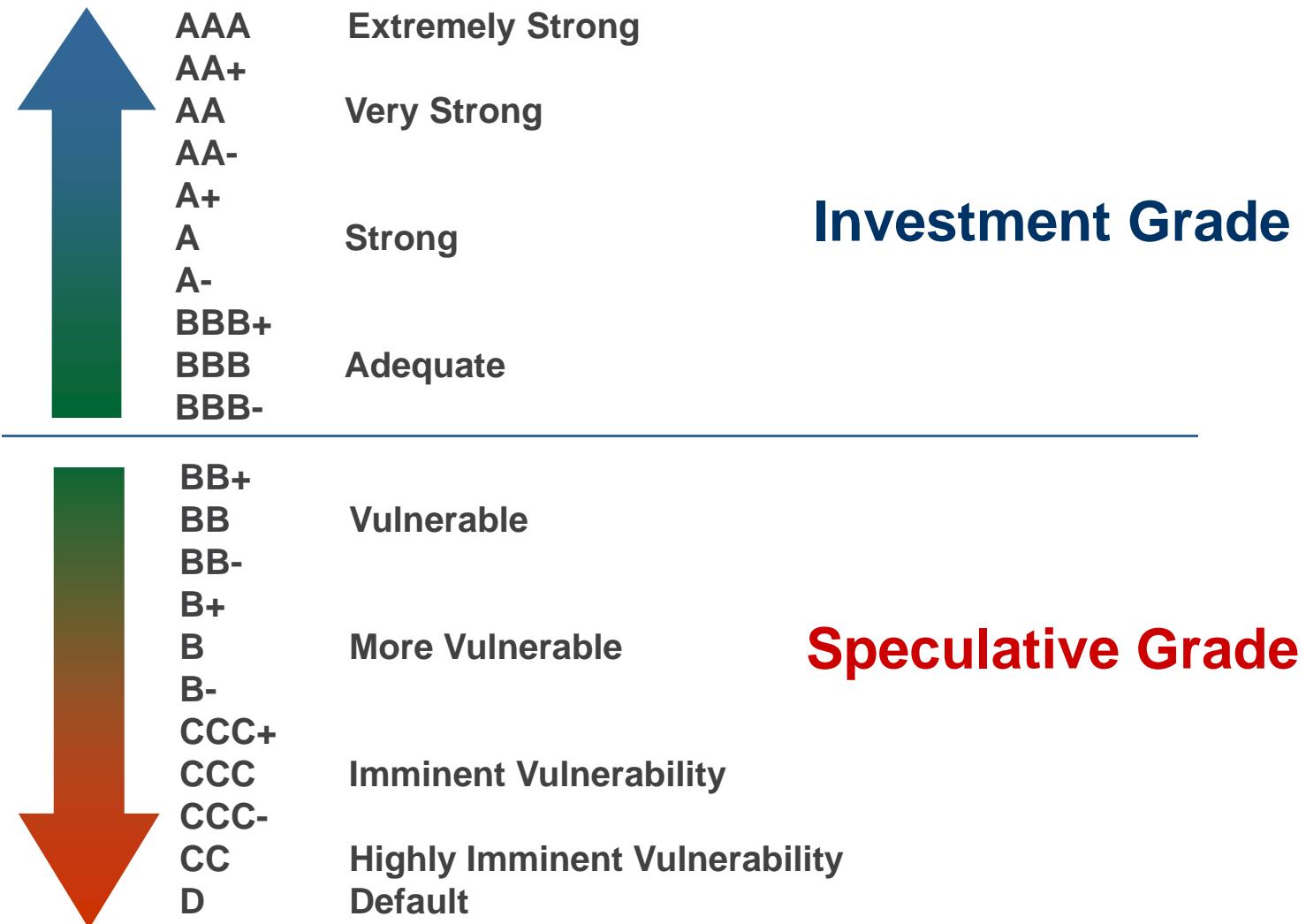
# What A Credit Rating Is *Not*...

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A Credit Rating Does Not Provide Investors, Traders And Counterparties...

- ✖ *A Recommendation To Buy, Sell Or Hold A Security*
- ✖ *An Audit Of Obligors' Financial Statements*
- ✖ *An Indication Of Investment Merit*
- ✖ *A Guarantee Of Credit Quality*

# Credit Ratings Scale



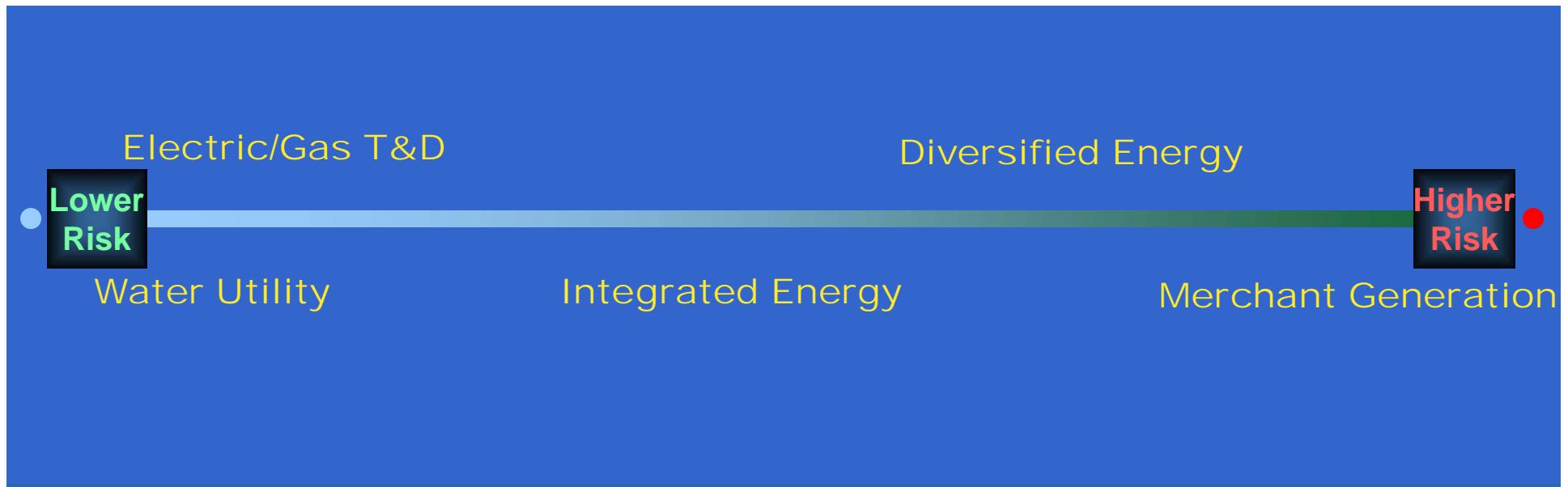
# Utility And Power Industry Risk Spectrum

Washington Gas Light (A+/Stable/A-1)  
Aqua Pennsylvania (A+/Stable/-)  
Consolidated Edison (A-/Stable/A-2)

Exelon (BBB/Stable/A-2)  
PSEG Corp. (BBB/Pos/A-2)  
Edison Int'l (BBB-/Stable/-)

Southern Co. (A/Stable/A-1)  
Xcel Energy (A-/Stable/A-2)  
Pacific Gas and Electric (BBB/Stable/A-2)

NRG Energy (BB-/Negative/-)  
Calpine (B+/Stable/-)  
Edison Mission (CCC+/Neg/-)



## Credit Themes We See Affecting Utilities

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- **Substantial Infrastructure Spending Requirements (\$1.8 Trillion Over 20 Years For Electric\*; \$335 Billion For Water\*\*)**
  - Aging Generating Plant
    - About 45% Of Total Electricity Generating Capacity Is More Than 30 Years Old; About 20% Is More Than 40 Years Old
    - About Two-Thirds Of Coal Capacity Is At Least 30 Years Old; About One-Third Is More Than 40 Years Old
    - About 50,000 MW Are Needed By 2014 And 258,000 MW By 2030, Or About \$412 Billion Through 2030 (EIA)

\*Brattle Group estimates

\*\*EPA estimates

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## Credit Themes We See Affecting Utilities (Cont'd)

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- **Environmental Mandates (Refurbish, Retire, Or Adjust Dispatch)**

- EPA's Rules, Either Issued Or Pending
  - Cross-State Air Pollution Rule (SO2, NOx; Under Legal Challenge)
  - MACT (Mercury, Air Toxics; Under Legal Challenge)
  - Cooling Water Intake
  - Ash Disposal
  - Greenhouse Gas Restrictions

# The Nexus Of Credit Quality And Regulatory Decisions

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- Rate Cases Will Likely Be A Sustained Characteristic Of Utility Activity For Several Years
- Regulators Will Be Significantly Challenged, We Believe, To Achieve The “Right” Balance Among Various -- Often Conflicting -- Goals:
  - Customer ‘Protection’/Rate Constraint In The Face Of Upward Cost Pressure And Uncertain Economic Conditions
  - Reliability Of Service
  - State And Federal Public Policy Initiatives
  - ***Financially Healthy, Solvent, And Creditworthy Utilities***

# Supportive State Commission Actions

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- **Major Capital Expenditures**
  - Construction Work In Progress (IN, FL, VA)
  - Pre-Approval Of Construction Plans And Budgets (IN, NY, KY)
  - Plant-Specific Rate Of Return (IA, VA)
  - Financial Benchmark Maintenance During A Capital Expansion (CO, MO, KS)
- **Uncontrollable/Unavoidable Costs, Public Policy Initiatives**
  - Automatic Adjustment Ratemaking Mechanisms
    - Revenue Decoupling Mechanisms (More Common Among Gas Than Electric Utilities)
    - Trackers
      - Environmental/Conservation/Demand Response (CA, CO, IN, MN)
      - Transmission (IN, TX)
      - Pension/OPEB (MO, CT)
      - Bad Debt (IN, MI, OH)
    - Securitization (WV, FL, TX)

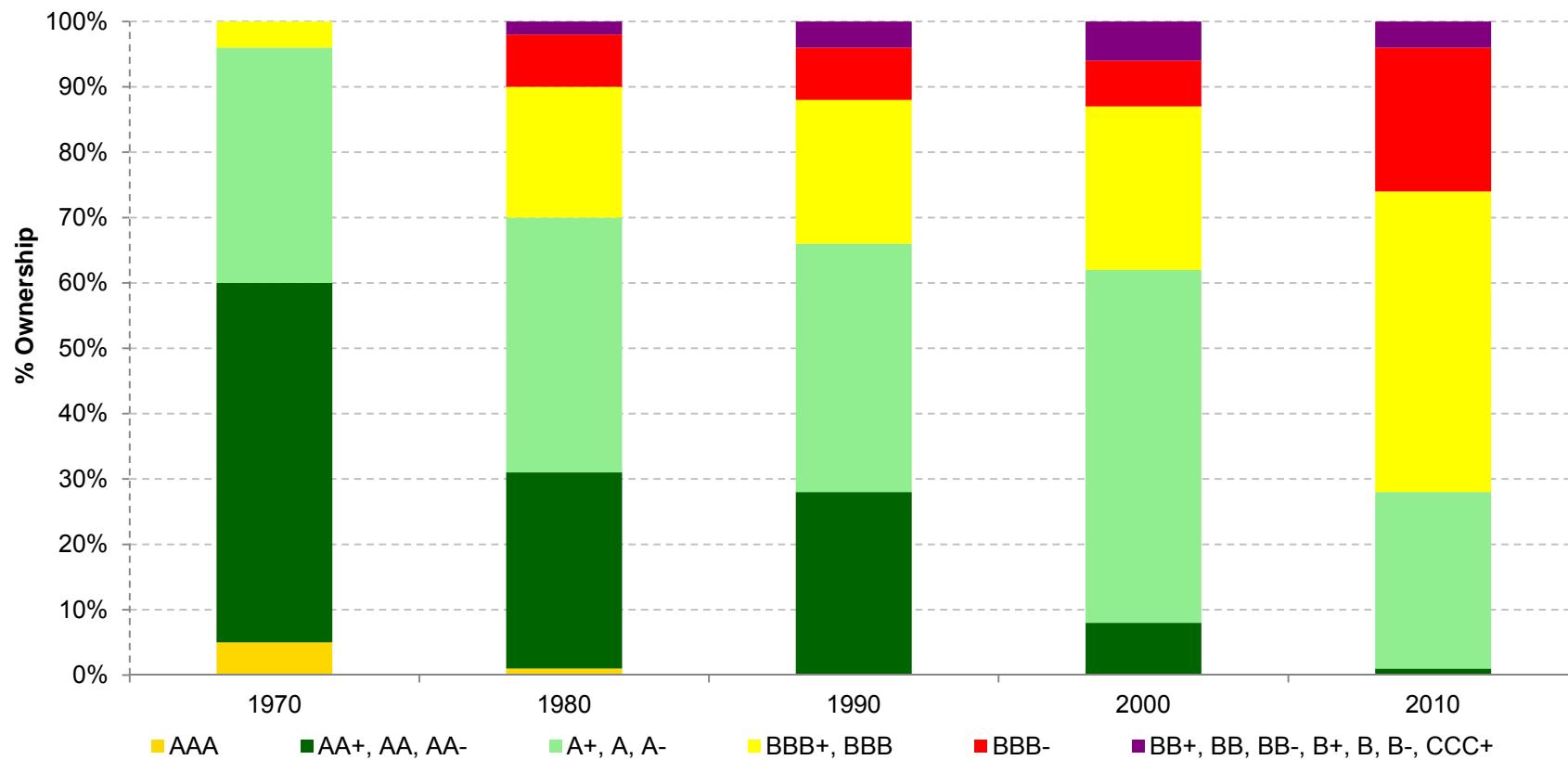
# Utility Business Strategies

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- **A Reinvigorated ‘Back To Basics’ Theme**
  - An Exclusively Regulatory, Or More Regulatory-Centric Focus (PNM Resources; PSEG)
  - Managing The Politics (You Pick The Example)
- **Mergers And Acquisitions**
  - A Notable Change In Rationale From A Pure Equity Play (Duke Energy/Progress Energy)
  - Scale/Cost Control, Credit Strength
  - Regulatory/Geographic Diversity
- **A ‘FERC’ Strategy (Northeast Utilities)**
- **An Environmental/Public Policy Approach (NextEra, Xcel Energy, PSEG)**

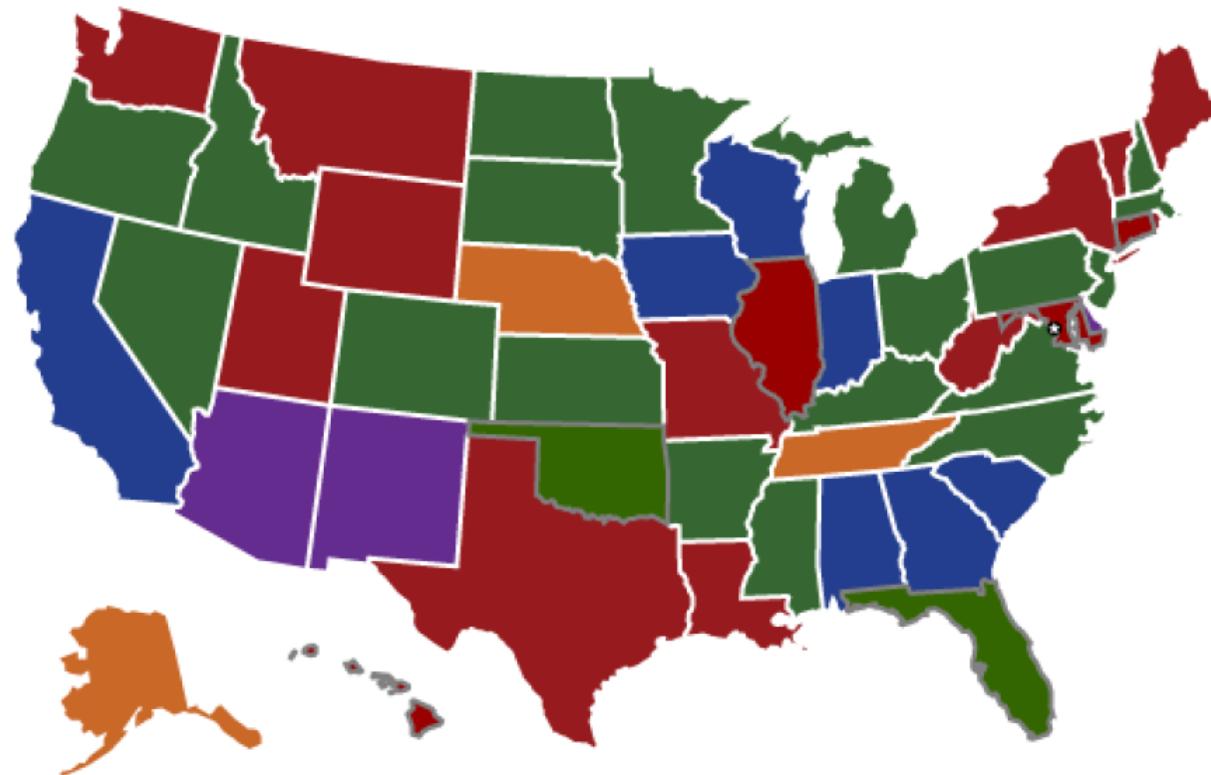
# U.S. Electric IOU Rating History

- Electric Utility Credit Quality Has Weakened Considerably Since The Last Major Utility Construction Cycle



# Assessments Of State Political/Regulatory Credit Posture

Most credit supportive\*    More credit supportive    Credit supportive  
 Less credit supportive    Least credit supportive    No credit assessment



\*The assessments are made against an absolute standard of the degree of credit support. At this time, we observe no U.S. jurisdictions that qualify in the top category. States outlined in gray have changed their regulatory condition since last surveyed.

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# A Comparison Of Jurisdictional Assessments

## Alabama\*



- **Formula Rate Adjustments Across A Host Of Investment And Cost Centers That Provide For Timely Recovery In Rates**
- **Well Above Average Authorized Rates Of Return**
- **Absence Of Politicization In The Rate Making Process**

\* “More Credit Supportive”

## Maryland\*



- **Recent History Of Politicization In The Rate Setting Process**
- **Increased Unpredictability Of Regulatory Decisions**
- **Well Below Average Authorized Rates Of Return**
- **Electric And Gas Decoupling Mechanisms (A Positive Factor)**

\* “Less Credit Supportive”

State flags source: [netstate.com](http://netstate.com)

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