

Institute for Regulatory Policy Studies:

*Energy, Environmental Policy, and The
Recession: Impacts of Proposed Federal Policies*

**Panel: Regulatory Policy In The Current
Economic Environment**

**Springfield, Illinois
April 30, 2009**

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Standard & Poor's Role in the Capital Markets

Investors And Issuers Use Credit Ratings Because They Provides Investors, Traders And Counterparties...

- ***An Independent, Objective And Forward Looking Opinion Of Creditworthiness***
- ***A Global Benchmark For Investors To Evaluate Risk/Reward Metrics And Compare Credit Risk Among Peers***

What Is A Credit Rating?

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
- **Credit Analysis Resulting In Assignment Of A Rating Opinion Is An Art, Not Science**
- **A Credit Rating Is The Result Of Qualitative And Quantitative Assessments, As Well As Historic And Prospective Data And Analysis**
- **It Is One Of Many Tools Used By Investors To Make Investment Decisions**

While A Rating Is The Result Of Independent, Objective Analysis

...

What Is A Credit Rating *Not*?

***It Is Not a Recommendation to Buy, Sell
or Hold a Security***

***It Is Not an Audit of Obligor's Financial
Statements***

It Is Not An Indicator Of Investment Merit

Standard & Poor's Rating Scale



Improving Credit Quality

Investment-Grade Ratings

AAA
AA+
AA
AA-
A+
A
A-
BBB+
BBB
BBB-

Speculative-Grade Ratings

BB+
BB
BB-
B+
B
B-
CCC+
CCC
CCC-
CC
C
D



Declining Credit Quality

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Utility/Power Industry/ Risk Spectrum

Nicor Gas (AA)

IntegrYS (BBB+)

Exelon (BBB)

Peoples Gas (BBB+)

Ameren (BBB-)

North Shore Gas (BBB+)

MidAmerican Energy (A-)

Commonwealth Edison (BBB-)

Central Illinois Light (BBB-)

Central Illinois Public Service (BBB-)

Illinois Power (BBB-)



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Standard & Poor's Ratings Matrix

Financial Risk

<i>Business Risk</i>	Minimal	Modest	Intermediate	Aggressive	Highly Leveraged
Excellent	AAA	AA	A	BBB(+)*	BB
Strong	AA	A	A-	BBB-	BB-
Satisfactory	A	BBB+	BBB	BB+	B+
Weak	BBB	BBB-	BB+	BB-*	B
Vulnerable	BB	B+	B+	B	B-

*Median **Utility/Corporate** Rating

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Principal Credit Themes We See Affecting Regulated Utilities

Significant Challenges Were Already Threatening Commissions' Ability To Achieve Reasonably Balanced Orders In "Normal" Times:

- Need for Substantial Infrastructure Spending >> Aging Plant, Environmental Mandates
- Limited Near-Term Generation Options To Satisfy Increasing Load
- Increasing Labor/Benefits And Volatile Material Costs
- Balkanization Of Environmental Planning
- Weakened Utility Balance Sheets Compared With Last Major Construction Cycle

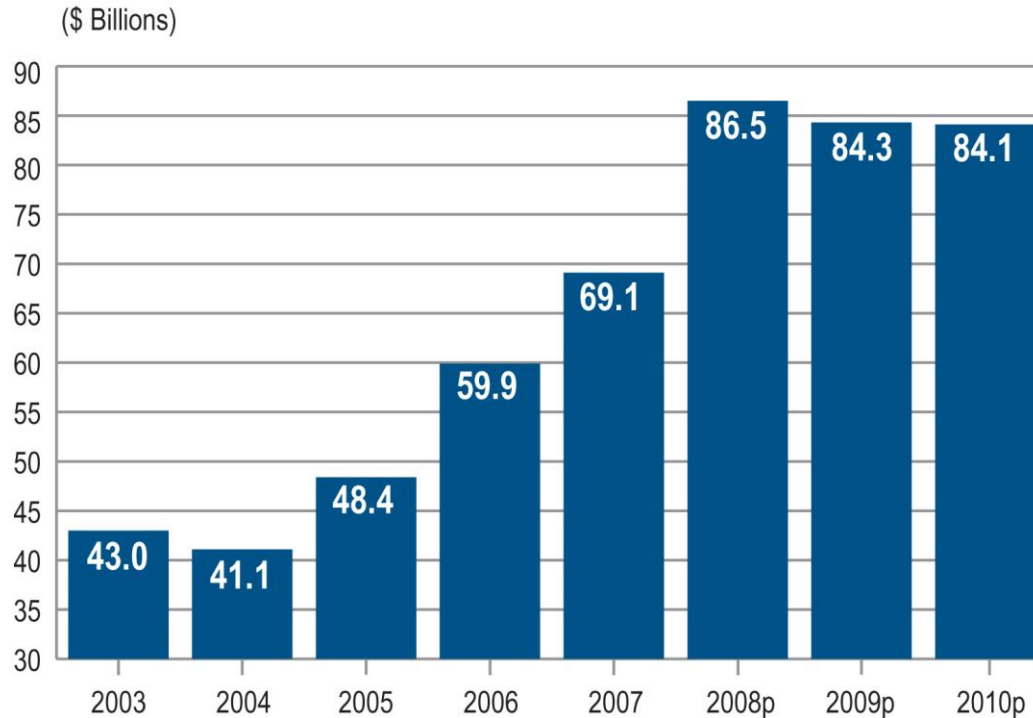
... Then The Capital Markets And The Global Economy Imploded:

- Stagnation And Even Decline In Customer Growth, At Least In Near Term
- Shrinking Capital Availability → Uncertainty Of Liquidity/Borrowing Availability
→ Spiking Risk Premiums
- Rising Bad Debt Expense And Increasingly Underfunded Pension Plans

Consumer Backlash To Rate Hikes Is Virtually A Certainty, Increasing Pressure On Regulators To Lower ROEs, And Perhaps Encourage Deferral of Capex And Costs

EEI Estimate Of Future Capital Spending

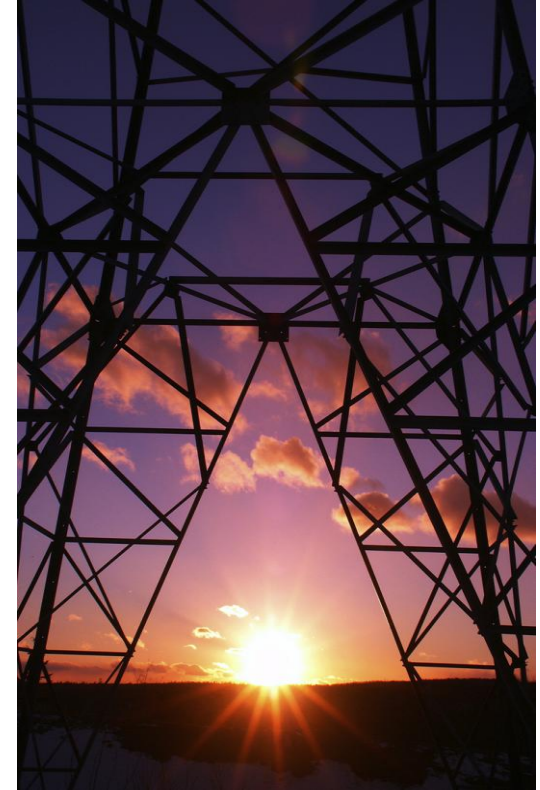
U.S. Shareholder-Owned Electric Utilities



p = projected

Sources: EEI Finance Department, Company Reports, and SNL Financial.

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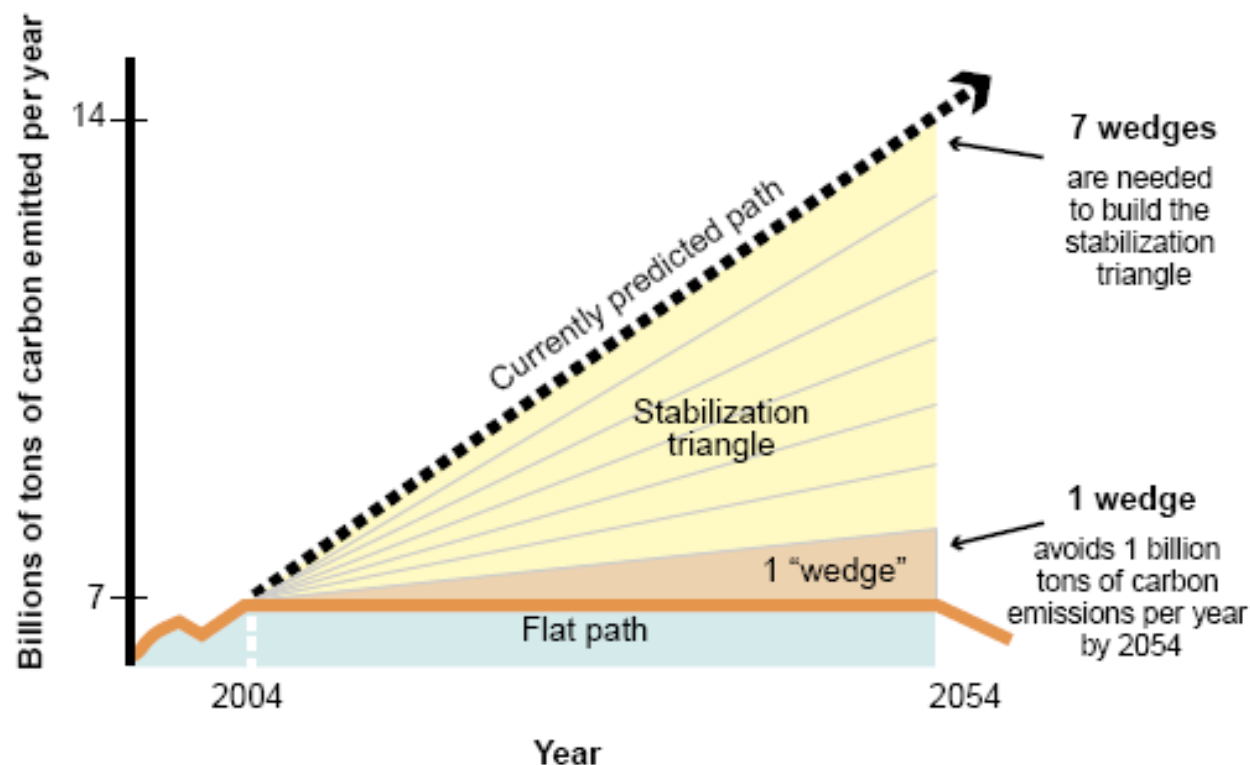


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Climate Change – The Big Picture



SOURCE: R. Socolow, R. Hotinski, J. B. Greenblatt, and S. Pacala.

- Scientific CO₂ Target Of 450 – 550 Ppm
- 50-Year Timeframe Is Appropriate
- Developing Countries Modeled To Grow By 60-80%

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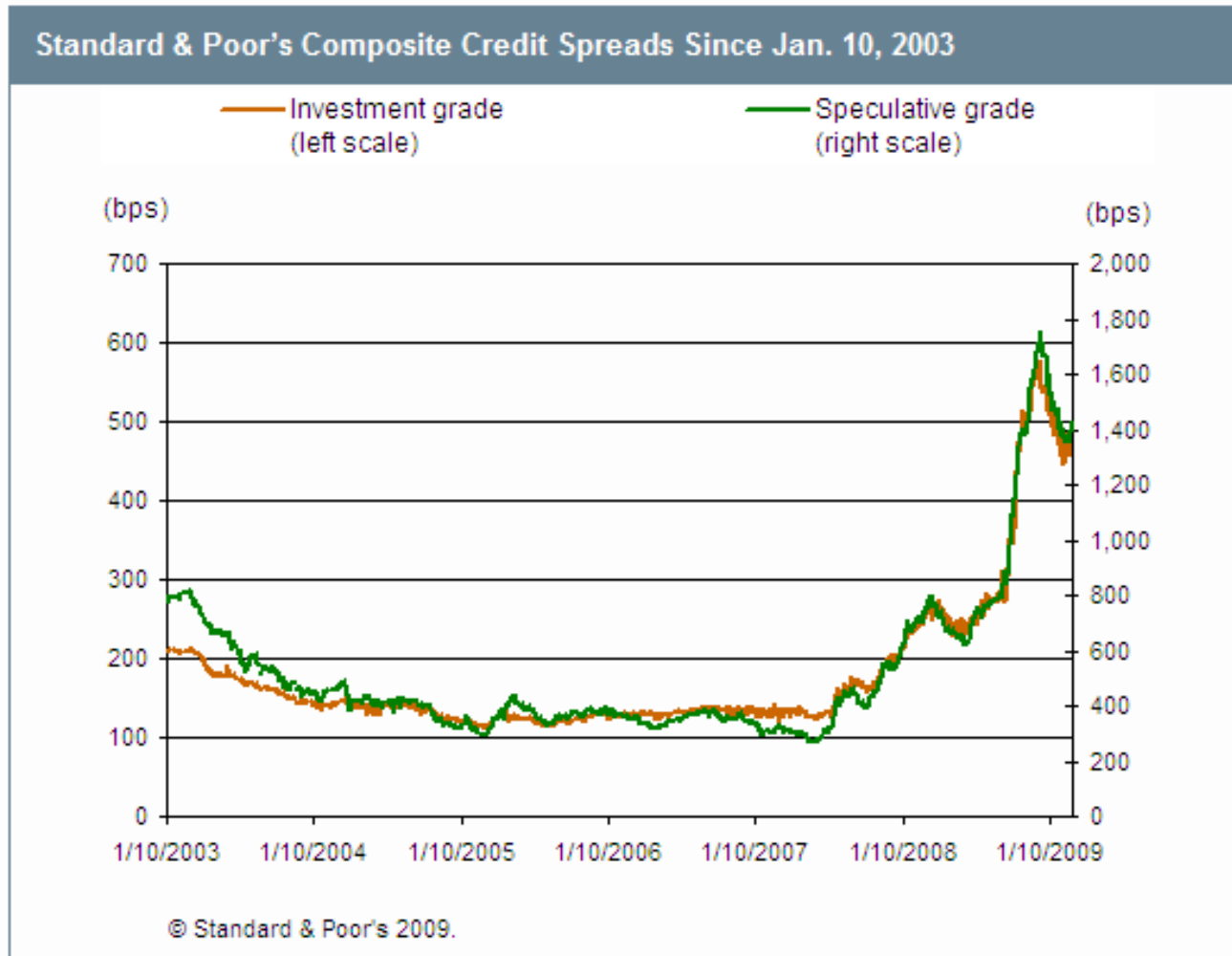
Climate Change – A Portfolio of Strategies Needed

What Does One Wedge Mean?

Efficient Buildings	Cut Carbon Emissions By 25% In Buildings/Appliances Projected For 2054
Efficient Cars	<i>Increase Fuel Economy For Two Billion Cars From 30 To 60 MPG</i>
Efficient Baseload Coal Plants	Produce Twice Today's Coal Power Output At 60% Instead Of 40% Efficiency
Fuel Switching To Gas From Coal	<i>Replace 1,400 GW Coal Plants With Gas Plants</i>
Capture CO2 At Baseload Power Plant	Introduce CCS At 800 GW Coal Or 1,600 GW Natural Gas
Nuclear Power For Coal Power	Add 700 GW (Twice The Current Capacity)
Wind Power For Coal Power	<i>Add Two Million 1MW-Peak Windmills (50 Times The Current Capacity) "Occupying" 30 Million Hectares On Land Or Offshore (Size Of Wyoming)</i>
Biomass Fuel For Fossil Fuel	Add 50 Times The Combined Brazil And U.S. Ethanol Production, With The Use Of 250 Mill Hectares (One-Sixth Of The World's Cropland)

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Historical Composite Credit Spreads

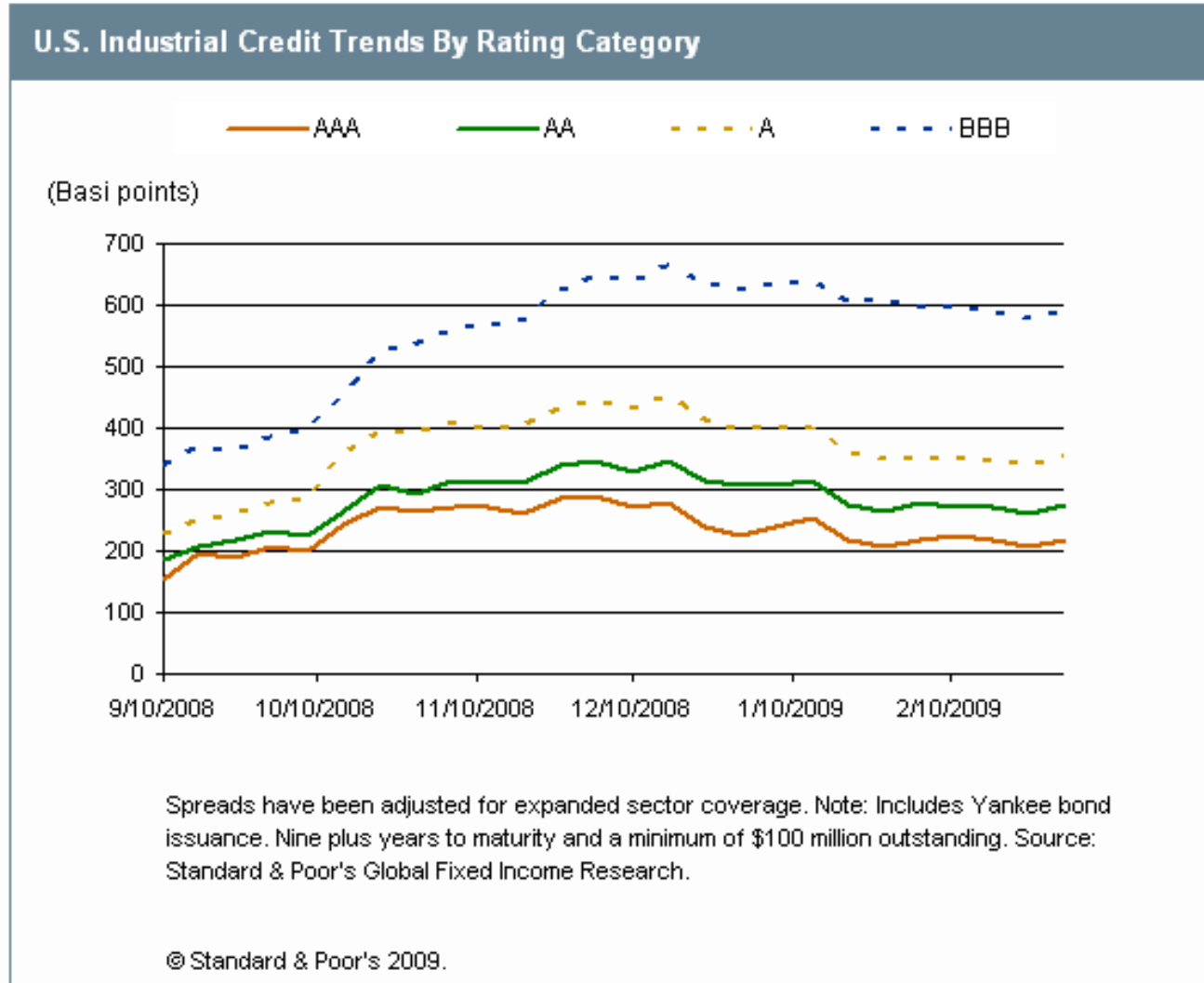


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U.S. Investment-Grade Industrial Credit Trends

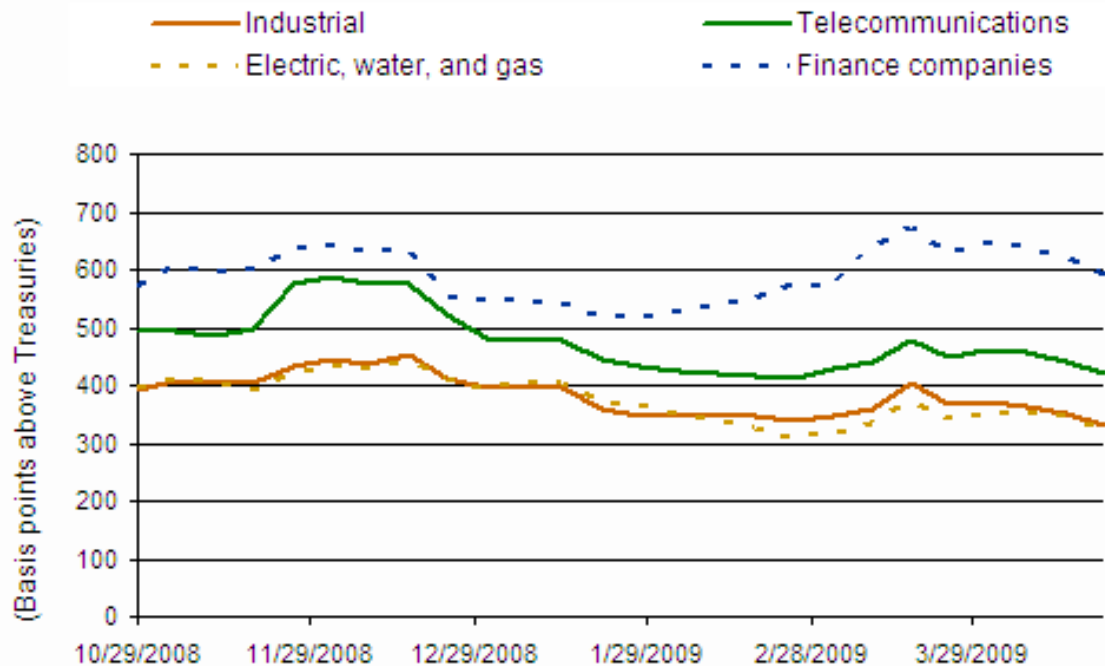


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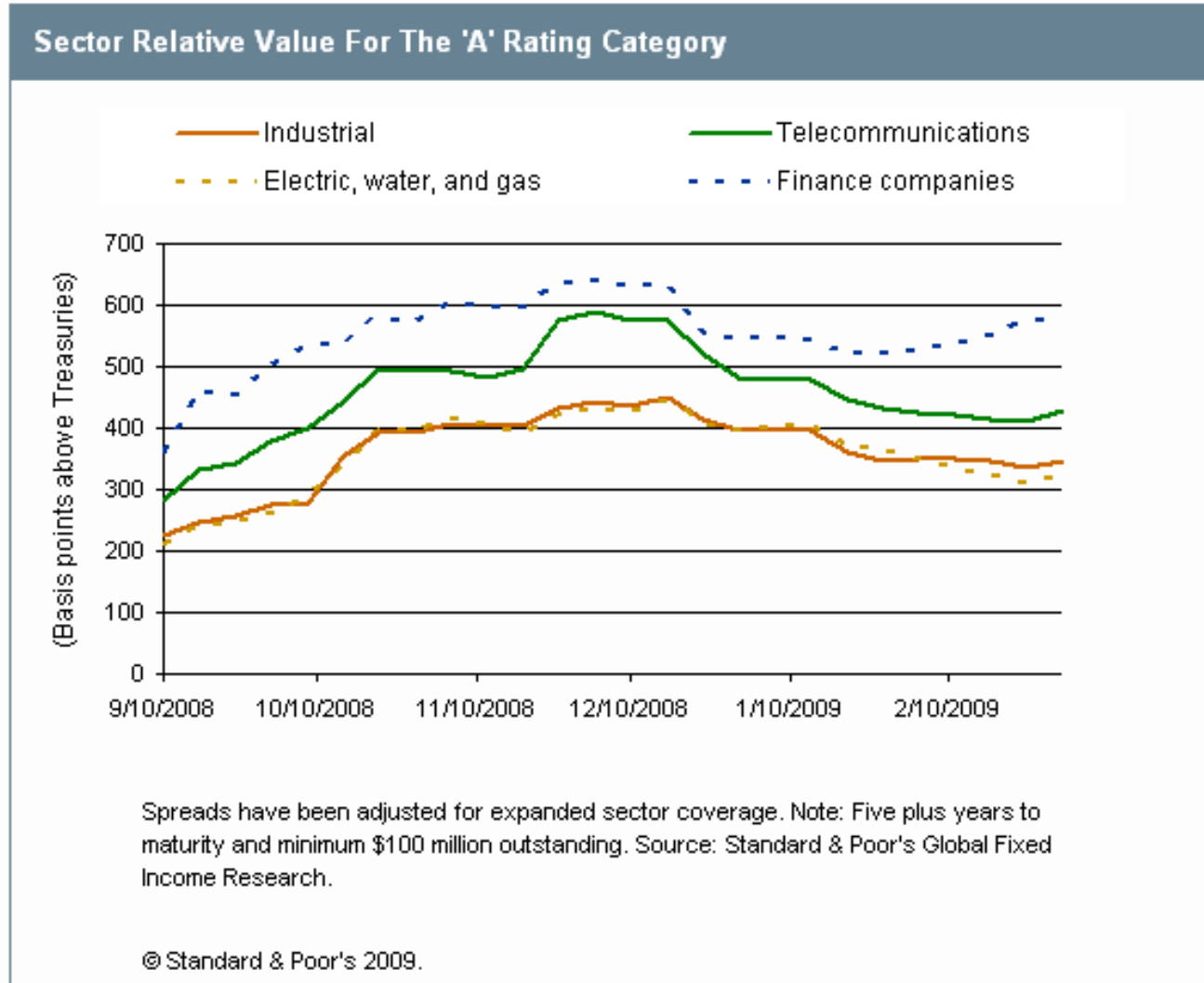
Sector Relative Value For The 'A' Rating Category



Spreads have been adjusted for expanded sector coverage. Note: Five plus years to maturity and minimum \$100 million outstanding. Source: Standard & Poor's Global Fixed Income Research.

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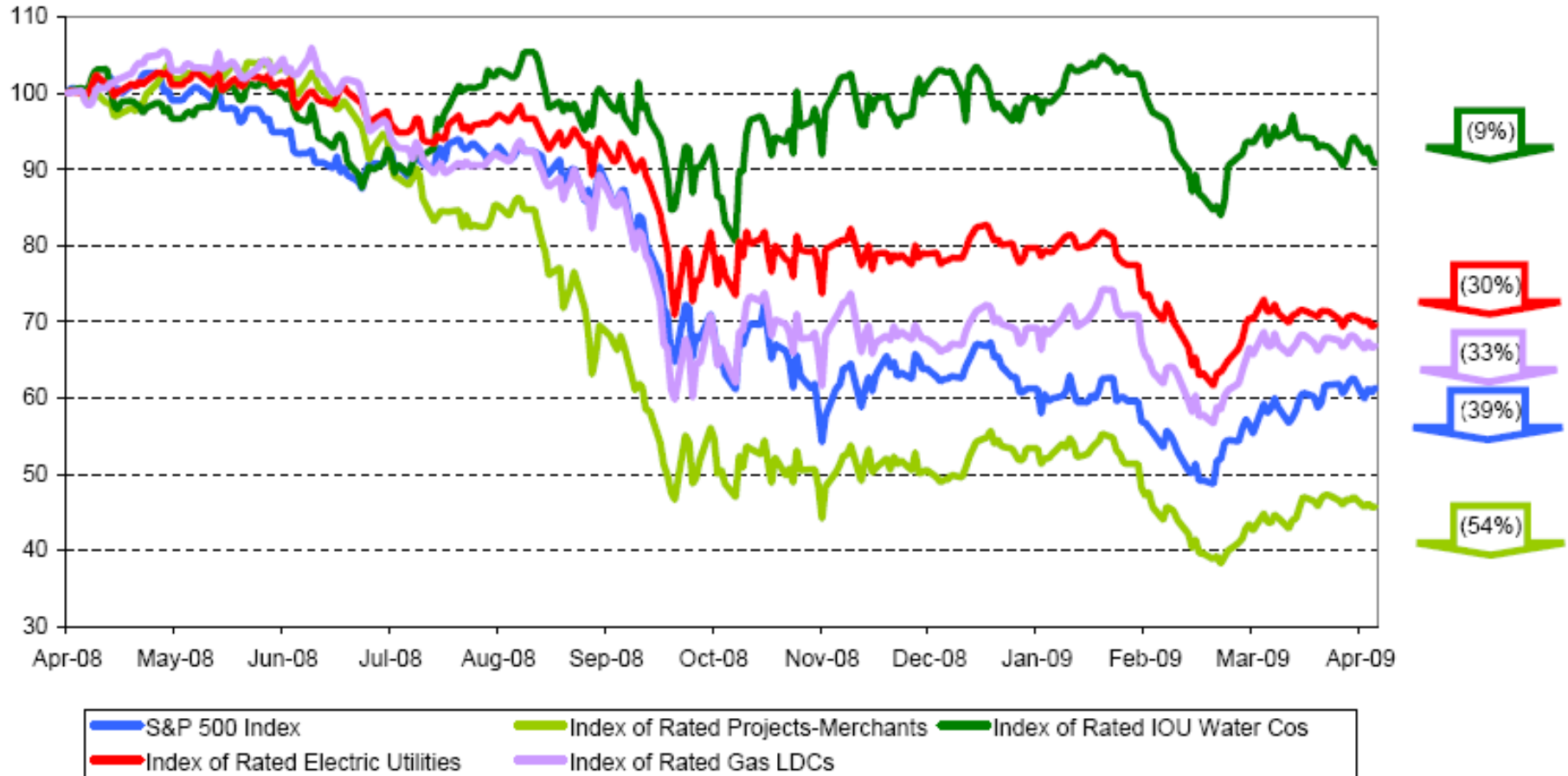
Sector Relative Value For the 'A' Rating Category



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Utility Shareholder Value Is Not Immune To Market Conditions

12-month Performance of Standard & Poor's Utility & Infrastructure Practice



Source: Capital IQ, Standard & Poor's Ratings Services.

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Vigorous Utility Capital Markets Activity

Energy capital offerings for the week ended March 20			
Company	Comp. date	Amount offered w/overallotment (\$000)	Offer price (%)
Debt offerings			
Empire District Electric Co. 7.000% senior secured first mortgage bonds, due 04/01/24	03/20/09	75,000	NA
Northwest Natural Gas Co. 5.370% series B secured medium-term notes, due 02/01/20	03/20/09	75,000	100.00
Kansas City Power & Light Co. 7.150% series 2009A secured mortgage bonds, due 04/01/19	03/19/09	400,000	99.89
PECO Energy Co. 5.000% first and refunding secured mortgage bonds, due 10/01/14	03/19/09	250,000	99.89
Duke Energy Indiana Inc. 6.450% series MMM secured first mortgage bonds, due 04/01/39	03/18/09	450,000	99.71
Duke Energy Ohio Inc. 5.450% secured first mortgage bonds, due 04/01/19	03/18/09	450,000	99.96
Potomac Electric Power Co. 6.200% series 2006 pollution control revenue refunding bonds, due 09/01/22	03/17/09	109,500	NA
Southern California Edison Co. 6.050% series 2009A secured first and refunding mortgage bonds, due 03/15/39	03/17/09	500,000	99.18
Southern California Edison Co. 4.150% series 2009B secured first and refunding mortgage bonds, due 09/15/14	03/17/09	250,000	99.99
Progress Energy Inc. 7.050% senior unsecured notes, due 03/15/19	03/16/09	450,000	99.59
Progress Energy Inc. 6.050% senior unsecured notes, due 03/15/14	03/16/09	300,000	99.73
Texas-New Mexico Power Co. 9.500% series 2009A secured first mortgage bond, due 04/01/19	03/16/09	262,000	97.64
Total debt		3,571,500	Offer price (\$)
Equity offerings			
Plains All American Pipeline LP Limited partner common units	03/17/09	184,500	36.90
Northeast Utilities Common stock, \$5.00 par value	03/16/09	383,295	20.20
Total equity		567,795	
Comprehensive coverage of private placements and Rule 144a transactions may not be possible due to limited disclosure and public documentation. These transactions are presented, where available. Source: SNL Energy			

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Recent Utility Debt Offerings

- **NiSource Finance Corp. (BBB-) \$600 million 10.75% notes due 03/15/16**
 - *833 bps spread*
- **Union Electric Co. (BBB) \$350 million 8.45% senior secured notes due 03/15/39**
 - *482.5 bps spread*
- **Appalachian Power (BBB+) \$350 million 7.95% mortgage bonds due 01/15/20**
 - *483 bps spread*
- **Atmos Energy (BBB+) \$450 million 8.50% senior notes due 03/15/19,**
 - *587.5 bps spread (~\$446 million to redeem \$400 million 4.00% senior notes due 2009)*
- **Kansas City Power & Light (BBB+) \$400 million 7.15% mortgage bonds due 2/15/19**
 - *460 bps spread*
- **Southern California Gas Co. (A+) \$250 million 5.5% senior secured due 03/15/14**
 - *332 bps spread*

Regulation Will Exert A Strong Gravitational Pull On Credit

- **Rate Cases Will Be A Sustained Characteristic Of Utility Activity For Several Years**
- **Regulators Will Be Challenged Severely To Achieve The “Right” Balance Among “Meritorious But Conflicting Goals:”**
 - Customer Protection/Rate Constraint In The Face of Ever-Upward Cost Pressure And Depressed Economic Conditions
 - Reliability of Service
 - *Financially Healthy And Solvent Utilities*

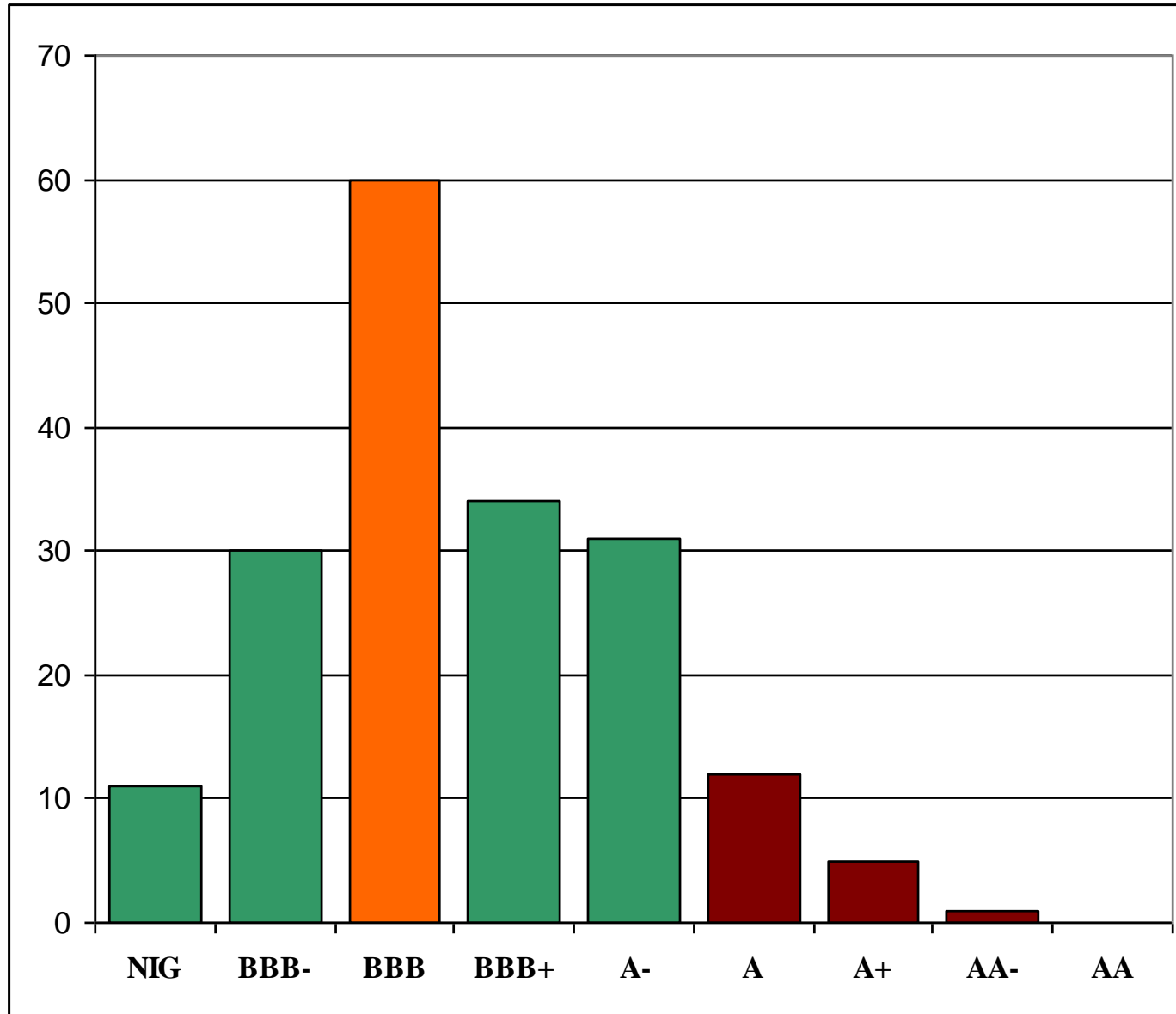
Characteristics Of Credit-Supportive Regulation

- **Consistency And Predictability Of Decisions**
- **Timeliness Of Rate Orders**
- ***Use Of Forward-Looking Measures***
- ***Use Of Adjustment Clauses/Trackers***
 - ***CWIP***
 - ***Pre-Approval Of Significant Capital Outlays***
 - ***Transmission***
 - ***Environmental***
 - ***Conservation***
 - ***DSM***
 - ***Bad Debt***
 - ***Pensions***
 - ***... Etc.***

Investor-Owned Utility Ratings In The Late 1970's

At The Beginning Of The Last Major Utility Generation Construction Cycle, Utility Senior Debt Ratings Were Typically In The **AA and A** Category. Today, In Advance Of Another Major Capital Expenditure Period, Ratings Are Much Lower...

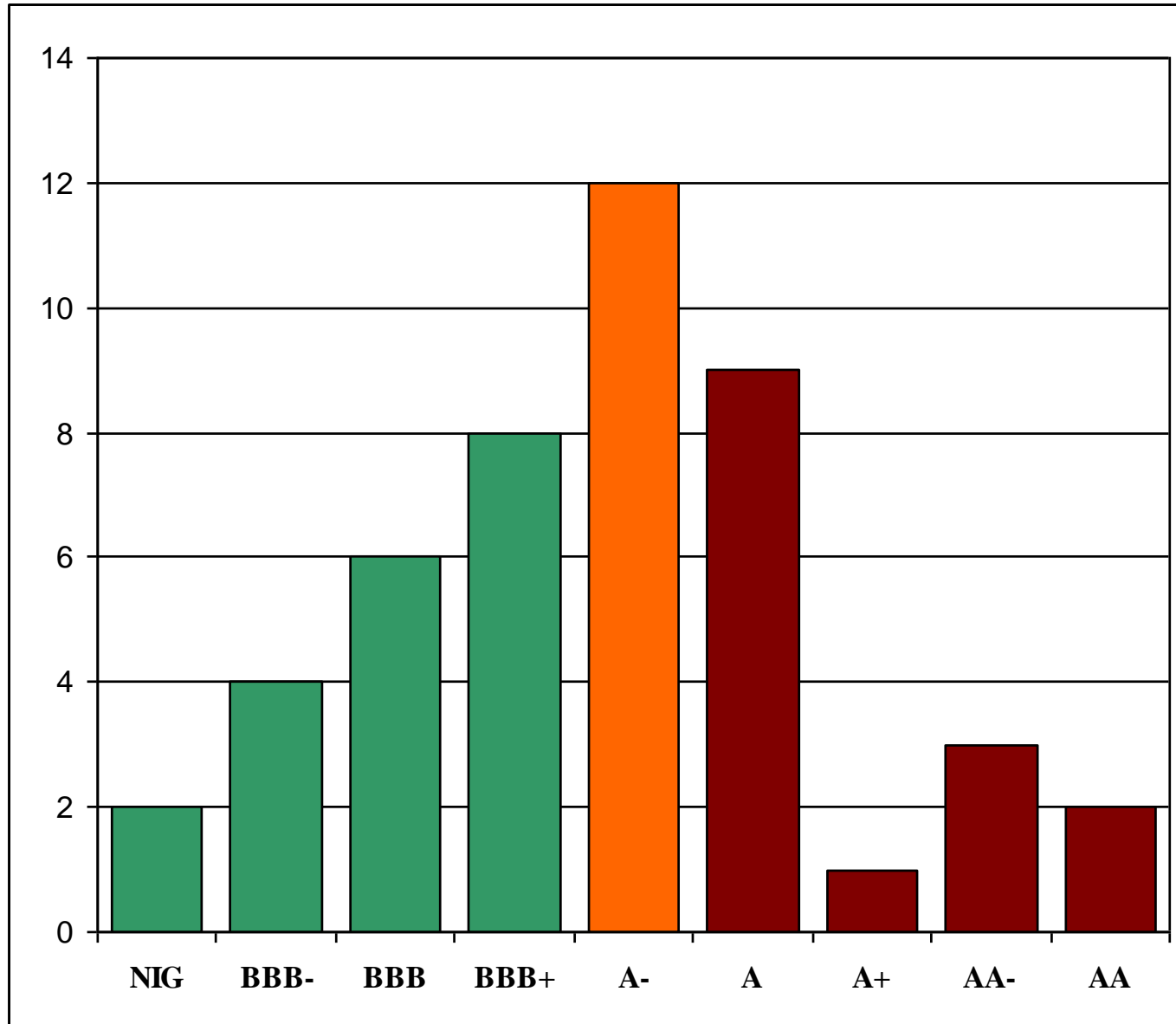
U.S. Electric Ratings Distribution



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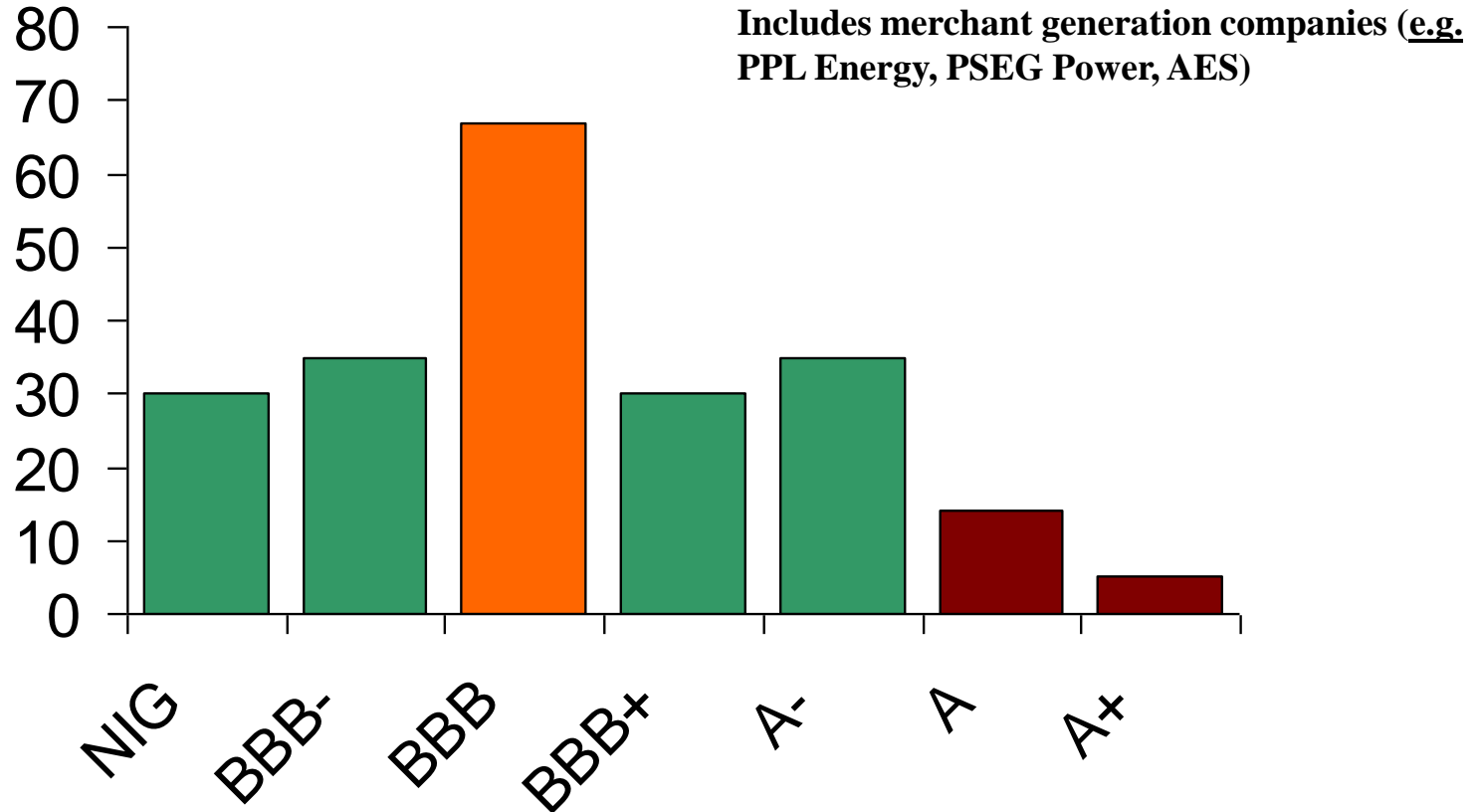
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U.S. LDC Ratings Distribution



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U.S. Utility/Power Industry Ratings Distribution



Note: About 60% Of All Corporate Issuers Are Speculative Grade, And The Median Rating For Non-Financial Issuers Is “BB-;” 33% Are “B” Category Credits

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U.S. Electric Utilities – 2009 Ratings Trend

Stable Ratings Trend For 2009 Are Supported By Expectations Of:

- Responsive Regulatory Actions
- Continued Access To Capital Markets
- Delay In New Base Load Construction (A Perverse Positive)
- A Relatively Smooth Transition To Deregulated Market Status (Contrast Maryland With Pennsylvania)

Higher Credit Ratings Longer Term May Be Limited By:

- Substantial And Sustained Capital Expenditures
- Recessionary Pressure on Cash Flow and Debt Balances
- Carbon Debate in Washington
- Political Interference

General Conclusions On The Utility Industry

- **Regulated Utilities Appear As Well Positioned As Any Market Sector To Contend With The Currently Clogged Credit Markets**
- **The Liquidity That Utilities Secured During The Go-Go Years Of The Credit Push Should Serve Them Well**
 - But Credit Will Become More Costly For An Indeterminate Period Of Time --- Permanently? --- And Refinancing Terms Will Be Dictated By The Banks
- **Projects Will Be Delayed Where Possible, With Budget Dollars Directed Toward Maintenance, Which May Eventually Increase Longer-Term Threat To Reliability As Economy Recovers**
- **Investors --- Fixed Income And Equity --- Are Signaling A Strong Focus On The Relationship Between Utilities And Their Commissions As Closely As They Ever Have**

Credit Highlights On Illinois Regulation

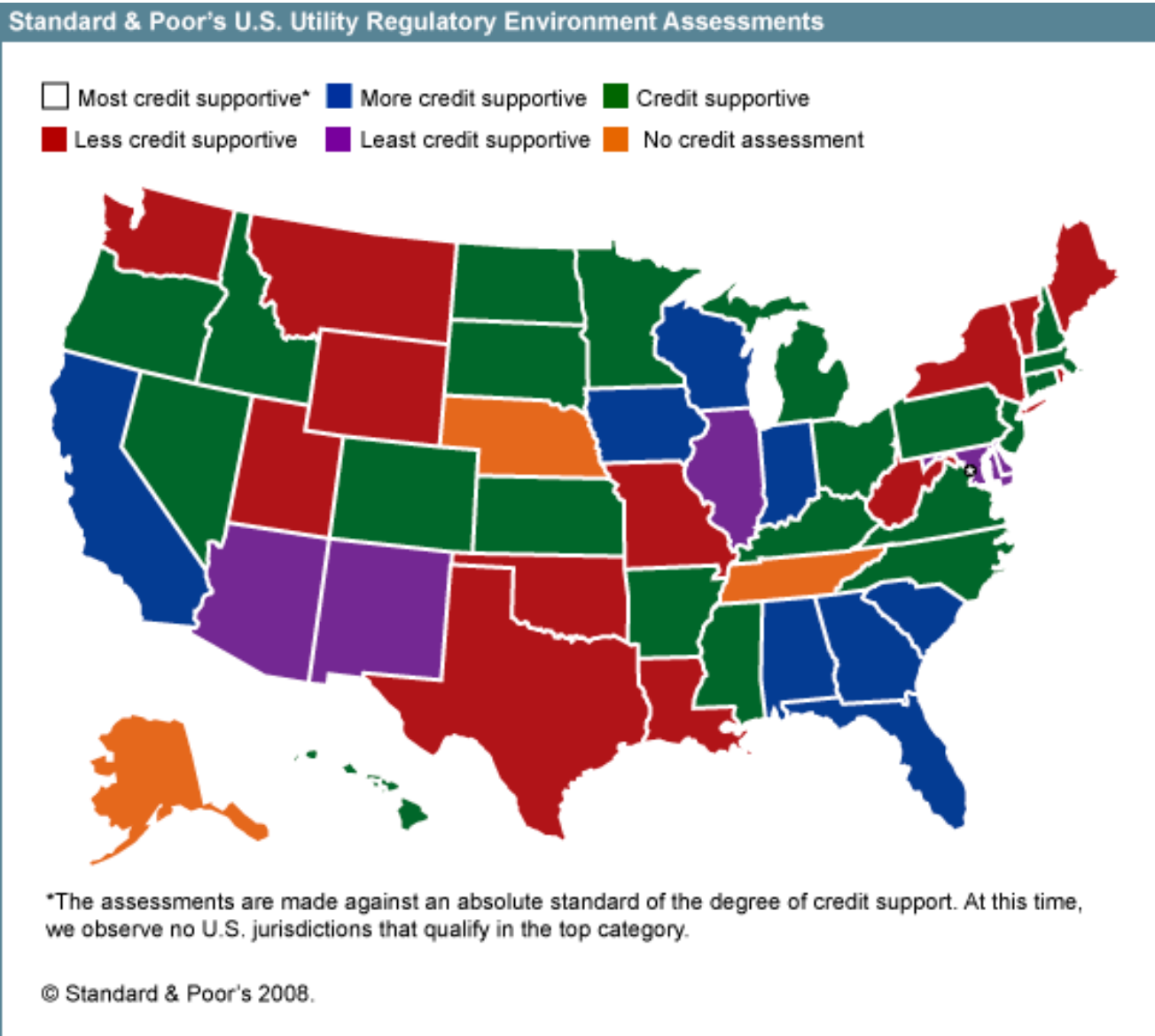
Strengths

- Diminished Headline Rhetoric
- Reasonably Supportive Recent ICC Orders
- Selective Use Of Riders

Weaknesses

- The Recent Past Resonates: What Might Rate Increases In The Future Unleash?
- Uncertainty Inherent In A New State Administration
- General Use Of An Historical Test Year

Standard & Poor's Assessment of State Regulatory Climates



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