ComEd Ex. 5.0

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY	:	
	:	No. 10-_____
Proposed general increase in electric rates	:	

Direct Testimony of

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On Behalf of

Commonwealth Edison Company

List of Issues & Major Conclusions

- As a long-time institutional investor and rating agency analyst, Ms. Abbott explains the importance to utilities generally, and ComEd in particular, of maintaining sound credit ratings and therefore access to reasonably priced capital.

- Access to reasonably priced capital is particularly important in times of considerable stress in the capital markets, like the present.

- The previous rate order of the Commission in ComEd's 2007 Rate Case was instrumental in allowing ComEd to improve its credit rating, and further supportive action by the Commission is necessary, especially in light of the recent rate order in *Ameren*, if ComEd is to improve or even maintain its present rating.

- ComEd currently has the lowest investment grade rating assigned to utilities and is one of only nine transmission and distribution utilities nationwide with so low a rating (two others are also Illinois utilities).

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I. Introduction and Background

Q. What is your name and for whom do you work?

A. My name is Susan D. Abbott and I am the Principal of Susan Abbott Consulting, LLC. I am an independent consultant to companies in the regulated water, gas and electric utilities sector, providing advice surrounding questions relative to credit ratings, credit worthiness, and rating agency relationships.

Q. What are your qualifications?

A. I have worked in the financial services industry focused primarily on the electric, gas and water utility sectors since 1977. I have worked as an institutional investor, a rating agency analyst and Managing Director, and most recently as an investment banker. The vast majority of my career, however, was spent at Moody's Investor's Service ("Moody's"), one of the three principal U.S. based global rating agencies. For a total of 13 of the 20 years I was employed by Moody's, I was either a member, or the Managing Director of the Power and Project Finance Group, and was responsible for ratings of electric utility, electric and gas combination utility, water utility, and project finance ratings. Since leaving Moody's, I have been involved in rating agency advisory work with clients, chaired many rating agency panels for the jointly sponsored "Dialogue with Wall Street," (produced by Edison Electric Institute ("EEI"), and Gee Strategies, the consulting firm formed by Robert Gee, a former Assistant Secretary at the Department of Energy, a former Commissioner with the Texas Railroad Commission, and a former staff attorney at the Federal Energy Regulatory Commission), which is a forum for discussion between financial market participants and regulators.

I have a Bachelor's Degree in Literature from Syracuse University, and an M.B.A. in Finance from The University of Connecticut. I sit on the Board of Directors of the Student Managed Funds for the University of Connecticut, and am a member of the UConn Business School Hall of Fame. I have lectured at The Business School of the University of Connecticut, and Wharton Business School at the University of Pennsylvania, and was a faculty member at the University of Idaho's Public Utility Executive Course for 10 years. My CV is attached as ComEd Ex 5.1.

I have testified in a number of rate proceedings. A list of testimony is provided in ComEd Ex. 5.2.

Q. **What is the purpose of your testimony?**

A. I have been asked by Commonwealth Edison ("ComEd") to use my years of involvement in the financing of the utility industry, and my extensive experience with creating and using credit ratings, to provide testimony on the importance of creditworthiness for utilities, and the key role that regulation plays in the maintenance of that creditworthiness. I will provide perspective on the rating process, why credit ratings are important for regulated utilities and their customers, and what needs to be done to maintain or strengthen ComEd's ratings.

Q. **Please summarize your testimony.**

A. My testimony discusses the rating agencies, what is important to them, how they derive their ratings and how ComEd's performance fits into their parameters; the difficult state of the capital markets, especially for lower rated entities; why a strong balance sheet and healthy cash flow metrics are essential to access those difficult financial markets at reasonable costs; and the positive role the Illinois Commerce Commission ("ICC") has played recently in helping ComEd regain its very important investment grade ratings, and why continued support is essential (especially in light of the doubt created by the ICC's April 29, 2010 *Ameren* Order).

Q. **In brief, what is your conclusion?**

A. The outcome of this rate proceeding is extremely important to ComEd's ability to access the capital markets which, in turn, is vital to its ability to pursue its extensive, and very important capital program. The rating agencies and the financial community are focused on regulatory activity in Illinois, and the ability of ComEd to maintain or improve its ratings is highly dependent on whether the ICC continues its recent supportive regulatory practices in this and future cases. By "supportive" I mean granting fair and reasonable requests for rates and rate designs that will allow the utility to generate cash flow sufficient to achieve credit metrics that support the rating, and even provide an opportunity for an improvement in the rating. Unfortunately, as I discuss later the ICC's April 29, 2010 Order in the *Ameren* cases seems to presage a return to a less supportive regulatory climate which could have serious adverse consequences for utilities in Illinois and their ability to access capital, certainly on reasonable terms.

II. <u>The Effect of Regulation on Creditworthiness</u>

Q. **What effect does regulation in Illinois have on ComEd's creditworthiness and ability to access the capital markets?**

A. The ICC's decisions have enormous influence in the deliberations of the rating agencies over the credit rating of ComEd and over investors when they make their decisions about which company to invest in. Thus, the ICC plays a critical role in the ability of ComEd to access the capital markets. Moody's terms regulatory bodies' "supportiveness…a critical rating factor."[1] Moody's considers the four most important factors affecting the creditworthiness of utilities to be: 1) regulatory framework; 2) ability to recover costs and earn returns; 3) diversification; and 4) financial strength and liquidity. Under Moody's framework, regulation carries fully 50% of the weight of all utility ratings. Moody's has actually quantified the importance of regulation to the credit quality of utilities and emphasizes that "the predictability and supportiveness of the regulatory framework… is a key credit consideration," Standard & Poor's (" S&P") writes articles with titles such as "Utility Regulation Determines Its Ratings." Both Moody's and Fitch Ratings ("Fitch") upgraded ComEd to the lowest investment grade rating ("Baa3"/"BBB-" respectively) as a direct result of the regulatory decisions made by the ICC in ComEd's 2007 rate case. Moody's key ratings drivers for ComEd include an "improved political and regulatory environment in Illinois." The upgrade was attributed to "the impact on the company's expected financial metrics following their September 10, 2008 receipt of the distribution rate order rendered by the ICC….Moody's views the outcome of this rate case decision along with other recent rate case decisions rendered by [the] ICC as being supportive of utility credit quality."[2]

However, the rating agencies also highlight the quality of regulatory decisions as being the single most important risk to ComEd losing its newly won investment grade rating. Fitch upgraded ComEd's issuer default rating from "BB+" to "BBB-" as well, on January 25, 2010, reflecting "the financial improvement achieved over the past year [and]

[1] Credit Opinion: Commonwealth Edison, Moody's Investors Service, October 6, 2008

[2] *IBID*

a more settled regulatory and legislative environment in Illinois."[3] They further stated that "achieving constructive regulatory outcomes that allow for timely recovery of utility investments and the opportunity to earn the allowed return on common equity will be required to *support ratings and credit quality*."[4] (Emphasis added) Fitch also stated that "continuation of Illinois Commerce Commission procedures for full and timely recovery of electricity supply costs is critical to maintaining existing ratings." [5] Finally, S&P cited "ComEd's stand-alone financial measures [which] have steadily strengthened during the past several months due to the rate case increase, and are expected to be maintained at their current level for the near to intermediate term."[6]

Q. **Has anything happened recently that might concern the investment community relative to the ICC's decisions in this case?**

A. Yes. The decisions recently handed down by the ICC in the cases brought by Ameren's regulated subsidiaries are troubling. Regulatory Research Associates, a subsidiary of SNL Financial, commented that "there is a possibility that the commission may be setting a different course"[7] than expected after its supportive actions of 2008. RRA is concerned about what will happen when other Illinois utilities, including ComEd, bring their rate cases.[8] As explained in detail later, RRA continues to afford Illinois a ranking of "Below Average 2" Only Connecticut carries a lower ranking of "Below Average 3."

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[3] *Op. Cit.* FitchRatings,

[4] *Op. Cit.* Fitch Ratings

[5] Global Power U.S. Credit Opinion, Commonwealth Edison Company, FitchRatings, February 22, 2009

[6] Ratings Direct, Commonwealth Edison, Standard & Poor's, July 24, 2009

[7] SNL.com, May 3, 2010

[8] *IBID*

Q. What would improve the opinion of the rating agencies of regulation in Illinois?

A. It is critically important that the ICC continue to be supportive of ComEd by granting fair and reasonable requests for rates and rate designs that will allow the company to generate cash flow sufficient to reach credit metrics that support their rating, and even provide an opportunity for an improvement in the rating. Moody's, while highly praising the actions of the ICC in the 2007 distribution rate case, emphasizes that it is concerned that the supportiveness will not persist. Moody's indicates that under its methodology, ComEd's indicative rating would be "Baa2."[9] However, because of Moody's skepticism about continued supportive regulation in Illinois, it maintains a lower "Baa3" rating.[10] Likewise, Fitch cites "a more settled regulatory and legislative environment in Illinois"[11] as the principle reason for their January 25, 2010 rating increase from "BB+" to "BBB-." Like Moody's, Fitch is concerned about ComEd "achieving constructive regulatory outcomes….to support ratings and credit quality."[12] RRA, who rates regulatory environments, places Illinois in the "Below Average 2" category ---next to the bottom--- in a nine category schema which ranges from Above Average 1 (highest) to "Below Average 3" (lowest). RRA cites an historically politically contentious environment which has admittedly become more stable, but is still riddled with indications "that uncertainty is likely to remain."[13] In addition, RRA points out allowed returns on equity that they call "meaningfully below prevailing industry averages" and the rejection of "a

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[9] *Op. Cit.*, Moody's Investors Service

[10] *Op. Cit.,* .Moody's Investors Service

[11] *Op. Cit.,* FitchRatings

[12] *Op. Cit.,* FitchRatings

[13] Illinois Commerce Commission, SNL.com, March 11, 2010

slate of cost recovery mechanisms that had been proposed by the utilities…"[14] While at least before the April 2010 *Ameren* decision RRA praised the ICC for constructive rate treatment relative to the revenue impact of reductions in usage, they are still concerned about "the restrictive rate decisions that…could portend a return to a more restrictive regulatory climate…in the coming years.""[15] The only way to alleviate the concerns of RRA, the rating agencies, and investors, is to continue to make decisions that support ComEd's ability to generate cash flow at levels that support, or improve, its ratings.

Q. **Can you elaborate on what the ICC needs to do to remain supportive?**

A. Regulatory decisions have significant consequences, all of which should be kept in mind when making a decision with the import of this one. In order for ComEd to maintain and/or improve its ratings, which will allow them to access the capital markets in a reasonable manner, any decisions made by the ICC must take into serious consideration the credit metrics that fall out from those decisions. If the decisions made do not allow ComEd to generate enough cash flow to support its ratings, those ratings will fall again to non-investment grade where debt is substantially more expensive, and market access highly subject to volatility. For instance, the long term bond yield average for an A rated utility on June 2, 2010 was 5.6%, or 186 basis points above comparable Treasuries. For Baa utilities it was 6.19%, or 245 basis points above Treasuries. However, for non-investment grade companies, average yields were 697 basis points above Treasuries (as of May 25, 2010). It would be extraordinarily expensive for ComEd to raise the money it needs to complete its extremely important capital expenditure program without an

[14] *IBID*

[15] *Op. Cit.* SNL.com

investment grade rating. That level of rating will only be sustainable with supportive regulatory decisions from the ICC. Because ComEd's ratings were just recently upgraded to investment grade, the implications of which will be discussed in greater length later, maintenance of the current BBB/Baa3/BBB- ratings could be fragile if a decision in this case does not support credit metrics at levels commensurate with investment grade ratings. ComEd's position is precarious in this regard and special attention needs to be paid to the effect on the company's credit metrics of any decision being made in this case.

III. Background on Credit Ratings

Q. **What are credit ratings?**

A. Credit ratings are gatekeepers to the financial marketplace. Their primary function is to convey the level of creditworthiness of companies wishing to access capital in the public debt markets. Credit ratings assist investors in determining: 1) which companies fit their risk appetite, 2) the appropriate interest rate that should be paid relative to credit quality, and 3) the likelihood that their investment is going to behave as expected in terms of timely payment of interest and principal.

Q. **What do credit ratings mean?**

A. A. Each credit rating level is associated with a probability of default; the lower the rating, the higher the probability of default. When credit ratings fall from investment grade to non-investment grade, the probability of default rises rapidly to levels that are often double those of the lowest investment grade rating.

Q. **How are credit ratings expressed?**

A. Credit ratings are conveyed as a series of letters and qualifiers used to indicate to investors the likelihood that a company issuing debt will pay principal and interest on time, in amounts expected. Generally, AAA/Aaa is the highest, while C is the lowest. S&P and Fitch use the same nomenclature, while Moody's is slightly different. However, their credit ratings are comparable. In other words, a "BBB" from S&P and Fitch is equivalent to a "Baa2" from Moody's. A complete list of credit rating symbols is attached as ComEd Ex. 5.3.

Q. **How are credit ratings derived?**

A. The credit rating process is complex, and is more art than science. It attempts to describe to investors the likelihood that cash flow generated by a business will be sufficient to cover a company's fixed financial obligations. Fundamentally, rating agencies arrive at their opinions of the creditworthiness of a company by examining its financial results in light of its business risk.

Q. **What do the rating agencies consider to be the most important financial metric?**

A. Cash flow is the most important financial metric. This is not surprising because credit ratings are intended to measure the ability of a company to pay its financial obligations on time, and in amounts expected. Those financial obligations are cash obligations. Therefore, the ability of a company to generate cash flow in amounts that are sufficient to pay its obligations, plus have a cushion for unexpected events, is of utmost importance. Because a utility's cash flow is heavily influenced by regulatory actions, the regulatory environment is also heavily weighted; under Moody's approach, for example, 50% of the rating depends on the regulatory environment.

Q. **How do the rating agencies treat cash flow metrics?**

A. Fitch states that "the financial assessment emphasizes cash flow financial measures rather than equity or earnings-based ratios. The analytical focus is on the adequacy of the utility's cash flow relative to fixed charges, debt obligations and capital expenditures as well as its capital structure, liquidity and profitability."[16] S&P emphasizes that "interest or principal payments cannot be serviced out of earnings, which is just an accounting concept….cash flow analysis is the single most critical aspect of all credit rating decisions."[17]

Q. **Are some cash flow metrics more important than others?**

A. The cash flow metric deemed most important is cash flow as a percentage of debt outstanding, or "FFO ("Funds From Operations")/Debt." This measures the ability of a company to generate sufficient cash flow relative to its obligations, which often covers not just debt, but what rating agencies call "debt-like" obligations, or anything that is an ongoing obligation that must be satisfied with cash. The other cash flow metric that is heavily depended on is cash flow coverage of interest, or "FFO/Interest." While this is an important metric, it is not considered as reliable an indicator as FFO/Debt because interest rates can fluctuate over short periods of time, thereby distorting the long term financial health of a company.

Q. **Are other financial metrics besides cash flow metrics important?**

[16] CEO Message, fitchratings.com, (Feb. 1, 2009).

[17] *Op. Cit.*, S&P

A. Yes. Rating agencies calculate dozens of metrics when doing a rating exercise. In the end, however, the cash flow metrics carry so much more weight than any others that they, in combination with business risk levels, effectively define the credit rating.

Q. **What factors affect cash flow?**

A. There are many, but the most important are the allowed return on equity, and timely and predictable cost recovery.

IV. <u>Capital Markets Environment</u>

Q. **What is the state of the capital markets today?**

A. The crisis state of the capital markets observed in September of 2008 when the bond markets shut down completely for 10 days, commercial paper was utterly unattainable for some borrowers (including ComEd), and the equity markets were in free fall has stabilized. However, there is still a good amount of disquiet resulting from weak economic recovery in the U.S. as well as difficulties being experienced by several sovereign entities - - most notably Greece, but also Iceland, Spain and Portugal. Although spreads have narrowed both absolutely and relatively from their most dire point, credit spreads between "A" and "BBB" rated issuers remain high. On June 2, 2010 the spread between A and Baa rated utilities was 59 basis points as reported by Moody's on Moodys.com. It was close to 180 basis points at the height of the crisis. In addition, while spreads may be declining, the absolute level of interest rates is expected to rise over the next two years by as much as 100 basis points.[18]

[18] Forecast prepared by S&P

Q. **Doesn't that mean that the crisis has passed and the markets will return to "normal"?**

A. The "crisis" is proving to be somewhat intractable, keeping credit spreads, or the price a corporate borrower pays versus that which the U.S. Treasury has to pay, wide. They are, in fact, "somewhat above their year-end 2009 level."[19] Moreover, "the scope for spread narrowing will remain limited, and costly reversals will remain a distinct possibility."[20] Standard and Poor's estimates that unemployment will persist above 9% through 2011, and that GDP growth, calculated with a deflator to account for inflation, will be less than 2% for most periods through 2011. Moody's chief economist, John Lonski, iterated in his weekly economic review that the significantly low trend of business sales indicates that significant job growth in the U.S. could take much longer than anticipated, unemployment will continue to persist at high levels, and the housing market could easily deteriorate further. Moody's statement in this regard is critical to a company like ComEd which needs access to the capital markets, but has a barely investment grade rating. Moody's states that "if home sales do not grow sequentially . . . risk aversion could swell."[21] In short, investors will drift to ever higher rated investments as their avoidance of lower rated issuers increases.

Q. **Why is it important for ComEd to have access to the capital markets?**

A. ComEd has a large construction program over the period 2010 through 2014, that will require investment amounting to about $4.5 billion which is needed, as Mr. Donnelly

[19] U.S. Credit Market Review and Outlook, Moody's Investors Service, March 8, 2010

[20] *IBID*

[21] *Op. Cit.,* Moody's

explains in his testimony (ComEd Ex. 8.0) to install facilities for new customers, expand capacity, replace facilities that have failed or are at the end of their useful lives, and install new facilities that improve system performance.

Q. **As a utility, isn't ComEd able to access the marketplace whenever it needs to?**

A. No. ComEd is one of a handful of utilities that has ever lost its investment grade rating. That loss was largely the consequence of insufficient regulatory support in the form of inadequate or untimely rate relief. Now that it has regained that rating through the recent supportive actions of the ICC, it is extremely important that it retain its rating, or even improve it over time. The unfortunate lesson we've learned during this period of economic upheaval is that there <u>are</u> circumstances under which investors are not willing to commit capital to utilities, or anyone else for that matter. And then when they are again willing to commit capital, it may be only to companies rated "A" or better. This was amply demonstrated in the fall of 2008 when the first issuers who successfully tapped the bond market once it reopened after a 10 day closure were "A" rated utilities and "AAA" rated corporate entities. Even then, the price paid for capital was extremely high relative to what was being paid prior to the crisis. Illinois Power, a BBB/Baa3 rated issuer, raised money in the bond markets approximately one month after they reopened on September 25, 2008, but paid 9.75% for 10 year debt, which was *609 basis points* over comparable Treasuries. Prior to the crisis, Nevada Power, another BBB/Baa3 rated utility raised $500 million for 10 years at 6.5%, or 245 basis points over Treasuries. While the markets have eased somewhat, it is highly unlikely that they will return to the easy credit stance of the last 15 years. Market volatility remains, and spreads between credit rating categories remain substantially higher than they were prior to the credit crisis. Currently, the credit spread for long term funds (20+ years) for an "A" rated utility is 136 basis points over Treasuries. For a "BBB" rated utility it is 175 basis points, 29% higher than for an "A." On July 20, 2007, before the crisis was fully developed, the difference in basis point spreads between "A" and "BBB" rated utilities was 5.8. Investors' risk aversion is easily demonstrated by the fact that the basis point spread for "A" rated utilities is now 42% higher than it was in 2007, but 72% higher for "BBB."

Q. **Is it more important currently to have a solid investment grade rating than in the past?**

A. Although it is important for utilities to maintain an investment grade rating at all times, it is more important to maintain that rating in difficult times like the present. Credit ratings cannot be moved up and down at will, and in fact, usually take years to recover if lost. Utilities are capital intensive, and therefore need reliable, consistent access to capital markets at all times. More germane to the current discussion is the fact that the utility sector has entered a new construction cycle of heavy capital spending needed to refurbish, rebuild and expand systems to provide quality service to its current and future customers. Without adequate access to capital, providing for the needed infrastructure to distribute required amounts of power becomes, in the end, much more expensive than it otherwise would be. In addition, utilities are subject to higher levels of operational and financial risk during periods of heavy construction activity and are more vulnerable to credit quality diminution that may, or may not, be the result of something the utility itself is doing. "Contamination" during a construction cycle in which one utility has a significant problem causes investors to question all other utilities' ability to escape the same problem Problems accessing the capital markets could just as easily stem from economic dislocations or other extraneous events as from activity peculiar to a specific utility. Therefore, having an adequate cushion of creditworthiness to guard against unexpected events is most important during these periods.

Q. Does the fact that the entire utility industry is in a new construction cycle have bearing on ComEd's ability to access the capital markets?

A. Yes. The capital markets are becoming increasingly competitive. That gives investors more choice, and given their state of risk aversion, they are likely to choose the less risky investments first. Borrowers with better ratings are likely to have little trouble accessing the market at all times at reasonable cost. Borrowers with less stellar credit will find conditions sometimes less than welcoming, and sometimes downright hostile.

Q. Why are the capital markets "increasingly competitive?"

A. According to an article in Electric Perspectives dated February 9, 2009, the last construction cycle in the utility industry was completed almost 30 years ago. Electric infrastructure in the United States is tired and outdated. Therefore, most utilities are, or will be, accessing capital to rebuild infrastructure and install new, modern equipment for the foreseeable future. Added to that is the need to renew other infrastructure in North America like roads, bridges and tunnels. The California Public Employees Retirement System (CALPERS) estimates that $20 trillion needs to be invested in North American infrastructure over the next 25 years. That means that not only will utilities be vying with each other for funds, but other, non-utility issuers will also be tapping the capital markets at the same time, giving investors unprecedented choice.

Q. Is the utility industry well positioned to compete for funds at this time?

A. Not especially. The industry suffers from a credit standing that is lower than is comfortable given the amount of pressure it will have to withstand as it journeys through this new construction cycle. David Owens, Executive Vice President of the Edison Electric Institute, pointed out in his remarks to Wall Street on February 12, 2009[22] that "at the onset of our last major capital expenditure cycle in the 1970s and 1980s, our senior debt was largely rated 'A' and 'AA."' Today, the average S&P senior debt rating is 'BBB.'" Moody's characterizes this issue in its Industry Outlook for 2009 by stating that while the "fundamental credit outlook for the…electric utility sector currently remains stable," the stability of credit metrics in the industry over the past few years has become "a credit negative since stronger metrics would be needed to offset the pace of rising business and operating risk."[23] Those risks reference the building cycle in which the industry is currently engaged. Moody's also opined that "deferrals and delays are temporary solutions,"[24] addressing the concept that utilities will not need to spend as much as previously thought because of the economic slowdown. In reality, utilities invest for the needs of the public for 30 and 40 years. Any temporary slow-down will need to be caught up eventually. As Moody's so succinctly put it, "the sector's substantial negative free cash flow generation creates a need for unfettered access to the capital markets. This represents a fundamental weakness to the sector's business plan."[25] In other words, utilities are entering this current construction cycle from a position of relative weakness. The last construction cycle drove ratings down from the "A" level to

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[22] Electricity: Powering the Change that America Needs, David Owens

[23] Industry Outlook, U.S. Electric Utility Sector, Moody's Investors Service, January, 2008

[24] U.S. Investor Owned Electric Utilities, Industry Outlook, Moody's Global Infrastructure, Moody's Investors Service, January, 2009

[25] *IBID*

the "BBB" level. The danger is that this construction cycle, absent regulatory support, could drive the industry average rating to non-investment grade, which would be to no one's benefit.

Q. **Doesn't the utility industry in general have good access to the capital markets?**

A. At one time that may have been true, but no longer. Investments in utilities were, for many years, considered to be safer than those in many other industrial companies. However, that is not now, and for many years has not been, the case. SNL, a financial information firm that covers the power and energy industries, reported in its Electric Utility Monthly – March 2010, that those utility stocks have not been doing well relative to other investments, despite the fact that the group "finished 2009 in fairly good shape."[26] Regulatory Research Associates (RRA), a subsidiary of SNL, reported that its RRA Index, an index of utility stocks, was well short of the performance of the Dow, the S&P 500 and the NASDAQ. The RRA index was up 12.3% for the trailing 12 months, while the Dow was up 44%, the S&P up 47% and the NASDAQ up 61%. These indices are made up of companies generally outside of the utility industry, which demonstrates just how much more attractive equity investors currently find non-utility stocks despite utilities' decent financial performance during the period. This has negative implications for utilities relative to their ability to access the equity capital markets. As ComEd is a subsidiary of Exelon, access to the equity markets *per se* isn't an issue. However, like any other shareholder, Exelon should not necessarily be expected to continue to invest in a company with deteriorating credit standing and poor prospects. In turn, Exelon's own shareholders will be less interested in maintaining positions in Exelon if its subsidiaries

[26] Electric Utility Monthly – March 2010, SNL.com

deteriorate. On the debt side, ratings levels are key to market access, and as discussed earlier, are under pressure. While Moody's emphasizes that their view of the industry is that it has a stable near-term ratings outlook, that outlook is highly qualified because it "incorporates an assumption that utilities will continue to have *unfettered access* to the capital markets."[27]

Q. **How does a utility maintain "unfettered access" to the capital markets?**

A. It is essential that utilities maintain an investment grade level credit rating. Yet, a minimum investment grade rating, such as ComEd now has, might not be enough in a crisis situation. As mentioned previously, it was "A" level rated utilities that led the way when the public bond markets opened up after being essentially frozen for 10 days.

Q. **How does ComEd compare to other utilities with whom it is competing for funds?**

A. ComEd has one of the lowest ratings in the industry. The following chart shows Moody's senior unsecured ratings for ComEd and its peers in the transmission and distribution sector. ComEd holds, along with eight others, the lowest rating in the group, although one of those eight has a positive outlook.

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[27] U.S. Investor-Owned Electric Utilities; Somewhat Insulated but not Immune from Credit Market Stress, Economic Weakness, Special Comment, Moody's Global Infrastructure, Moody's Investors Service, October, 2008 (emphasis added).

Rating/Outlook*	Issuer Name	Rating/Outlook*	Issuer Name
A1/Stable	NSTAR Electric	Baa2/Stable	Duquesne Light
A3/Negative	Central Hudson Gas & Electric	Baa2/Stable	Jersey Central Power & Light
A3/Stable	Massachusetts Electric	Baa2/Stable	Metropolitan Edison Company
A3/Stable	Narragansett Electric Co.	Baa2/Stable	New York State Electric & Gas
A3/Stable	New England Power	Baa2/Stable	Ohio Edison
A3/Stable	Niagara Mohawk Power	Baa2/Stable	PPL Electric Utilities
A3/Negative	PECO Energy Company	Baa2/Stable	Pennsylvania Electric
Baa1/Stable	Central Maine Power	Baa2/Stable	Pennsylvania Power
Baa1/Stable	Connecticut Light and Power	Baa2/Stable	Potomac Electric Power Co.
Baa1/Stable	Oncor Electric Delivery Co.	Baa2/Stable	Rochester Gas & Electric Co.
Baa1/Stable	Orange and Rockland	Baa2/Stable	United Illuminating
Baa1/Negative	PPL Electric Utilities Corp.	Baa2/Stable	Western Massachusetts Electric
Baa1/Stable	Public Service Electric & Gas	Baa2/Stable	West Penn Power
Baa1/Stable	Superior Water, Light &	Baa3/On Review	CenterPoint Energy

	Power	Positive	Houston
Baa2/Stable	AEP Texas Central Company	Baa3/Stable	Central Illinois PS
Baa2/Stable	AEP Texas North Company	Baa3/Stable	Cleveland Electric
Baa2/Stable	Atlantic City Electric Co.	Baa3/Stable	**Commonwealth Edison Co**.
Baa2/Positive	Baltimore Gas & Electric Co.	Baa3/Stable	Illinois Power
Baa2 /Stable	Delmarva Power & Light Co.	Baa3/Stable	Potomac Edison
		Baa3/Stable	Texas-New Mexico Power Co.
		Baa3/Stable	Toledo Edison Co.
		Baa3/Stable	West Penn Power

*As of June 14, 2010

Note that three of the nine transmission and distribution companies Moody's has given a "Baa3" rating, the lowest investment grade rating, are located in the state of Illinois. The average rating of the group is "Baa1."

Other sub-sectors of the utility industry include 70 vertically integrated companies, of which 10 (14%) have Baa3 ratings. The average rating of this group is "Baa1." Of the 52 Parent holding companies rated by Moody's, 13 (25%) are rated "Baa3," with the average rating being "Baa2." And of the 30 local gas distribution companies Moody's rates, and that would be attractive to potential investors in transmission and distribution companies, only one (3%) is rated "Baa3." The average rating of the LDCs is "A3". As can be surmised from these statistics, ComEd has a lot of competition from better rated issuers in its own industry sector as well as those in other sub-sectors that would be of interest to the same investors interested in ComEd.

Q. **What are the other implications of being rated lower than issuers competing for the same funds?**

A. Access to funds is key, but price is also affected. While statistics are not available for interest rates by rating notches within broader rating categories, "A" rated utilities paid an average of 5.88% for debt on March 9, 2010, while "Baa" rated utilities paid an average of 6.26%. A "Baa3" rated utility would pay more than the 6.26%, and may not have as robust an audience as a higher rated utility. Market data is even more instructive. Since October of 2009, 59 utilities debt deals have been issued. A consistent pattern emerges when comparing utility debt issues of similar maturity against one another according to rating. "A" rated utilities are paying approximately 5.5% for 30 year debt, and "Baa" rated utilities are paying 100 basis points more, or approximately 6.5%. Interestingly, a Ba1 rated utility, Otter Tail Power, paid 9% for 7 year paper, almost 280 basis points higher than even "Baa3" rated Southwestern Electric paid for 30 year paper. Following is a list of utilities with different ratings tapping the debt markets for approximately 30 years.

Company	Maturity	Rate	Moody’s &S&P Ratings
NSTAR Electric	30 years	5.5%	A1/A+
Progress Energy	30 years	5.65%	A1/A-
Consolidated Edison	30 years	5.5%	A3/A-
Narragansett Elec.	30 years	5.638%	A3/A-
Southwestern Elec.	30 years	6.2%	Baa3/BBB
CLECO	25 years	6.5%	Baa2/BBB
Otter Tail Power	7 years	9%	Ba1/BB+

V. Summary

Q. **Please summarize your testimony.**

A. The outcome of this case is critical to ComEd’s retention of its investment grade rating and, thus its ability to access the capital markets to finance its substantial construction program. A decision similar in impact to that of the April 29, 2010 Order in *Ameren* would deal ComEd a serious blow and would further tarnish the reputation of regulation in Illinois.

Q. **Does this conclude your testimony?**

A. Yes, it does.