



IS Utility Credit Rating Stability Increasingly Vulnerable?

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Standard & Poor's Role in the Capital Markets

- **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...

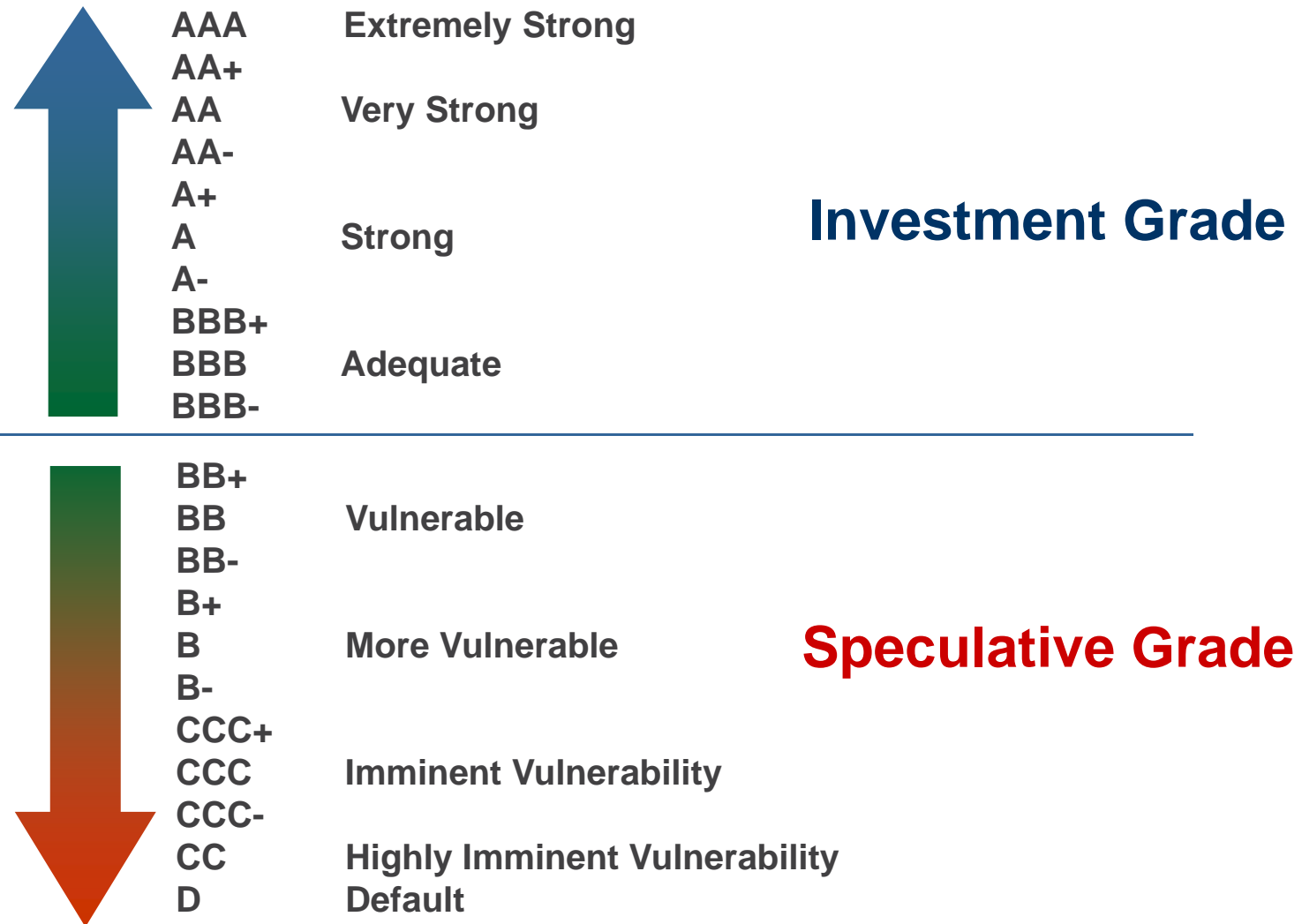
- **A Credit Rating Represents An Opinion Regarding ...**
 - The Likelihood That An Issuer Will Default On Its Financial Obligations
 - The Capacity And Willingness Of An Issuer Or Obligor To Make Timely Payments In Accordance With The Terms Of The Obligations
- **It Is One Of Many Tools That May Be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

What A Credit Rating Is *Not*...

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



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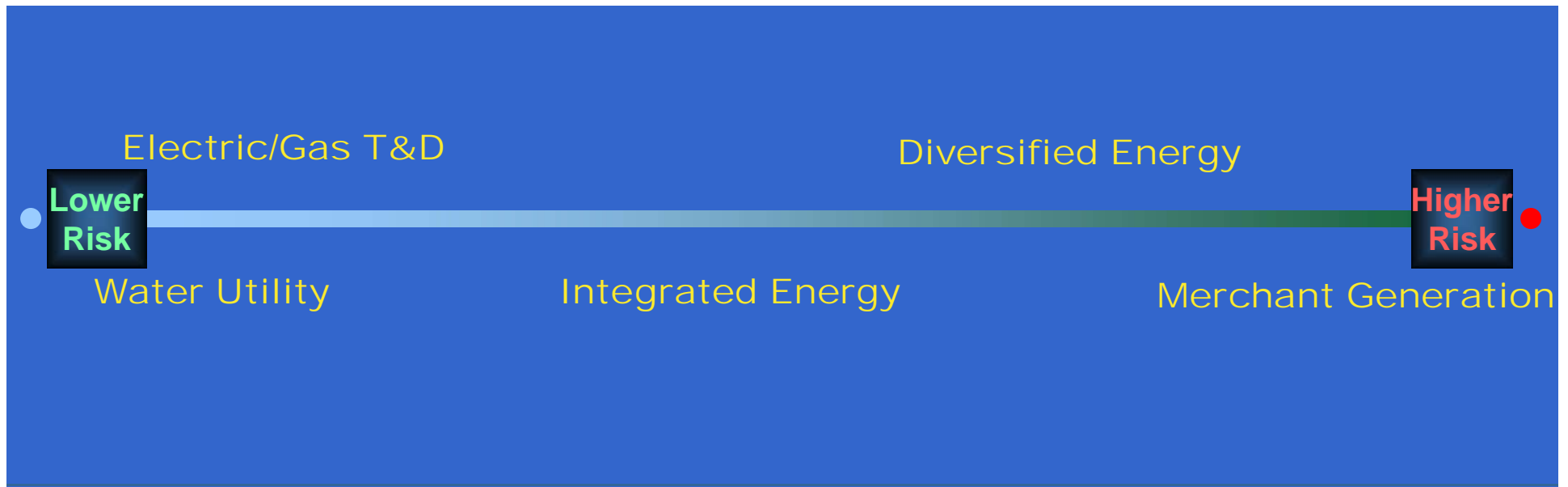
Utility And Power Industry Risk Spectrum

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

- **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)

- **Environmental Mandates (Refurbish, Retire, Or Adjust Dispatch)**
 - EPA's Rules, Either Issued Or Pending
 - Cross-State Air Pollution Rule (SO₂, NO_x; 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

- **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

- **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**

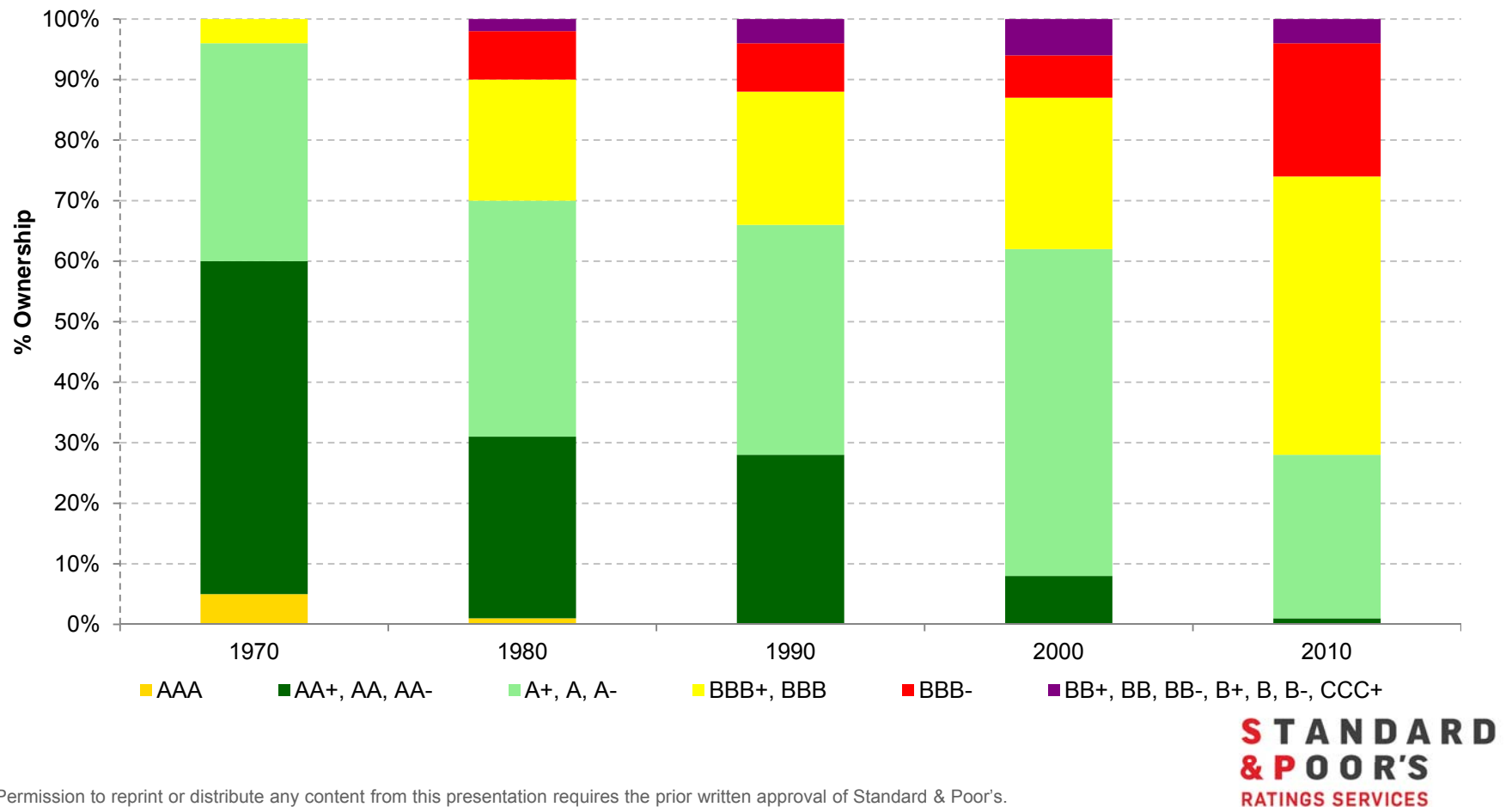
- Automatic Adjustment Ratemaking Mechanisms
 - Revenue Decoupling Mechanisms (More Common Among Gas Than Electric Utilities)
 - Trackers
 - Environmental/Conservation/Demand Response (CA, CO, IN, MN)
 - Transmission (IN, TX)
 - Pension/OPEB (MO, CT)
 - Bad Debt (IN, MI, OH)
- Securitization (WV, FL, TX)

Utility Business Strategies

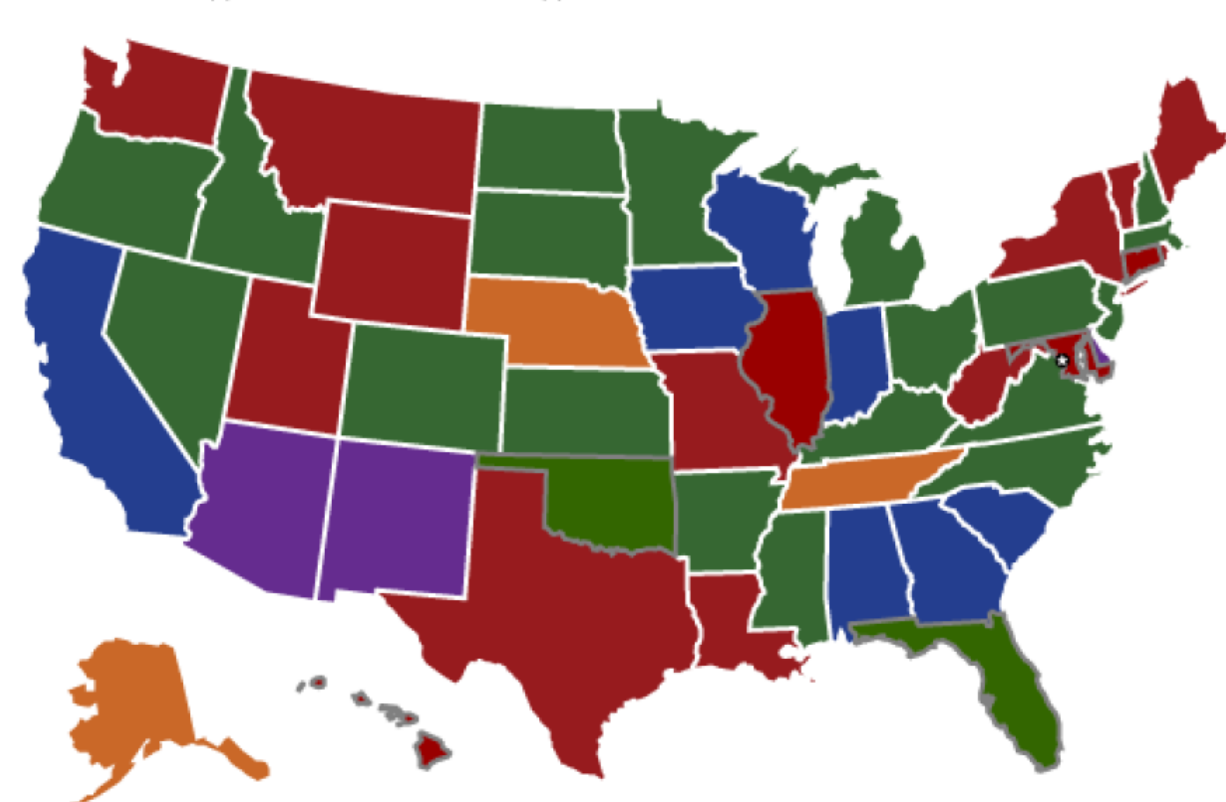
- **A Reinvigorated ‘Back To Basics’ Theme**
 - An Exclusively Regulatory, Or More Regulatory-Centric Focus (PNM Resources; PSEG)
 - Managing The Politics (You Pick The Example)
- **Mergers And Acquisitions**
 - A Notable Change In Rationale From A Pure Equity Play (Duke Energy/Progress Energy)
 - Scale/Cost 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



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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”**

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