EDISON ELECTRIC INSTITUTE

Draft: 5-Apr-07

Panel # 3 - Revisiting Capital Structure Issues in Ratemaking

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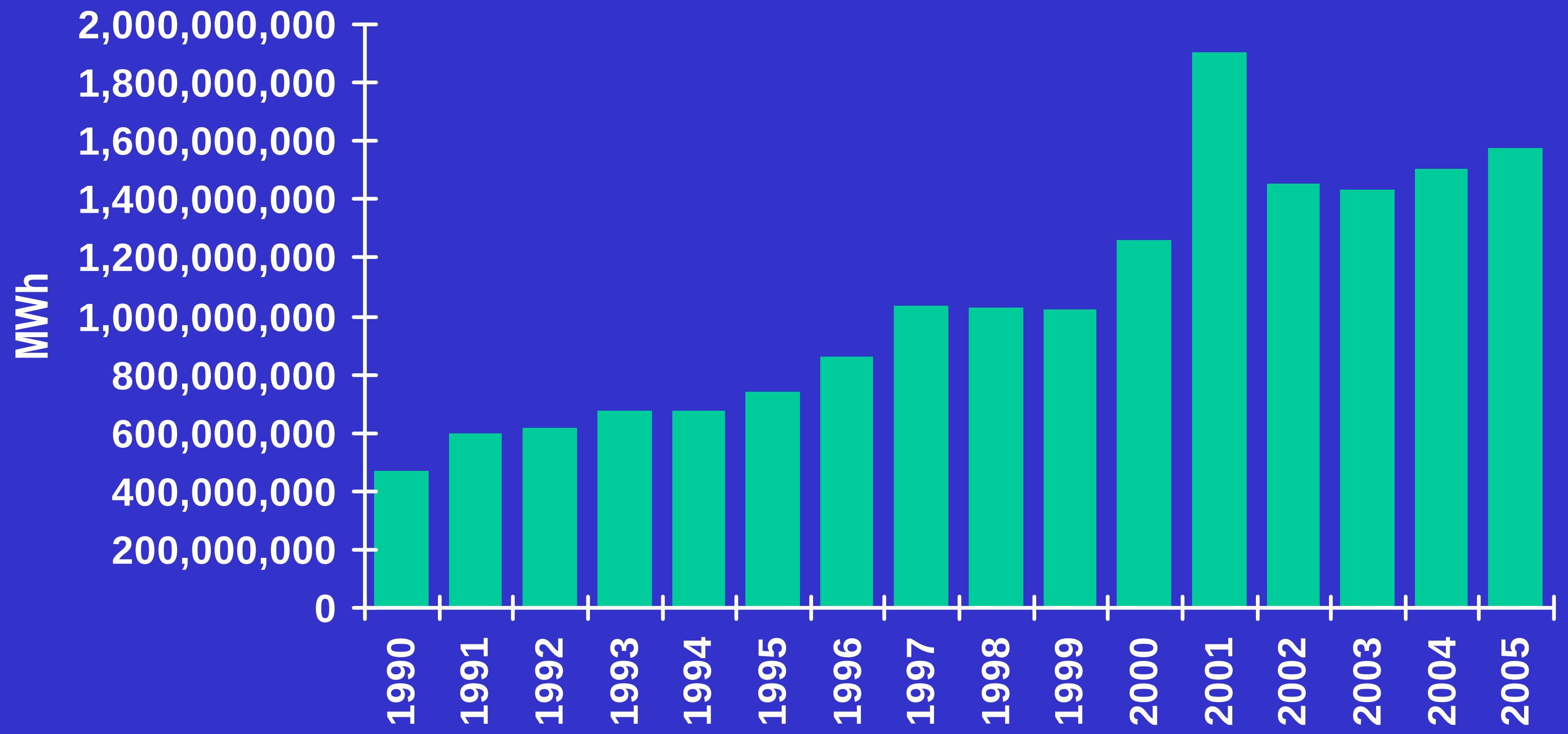
SURFA
April 19, 2007

IOU Purchases from Electricity Suppliers



Sources: Global Energy Intelligence, LLC (EIA 861 Schedule 2 Part B)

Renewable Portfolio Standards

- **23 states now have RPS** (including DC)
  - CA, CO, CT, DE, DC, HI, IL, IA, ME, MD, MA, MN, NV, NJ, NM, NY, PA, RI, TX, VT, WA, WI
- **The prospect of federal RPS has grown with Democratic control of Congress**
- **<u>A growing number of states are requiring long-term purchase commitments to help finance renewable projects</u> –** (CA, CO, CT, ME, NV, RI)

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Needed New Infrastructure

- **Generation - $300 billion through 2030**
  - Assuming conservation reduce need 60% (Source: EIA Annual Energy Outlook 2006)
- **Transmission - $138 billion through 2030**
  - Based on $6 billion/year (Source: EEI member survey, May 2005)
- **Distribution - $ 300 billion through 2030**
  - Source: (CHECK SOURCE – BRATTLE? EIA?)
- **Environmental - $ 85 billion through 2025**
  - Source: EIA, EPA

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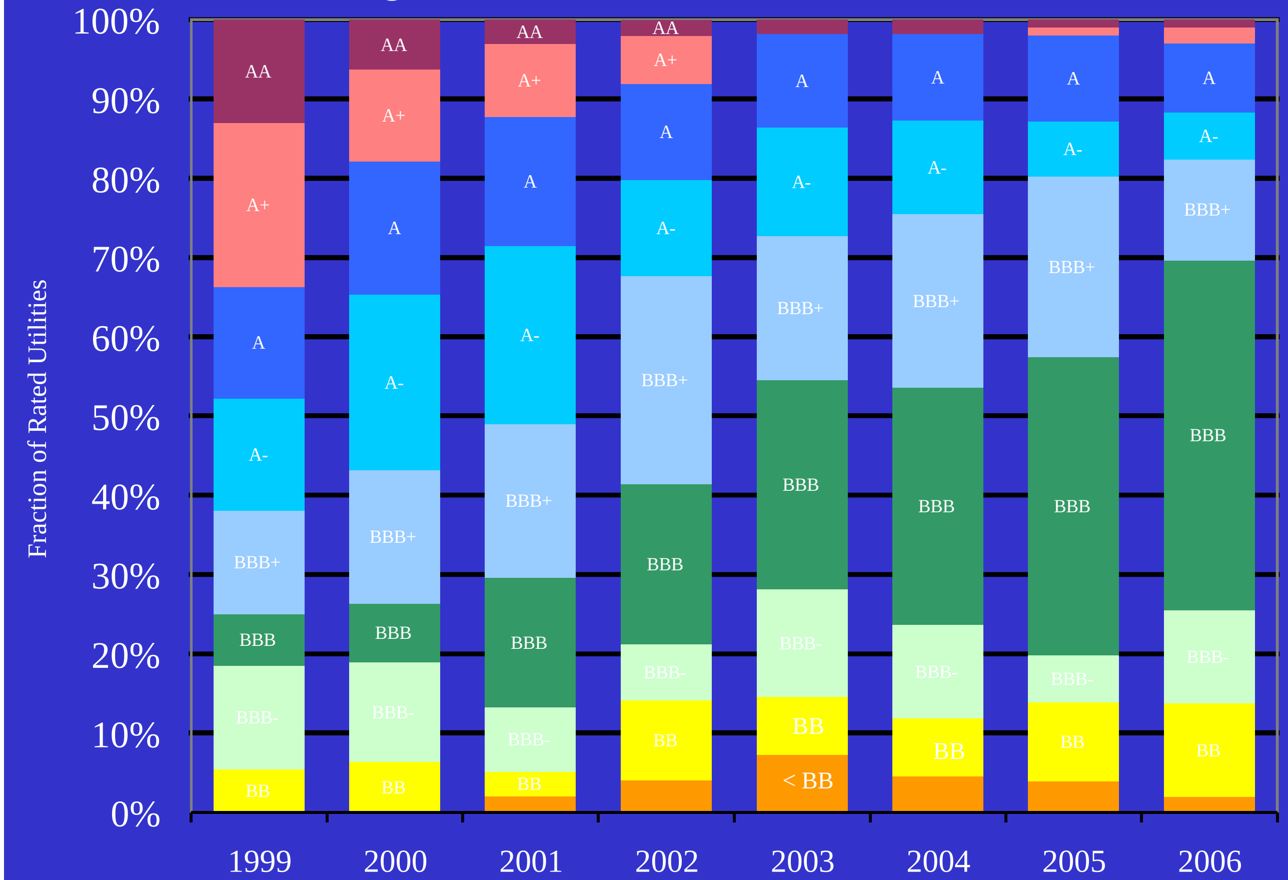
Creditworthiness Has Been Declining

Debt Ratings of Electric and Combination Utilities, 1999-2006



- **Over the last 6 years, the typical credit rating of utilities has dropped from A to BBB**
- **Only 30% of all utilities maintain ratings of BBB+ or above, down from 75% in late 90s**
- **BBB- and below investment-grade ratings fell to 20% in 2005 but have increased since**
- **Will lower quartile of utilities be able to address challenges faced today and in years ahead?**

Sources and Notes: The Brattle Group, S&P ratings as reported by Compustat. The sample consists of 121 companies based on Compustat GICS codes for electric utilities and multi-utilities; to avoid double counting, excludes holding companies if financial data for [illegible] subsidiaries is reported separately. Values are as of December for each year.

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Framing The Issues

- **Healthy utilities are in the public interest**
  - The industry needs to raise ~$750 billion over the next 25 years for new infrastructure
  - Better credit will lower costs
- **PPAs transfer net isk to purchasing utilities**
  - Can undermine credit ratings
  - Accurate measurement, appropriate mitigation/compensation is essential!
- **Public policy trade off**
  - Is it more efficient to manage utility risk or compensate investors for bearing it?