

Assessing U.S. Vertically Integrated Utilities' Business Risk Drivers

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The methodology that Standard & Poor's Ratings Services uses to rate vertically integrated electric, gas, and combination investor-owned utilities in the U.S. is based on the same precepts that we have used for many years, though the emphasis has changed as the utility industry has evolved. The fundamental methodology encompasses two basic components—business risk and financial risk—and their relationship. Where a utility presents a strong business risk profile, the financial profile can be less robust for any given rating. Likewise, where a utility's business risk profile is weaker, its financial performance must be stronger for any given rating. For combination utilities, the gas operations may have a stabilizing influence on credit quality, but since the electric business is typically significantly larger, it is the major credit driver. *(For details on Standard & Poor's analytical approach to gas utilities, see "Key Credit Factors For Natural Gas Distributors" published Feb. 28, 2006.)*

Often, an integrated utility is a part of a larger holding company structure that also owns other businesses, frequently unregulated electricity generation. This fact does not alter how we analyze the utility, but it may affect the ultimate rating outcome due to any credit drag that the unregulated activities may have on the utility. Such considerations include the freedom and practice of management with respect to shifting cash resources among subsidiaries and the presence of ring-fencing mechanisms that may protect the utility.

Five Factors Determine The Business Profile

Five basic characteristics define a vertically integrated utility's business profile:

- Regulation,
- Markets,
- Operations,
- Competitiveness, and
- Management.

Standard & Poor's is most concerned about how these elements contribute individually

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and in aggregate to the predictability and sustainability of financial performance, particularly cash flow generation relative to fixed obligations. While considerable attention has focused in recent years on companies in states that deregulated in the late 1990s and the early part of this decade and the related credit consequences of disaggregation and nonregulated generation, 27 states (plus four that formally reversed, suspended, or delayed restructuring) have retained the traditional regulated model. For utilities operating in those states, the quality of regulation and management looms considerably larger than markets, operations, and competitiveness in shaping overall financial performance. Policies and practices among state and federal regulatory bodies will be key credit determinants. Likewise, the quality of management, defined by its posture towards creditworthiness, strategic decisions, execution and consistency, and its ability to sustain a good working relationship with regulators, will be key. Importantly, however, it is virtually impossible to completely segregate each of these characteristics from the others; to some extent they are all interrelated.

On Standard & Poor's business profile scale (where '1' is excellent and '10' is vulnerable), vertically integrated utilities generally have satisfactory business profiles of '5' or '6'. (See tables 1 and 2 in the Appendix below for business profile benchmarks plus a list of utilities we rate and their business profile scores.) We view a company that owns regulated generation, transmission, and distribution operations, as positioned between companies with relatively low-risk transmission and distribution operations and companies with higher-risk diversified activities on the business profile spectrum. What typically distinguishes one vertically integrated utility's business profile score from another is the quality of regulation and management.

Regulation

Regulation is a critical aspect that underlies integrated utilities' creditworthiness. Decisions by state public service commissions can profoundly affect financial performance. Standard & Poor's assessment of the regulatory

environments in which a utility operates is guided by certain principles, most prominently consistency and predictability, as well as efficiency and timeliness. For a regulatory scheme to be considered supportive of credit quality, commissions must limit uncertainty in the recovery of a utility's investment. They must also eliminate, or at least greatly reduce, the issue of rate-case lag, especially when a utility engages in a sizable capital expenditure program and incurs substantial deferrals of fuel costs.

Standard & Poor's evaluation encompasses the administrative, judicial, and legislative processes involved in state and federal regulation, and includes the political environment in which commissions render decisions. Regulation is assessed in terms of its ability to satisfy the particular needs of individual utilities. Rate-setting actions are reviewed case-by-case with regard to the potential effect on credit quality. As frequently postulated in prior years, our evaluation of regulation focuses on the willingness and ability of regulation to provide cash flow and earnings quality adequate to meet investment needs, earnings stability through timely recognition of volatile cost components such as fuel and satisfactory returns on invested capital and equity. Regulators' authorization of high rates of return is of little value unless returns are realistic and achievable. Allowing high returns based on noncash items does not benefit bondholders. A regulatory jurisdiction that permits incentives whereby utilities are allowed to earn a return based on their ability to sustain rates at competitive levels is viewed favorably. In addition to performance-based rewards or penalties, flexible plans could include market-based rates, price caps, indexed prices, and rates premised on the value of customer service. Also important is the ability to enter into long-term arrangements at negotiated rates without having to seek regulatory approval for each contract.

Because the bulk of a utility's operating expenses relate to fuel and purchased power, of primary importance to rating stability is the level of support that state regulators provide to utilities for fuel cost recovery, particularly as gas and coal costs have risen. Utilities that

are operating under rate moratoriums, or without access to fuel and purchased-power adjustment clauses or with fixed-fuel mechanisms, or face significant regulatory lag, also are subject to reduced operating margins, increased cash flow volatility, and greater demand for working capital. Companies that are granted fuel true-ups may be required to spread recovery over many years to ease the pain for the consumer. Standard & Poor's notes that fuel-adjustment mechanisms have become more common in the industry, but not all are created equal. While some jurisdictions permit recovery on a dollar-for-dollar basis over a defined time period, certain jurisdictions, such as Washington State, impose a deadband in which the company absorbs all the risk and rewards of fuel costs above and below the established recovery rate. Beyond the deadband there is a sharing of risks and rewards with ratepayers. In Arizona, Arizona Public Service Co. has a 90/10 sharing mechanism between the company and ratepayers, respectively, for all costs passed through the power supply adjuster. The mechanism is triggered based on a date (once a year in February 2006) and not on a threshold level of deferrals. The annual adjustment is also subject to a lifetime cap of 4 mils per kilowatt-hour, which has led to power deferrals.

In addition to fuel cost recovery filings, regulators will have to address significant rate increase requests related to new generating capacity additions, environmental modifications, and reliability upgrades. Current cash recovery and/or return by means of construction work in progress support what would otherwise be a sometimes significant cash flow drain and reduces the utility's need to issue debt during construction.

Moreover, allowing rate recovery of projected costs with subsequent periodic updates for actual results reduces lags in cost recovery. Also supportive of credit quality is the ability of the utility, commission staff, consumer advocates, and other major interveners to reach a comprehensive settlement before construction of new base load capacity. Certain states, such as Indiana, Texas, Kansas, and Minnesota, have adopted environmental tracking mechanisms and other riders that

allow companies to reflect in rates capital costs associated with environmental compliance equipment without having to file a formal rate case. Creditworthiness can also be enhanced when a company has the authority to timely recover unanticipated costs, such as those incurred for repairing storm damage, as in Florida. While the Alabama Public Service Commission does not currently employ a separate storm repair cost recovery mechanism to ensure rapid recovery of storm repair costs, it has shown a willingness to work with utilities to help them recover at least some of these costs on a timely basis and to start replenishing storm reserves. Finally, the greater the percentage of a utility's rates that are recovered through fixed charges rather than volume-based charges, the greater the support for credit quality.

For utilities that own a natural gas business, automatic and timely pass-through of commodity costs provides the strongest level of credit support. Lesser clauses, including mechanisms that require after-the-fact sign-off by regulators, introduce the potential for disallowance if the regulator deems gas to be purchased at imprudent cost levels.

Due to the extreme volatility and high gas prices over the past few heating seasons, more regulators have revised gas adjustment clauses to provide monthly gas adjustments rather than awaiting the end of the heating season to begin reimbursement. This expedited treatment helps the utility to reduce any regulatory lag to recover costs and streamlines working capital needs, which in turn should allow the firm to modestly temper rising gas bills to their customers.

Both regulators and natural gas companies are increasing customer-education programs on energy efficiency and conservation. Lawmakers, state regulators, and companies are in preliminary discussions to potentially restructure the current rate structures to encourage these goals of energy conservation and efficiency without hurting the company's bottom line and still allow utilities to achieve their approved regulated rate of return. In essence, "conservation tariffs" would aim to decouple earnings and rates of return from delivered volumes and should eliminate a

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current major disincentive for utilities to develop such conservation programs. This would also better align the interest of consumers with utility shareholders by implementing innovative rate designs that would encourage energy conservation and efficiency.

Key success factors include:

- Alternative ratemaking/flexibility,
- Attention to credit quality,
- Timely and consistent rate treatment,
- Support for fuel cost recovery,
- Support for a reasonable cash return on investment, and
- Support for rapid return on investment.

Markets

Assessing market dynamics begins with an economic and demographic evaluation of the service area in which a utility operates. Strength of long-term demand for energy is examined from a macroeconomic perspective, which enables Standard & Poor's to measure the affordability of rates and the staying power of demand. Distribution by classification according to total number of customers, revenues, and margins is closely scrutinized to assess the depth and diversity of the utility's customer mix. For example, heavy industrial concentration is viewed with some caution because the utility may be exposed to cyclical volatility and face competitive alternatives. A large residential component, on the other hand, produces a more stable and predictable revenue stream. The utility's largest customers are identified to determine their stability and importance to the bottom line because the loss of one large customer could adversely affect the utility's financial position. Moreover, large customers may turn to self-generation, potentially leading to less financial protection for the utility.

Standard & Poor's also analyzes any long-term consumption trends and the reasons behind them. Factors addressed include the market's size and growth rate, the franchise's strength, historical and projected growth rates, income levels and trends in population, employment, and per capita income. A utility with a healthy economy and customer base, as illustrated by diverse employment opportunities, average or above-average wealth and

income statistics, and low unemployment, will be better able to support its operations.

For the gas business, Standard & Poor's also examines customer saturation. Firms that operate in service areas with low growth potential still can expand at healthy rates if a relatively low level of customer saturation permeates the service territory. For example, customers who convert to natural gas from other fuel sources (such as oil) provide growth opportunities to companies operating in low population growth service areas.

Despite the review of market characteristics, they are clearly a secondary consideration to regulation. In Nevada, for years the country's fastest growing state, Nevada Power Co. and Sierra Pacific Power Co. struggled to recover capital expenditures on a timely basis, and were accordingly rated as low investment-grade credits. In Florida, which has competed with Nevada for years in its pace of growth, the Florida Public Service Commission established policies of quick recovery of capital investments and, on a stand-alone basis, the state's utilities' credit metrics have remained strong.

Critical success factors include:

- A healthy and growing economy,
- Growth in population and number of customers,
- An attractive business environment, and
- An above-average residential base.

Operations

Standard & Poor's focuses on cost, reliability, safety, and quality of service when assessing a utility's operations. Management is always under pressure to optimize the use of resources, and if it is not cost-effective in meeting service standards and reliability, regulatory or competitive pressures are likely to increase. Consequently, Standard & Poor's emphasizes areas that require heightened and ongoing management attention, in the absence of which political, regulatory, or competitive problems are likely to arise.

The status of utility plant investment is reviewed with regard to generating station availability, efficiency, and utilization, as well as for compliance with existing and potential environmental and other regulatory standards. The record of plant outages, system losses,

equivalent availability, load factors, heat rates, and capacity factors are examined. Important considerations include the projected capital improvements and plant additions necessary to provide high-quality, reliable service. The general condition of the assets and how well such assets are maintained are also important considerations.

Emphasis is placed on reserve margins, fuel mix, fuel contract terms, purchased-power arrangements, and system operators. Moreover, the quality and concentration of capacity is just as important as the size of reserves. Standard & Poor's recognizes that reserve requirements differ among companies, depending upon individual operating and load characteristics.

Fuel diversity provides flexibility in a changing environment. Supply disruptions and price hikes can raise rates and ignite political and regulatory pressures that ultimately lead to erosion in financial performance. Thus, the ability to switch generating sources to take advantage of cheaper fuels is viewed favorably. Dependence on any single fuel, or asset concentration in one or two large generating stations, can cause significant swings in a company's financial performance. Similarly, utilities that rely on nuclear generation receive an elevated degree of attention due to the scale, technical complexity, and politically sensitive nature of nuclear facilities. Indeed, the sound operation of nuclear units can define a utility's operational risk profile and its ability to achieve projected financial results. Standard & Poor's seeks to distinguish between those operators that have exhibited sound and stable operational performance, and the likelihood that it will continue, and those whose nuclear operations are vulnerable to problems that may impair financial results.

But having a large concentration of capacity based on fossil fuels also imposes certain risks. Coal-fired capacity is burdened with increased environmental costs related to reducing sulfur dioxide, nitrogen oxide, mercury, and eventually carbon dioxide emissions. Gas-fired capacity presents its own challenges, particularly the extreme volatility and significant increase in gas prices over the past few years. Buying power may be a more

appropriate option for a utility than new plant construction because the utility avoids construction costs and the financial risks posed by regulatory lag when seeking recovery of costs. Purchasing power may enhance supply flexibility, fuel resource diversity, and maximize load factors. Utilities that plan to meet demand projections with a portfolio of supply-side options also may be better able to adapt to future growth uncertainties. Despite these benefits, such a strategy does commit the utility to a fixed obligation, which Standard & Poor's captures analytically through certain adjustments to financial statements. We calculate the net present value of future annual capacity payments (discounted at the company's cost of debt) over the life of the contract. Standard & Poor's then applies a risk factor against this value and adds the result to the utility's balance sheet. The risk factor is largely a function of the strength of the regulatory recovery mechanisms established to address procurement costs.

Other operational characteristics that will support an above-average evaluation for vertically integrated companies are assets that are in good physical condition and are well maintained. In addition, capital expenditures for necessary system improvements must be at manageable levels, yet sufficient to provide for constant renewal and refurbishment of the system. Operating performance, reliability statistics (such as outage duration and frequency), and efficiency measures are expected to meet industry and regional averages. Having interconnections that provide access to low-cost and diverse power supply sources is viewed favorably, as is limited environmental exposure.

For a gas company, drawing from a single interstate pipeline or relying on a particular gas basin exposes it to event risk and negative supply shocks, respectively. The ability to access multiple sources of gas supply through multiple pipelines protects the utility from such disruptions. Adequate storage access not only helps supply incremental gas needed to meet peak demand, but also provides opportunities without purchased-gas adjustment clauses to arbitrage seasonal pricing fluctuations. Gas distributors benefit from

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storage if the cost of buying peak gas exceeds the cost of making off-season purchases and the associated carrying cost. Outdated systems requiring extensive maintenance and capital expenditures lower profitability and efficiency metrics. Newly installed systems mainly consisting of plastic pipe require limited expenditures over the long term compared with older, cast-iron systems that need replacing as they age. In addition, operational efficiencies can be obtained through the use of new technology.

Critical success factors include:

- Well-maintained assets,
- Solid plant performance,
- Fuel diversity,
- Adequate generating reserves, and
- Compliance with environmental standards.

Competitiveness

For vertically integrated utilities, competitive factors include percentage of firm wholesale revenues that are most vulnerable to competition, industrial load, and revenue concentrations, particularly in energy-intensive industries; exposure of key customers to alternative suppliers; commercial concentrations; rates charged to various customer classes; rate design and flexibility; production costs, both marginal and fixed; the regional capacity situation; and transmission constraints. A regional focus is evident, but high costs and rates relative to national averages are also of significant concern because of the potential for electricity substitutes over time.

Electricity competes with other fuels—particularly natural gas—for certain segments of the market like space heating, water heating, and cooking. Thus, high electricity prices, which can be attributed to inefficient operations, are cause for concern if customers have access to alternative energy sources. Self-generation has been a risk, as large commercial and industrial customers may take advantage of cogeneration technologies to reduce their reliance on and in some cases to disconnect from the system. In the future, technology could pose a greater threat. Bypass risk, too, may grow if distributed generation, microgeneration, and self-generation

prove more economically attractive for smaller customers.

Due to their proximity to interstate gas pipelines, some large customers can directly tie into a transmission line and completely bypass gas distributors' services. Although such pipelines provide key sources of gas supply for these companies, it is important to recognize this bypass risk. Ideally located gas companies have adequate transmission access but have industrial customers far from interstate pipelines.

Critical success factors include:

- Low cost structure,
- Limited bypass risk, and
- Management's commitment to lowering costs.

Management

Evaluating management is of paramount importance to Standard & Poor's analysis because management decisions affect all areas of a company's operations and financial health. Although regulation, the economy, and other outside factors certainly influence results, the quality of management ultimately determines a company's success. Standard & Poor's private meetings with senior management significantly augment the public record in the effort to appraise management. Meetings are very useful for the candid interpretation of recent developments and, importantly, to provide executives with a forum for the presentation of goals, objectives, and strategies.

Management assessment is based on tenure, turnover, industry experience, financial track record, corporate governance, a grasp of industry issues, and knowledge of regulation, of customers, and their needs. Management's ability and willingness to develop workable strategies to address system needs, and to execute reasonable and effective long-term plans are assessed. Management quality is also indicated by thoughtful balancing of multiple—and often incompatible—priorities; a record of credibility; and effective communication with the public, regulatory bodies, and the financial community.

Standard & Poor's also focuses on management's ability to achieve cost-effective operations and commitment to maintaining credit quality. This can be assessed by evaluating accounting and financial practices, capitalization and common dividend objectives, and the company's philosophy regarding growth and risk-taking.

In addition, a company's accounting and financing practices are critical to Standard & Poor's analysis. For example, proactive management will likely adopt accounting practices that are more appropriate in a competitive environment such as higher depreciation rates for electric generation equipment. Large, growing cost deferrals or regulatory assets are viewed more negatively. Management can enhance its financial condition by taking any number of discretionary actions, such as selling common equity, reducing the common dividend payout, and deleveraging. A utility's management will also be evaluated on cost-cutting ability and creativity in entering into strategic alliances that improve efficiency.

Strong corporate governance, reflected in active, independent boards of directors that participate in determining and monitoring corporate controls, helps to support management's credibility and corporate financial disclosure. If it is evident that a company's board is passive and does not exercise proper oversight, it weakens the checks and balances of the organization and may detract from credit quality. Included in Standard & Poor's review of corporate governance is the proportion of independent directors on the board, the breadth and depth of the directors' experience, the proportion of independent directors on the board's audit committee, and directors' compensation.

Some vertically integrated utilities have felt compelled to invest outside their traditional

businesses to increase earnings, especially as stock prices have underperformed market indices. Participation in higher-risk, unregulated activities such as merchant generation, exploration and development, gathering and processing, or marketing and trading can significantly detract from the consolidated entity's credit profile. In this regard, credit ratings are not based on the regulated business only, but on the qualitative and quantitative fundamentals of the consolidated entity. Standard & Poor's considers the ratings of the regulated businesses as being less vulnerable to the negative credit influence of other affiliates and holding company activities, as relevant, where very strong structural and/or regulatory insulation exists, which tends to be more the exception than the rule.

Critical success factors include:

- Commitment to credit quality,
- Credibility,
- Strong corporate governance, and
- Conservative financial policies, especially regarding nonregulated activities, if relevant.

Effect On Ratings

In summary, Standard & Poor's examines the key business risk drivers for vertically integrated utilities—regulation, markets, operations, competitiveness, and management—in conjunction with financial measures when assigning credit ratings. The credit quality of most vertically integrated utilities is solidly investment grade. This is primarily a function of the existence of regulation. As discussed above, the factors that further differentiate ratings among this sector include their markets, operational track record, competitive posture, and management's risk appetite. Vertically integrated utilities generally have satisfactory business risk profile scores, with only a few having strong or weak business positions. ■

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Appendix

Table 1 **Industry Benchmark Ranges**

Business Profile	AA	A	BBB	BB
Adjusted FFO interest coverage (x)				
1	3.0-2.5	2.5-1.5	1.5-1.0	< 1.0
2	4.0-3.0	3.0-2.0	2.0-1.0	< 1.0
3	4.5-3.5	3.5-2.5	2.5-1.5	1.5-1.0
4	5.0-4.2	4.2-3.5	3.5-2.5	2.5-1.5
5	5.5-4.5	4.5-3.8	3.8-2.8	2.8-1.8
6	6.0-5.2	5.2-4.2	4.2-3.0	3.0-2.0
7	8.0-6.5	6.5-4.5	4.5-3.2	3.2-2.2
8	10.0-7.5	7.5-5.5	5.5-3.5	3.5-2.5
9	N/A	10.0-7.0	7.0-4.0	4.0-2.8
10	N/A	11.0-8.0	8.0-5.0	5.0-3.0
Adjusted FFO/average total debt (%)				
1	20-15	15-10	10-5	< 5
2	25-20	20-12	12-8	< 8
3	30-25	25-15	15-10	10-5
4	35-28	28-20	20-12	12-8
5	40-30	30-22	22-15	15-10
6	45-35	35-28	28-18	18-12
7	55-45	45-30	30-20	20-15
8	70-55	55-40	40-25	25-15
9	N/A	65-45	45-30	30-20
10	N/A	70-55	55-40	40-25
Adjusted total debt/total capital (%)				
1	48-55	55-60	60-70	> 70
2	45-52	52-58	58-68	> 68
3	42-50	50-55	55-65	65-70
4	38-45	45-52	52-62	62-68
5	35-42	42-50	50-60	60-65
6	32-40	40-48	48-58	58-62
7	30-38	38-45	45-55	55-60
8	25-35	35-42	42-52	52-58
9	N/A	32-40	40-50	50-55
10	N/A	25-35	35-48	48-52

Note: Business profile scores are characterized from '1' (excellent) to '10' (weak). FFO—Funds from operations. N/A—Not applicable.

Table 2 Vertically Integrated Utilities		
Company	Corporate credit rating	Business profile score
Aquila Inc.	B/CW-Pos/B-2	6
AGL Resources Inc.	A-/Negative/A-2	4
Alabama Power Co.	A/Stable/A-1	4
ALLETE Inc.	BBB+/Stable/A-2	5
Ameren Corp.	BBB+/CW-Neg/A-2	6
Appalachian Power Co.	BBB/Stable/—	5
Arizona Public Service Co.	BBB-/Stable/A-3	6
Atmos Energy Corp.	BBB/Stable/A-2	4
Black Hills Power Inc.	BBB-/Negative/—	6
Central Illinois Light Co.	BBB+/CW-Neg/—	7
Central Vermont Public Service Corp.	BB+/Stable/—	6
CILCORP Inc.	BBB+/CW-Neg/—	7
Cincinnati Gas & Electric Co.	BBB/Positive/A-2	6
Cleco Power LLC	BBB/Negative/—	6
Cleveland Electric Illuminating Co.	BBB/Stable/—	6
Consolidated Natural Gas Co.	BBB/Stable/A-2	6
Consumers Energy Co.	BB/Stable/—	6
Dayton Power & Light Co.	BB+/Positive/—	5
Detroit Edison Co.	BBB/Stable/A-2	6
Duke Power Co. LLC	BBB/Positive/A-2	4
El Paso Electric Co.	BBB/Stable/—	6
Empire District Electric Co.	BBB-/Stable/A-3	6
Energy East Corp.	BBB+/Negative/A-2	3
Enogex Inc.	BBB+/Stable/—	7
Entergy Arkansas Inc.	BBB/Negative/—	5
Entergy Gulf States Inc.	BBB/Negative/—	6
Entergy Louisiana LLC	BBB/Negative/—	5
Entergy Mississippi Inc.	BBB/Negative/—	6
Entergy New Orleans Inc.	D/—/—	8
Equitable Resources Inc.	A-/CW-Neg/A-2	8
Florida Power & Light Co.	A/CW-Neg/A-1	4
Georgia Power Co.	A/Stable/A-1	4
Green Mountain Power Corp.	BBB/CW-Pos/—	5
Gulf Power Co.	A/Stable/—	4
Hawaiian Electric Co. Inc.	BBB+/Negative/A-2	5
IDACORP Inc.	BBB+/Negative/A-2	5
Idaho Power Co.	BBB+/Negative/A-2	5
Indiana Michigan Power Co.	BBB/Stable/—	6
Indianapolis Power & Light Co.	BB+/Positive/—	4
Interstate Power & Light Co.	BBB+/Stable/A-2	5
IPALCO Enterprises Inc.	BB+/Positive/—	4

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Table 2 **Vertically Integrated Utilities** (continued)

Company	Corporate credit rating	Business profile score
Kansas City Power & Light Co.	BBB/Stable/A-2	6
Kansas Gas & Electric Co.	BB+/Positive/—	6
Kentucky Power Co.	BBB/Stable/—	5
Kentucky Utilities Co.	BBB+/Stable/A-2	5
Louisville Gas & Electric Co.	BBB+/Stable/—	5
Madison Gas & Electric Co.	AA-/Stable/A-1+	4
Michigan Consolidated Gas Co.	BBB/Stable/A-2	4
MidAmerican Energy Co.	A-/Stable/A-1	5
Mississippi Power Co.	A/Stable/A-1	4
Monongahela Power Co.	BB+/Positive/—	5
Montana-Dakota Utilities Co.	BBB+/Stable/—	6
National Fuel Gas Co.	BBB+/Stable/A-2	7
Nevada Power Co.	B+/Positive/—	6
New York State Electric & Gas Corp.	BBB+/Negative/A-2	3
NiSource	BBB/Stable/—	4
Northern Indiana Public Service Co.	BBB/Stable/—	5
Northern States Power Co.	BBB/Stable/A-2	5
Northern States Power Wisconsin	BBB+/Stable/—	4
Ohio Edison Co.	BBB/Stable/A-2	6
Oklahoma Gas & Electric Co.	BBB+/Stable/A-2	5
Pacific Gas & Electric Co.	BBB/Stable/A-2	5
PacifiCorp	A-/Stable/A-1	5
Pennsylvania Power Co.	BBB/Stable/—	6
Pinnacle West Capital Corp.	BBB-/Stable/A-3	6
PNM Resources Inc.	BBB/Negative/A-3	6
Portland General Electric Co.	BBB+/Negative/A-2	5
Progress Energy Carolinas Inc.	BBB/PositiveA-2	5
Progress Energy Florida Inc.	BBB/Positive/A-2	4
PSI Energy Inc.	BBB/Positive/A-2	4
Public Service Co. of Colorado	BBB/Stable/A-2	4
Public Service Co. of New Hampshire	BBB/Stable/—	5
Public Service Co. of New Mexico	BBB/Negative/A-3	6
Public Service Co. of Oklahoma	BBB/Stable/—	5
Puget Energy Inc.	BBB-/Stable/—	4
Puget Sound Energy Inc.	BBB-/Stable/A-3	4
Questar Market Resources Inc.	BBB+/Stable/—	8
Rochester Gas & Electric Corp.	BBB+/Negative/—	3
San Diego Gas & Electric Co.	A/Stable/A-1	5
Savannah Electric & Power Co.	A/Stable/—	4
SCANA Corp.	A-/Stable/—	4
Sierra Pacific Power Co.	B+/Positive/—	6

Table 2 Vertically Integrated Utilities (continued)		
Company	Corporate credit rating	Business profile score
Sierra Pacific Resources	B+/Positive/B-2	6
South Carolina Electric & Gas Co.	A-/Stable/A-2	4
Southern California Edison Co.	BBB+/Stable/A-2	6
Southern Co.	A/Stable/A-1	4
Southern Indiana Gas & Electric Co.	A-/Stable/—	4
Southwestern Electric Power Co.	BBB/Stable/—	5
Southwestern Public Service Co.	BBB/Stable/A-2	5
System Energy Resources Inc.	BBB-/Negative/—	7
Tampa Electric Co.	BBB-/Stable/A-3	4
Toledo Edison Co.	BBB/Stable/—	6
Tucson Electric Power Co.	BB/Stable/B-2	6
TXU U.S. Holdings Co.	BBB-/Negative/—	8
Union Electric Co.	BBB+/CW-Neg/A-2	5
Union Light Heat & Power Co.	BBB/Positive/—	5
Vectren Utility Holdings Inc.	A-/Stable/A-2	3
Virginia Electric & Power Co.	BBB/Stable/A-2	5
Westar Energy Inc.	BB+/Positive/—	5
Wisconsin Electric Power Co.	A-/Negative/A-2	4
Wisconsin Energy Corp.	BBB+/Negative/A-2	5
Wisconsin Power & Light Co.	A-/Stable/A-2	4
Wisconsin Public Service Corp.	A+/CW-Neg/A-1	4
Xcel Energy Inc.	BBB/Stable/A-2	5

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- [Pipeline/Midstream/MLP 2010 Outlook, Dec. 3, 2009](#)

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Overview

The U.S. Utilities, Power, and Gas (UPG) sector 2010 outlook is framed in the context of Fitch Ratings' outlook for a slow U.S. economic recovery in 2010, with stable outlooks for most of the business segments within the UPG universe except for negative 2010 credit outlook for competitive generators and retail propane distributors. Forces driving the credit outlook are summarized below:

- Growth in power sales adjusted for weather will resume after the declines of 2008–2009. Natural gas sales volume is expected to be relatively flat year on year.
- Market prices for natural gas and electric power and capacity are likely to remain in a low band. Relatively low prices are:
 - Beneficial or neutral for electric and gas utilities.
 - Unfavorable for competitive power generators and natural gas storage and midstream services.
- While non-energy commodity prices are up from their trough in 2009, we do not foresee an overheated economy with rapid expansion in the prices of construction materials; however, U.S. dollar weakness is likely to raise costs of imported machinery and equipment, and could eventually raise prices of U.S. construction materials, increasing capital investment cost pressures.
- Electric utilities reduced their 2010 capital expenditure budgets from earlier planned amounts, but the overall level of investment remains greater than internal funding and will require external financing, including raising equity capital.
- Continued good access to debt and equity capital markets is expected, along with gradual improvement in bank market conditions.
- Electric and gas utilities are in a long-term cycle of rising unit costs, requiring frequent base rate increases to maintain stable financial results.
- While Fitch expects that most utilities will achieve reasonable regulatory outcomes, the dependence on rate increases exposes utilities to potential resistance from regulators, state politicians, and consumers/voters.
- Fitch expects passage within two years of national laws limiting greenhouse gas (GHG) emissions and possibly a national renewable portfolio standard, as well as more stringent environmental regulations on other emissions. This will have little effect on cash flow in 2010, but longer-term consequences for many competitive power generators are unfavorable, especially for owners of coal-fired generation, and it will add to cost pressures for integrated electric utilities and their consumers.

The "Credit Outlook Summary by Segment" table on page 2 of this report delineates the outlook and median rating with supporting bullet points for each business segment in the UPG sector. Fitch's business segment outlooks are formulated based on an analysis of fundamental factors, not by tallying the current rating outlooks of individual issuers in the business segment. Rating Outlooks for individual companies often vary from

segment outlooks due to the specific circumstances of each entity. As of Dec. 1, 2009, more than 86% of individual issuer Rating Outlooks in the UPG sector are Stable.

Resilient Performance in 2009

Companies in the UPG sector weathered the recession and financial crisis of 2008–2009 with considerably less pain than sectors such as financial institutions, cyclical industrials, and retailers. The absence of significant defaults in the sector is in stark contrast to the upswing in defaults and bankruptcy filings across the rest of the U.S.

Credit Outlook Summary by Segment

The segment credit outlooks in the left column reflect fundamental analysis of factors influencing developments in the segment, not the aggregate Rating Outlooks of the entities in the segment. Median ratings indicated are based on the issuer default ratings (IDR) of entities rated by Fitch Ratings, with the exception of the public power utility segment, which is based on senior instrument ratings. Public power utilities are not assigned IDRs.

Segment	Drivers in Credit Outlooks for 2010
Utility Parent Companies Median IDR: BBB Credit Outlook Stable (One Year) Negative (Longer Term)	<ul style="list-style-type: none"> Continued cost cutting for earnings and cash flow growth. Investment focus on organic growth, investments in transmission, and renewables. M&A activity will be limited. Focus on core businesses; selective divestitures. Equity issuance needed to maintain balanced capital mix.
Electric Utilities, Investor-Owned Median IDR Integrated Electric: BBB Median IDR Electric Distribution: BBB Credit Outlook Stable (One Year) Stable to Negative (Longer Term)	<ul style="list-style-type: none"> Sustained high capital spending for the majority of companies. Relatively low gas and power prices will mitigate effect of rising infrastructure costs in 2010. Rising unit costs longer term due to new infrastructure and carbon regulations. Serial base rate cases to recover infrastructure investments in 2010 and longer term. Significant new debt, hybrids, and equity issuance to fund capex.
Gas Distributors, Investor-Owned Median IDR: A– Credit Outlook Stable (One Year and Longer Term)	<ul style="list-style-type: none"> Oversupply of gas into the 2010 winter season will relieve rate pressure. Sales growth constrained by continued weakness in the housing sector. Capital expenditures will remain fairly low and manageable. Expect consistent regulatory treatment and manageable external funding.
Competitive Generation Companies Generating Companies and Energy Trading Median IDR: BB– Credit Outlook Negative (One Year) Negative to Stable (Longer Term)	<ul style="list-style-type: none"> Excess power reserve margins will linger with modest demand growth. Low gas and power price environment will hold down margins for most generators. Need to replace expiring hedges and contracts in a weak pricing environment. Uncertainty surrounding carbon legislation remains a key operating and credit issue for this group.
Natural Gas Midstream Companies Midstream and Pipeline Companies Median IDR: BBB– Credit Outlook: Pipelines Stable (One Year and Longer Term) Credit Outlook: Midstream Stable (One Year and Longer Term) Credit Outlook: Propane Negative (One Year and Longer Term)	<ul style="list-style-type: none"> Development of low-risk, contractually supported pipelines to connect increased shale gas production to high-demand eastern markets. Midstream processing volumes and margins likely to be supported by significant price advantage of NGLs over oil-based naphtha as ethylene feedstock. Modest increase in volumes on natural gas and refined products pipelines due to recovering economic activity. Companies are likely to continue to pursue conservative financial practices.
Public Power Utilities Municipal, State, and Federal Agencies and Cooperatives Median Rating ^a (Retail Systems): A+ Median Rating ^a (Wholesale Systems): A Credit Outlook Stable (One Year) Stable to Negative (Longer Term)	<ul style="list-style-type: none"> Benefit from less state regulatory oversight; local control over rate-setting. Continued lower usage and decreased revenues from surplus power sales anticipated for 2010. Growing pressure for local governments to slow rate increases and boost transfers from the utility system to replace lost city tax revenue and fund pension obligations. Generation investment will continue, albeit at a slower pace. Rising unit costs longer term due to new infrastructure and carbon regulations. Improving access to third party liquidity; expect extension of federal stimulus program which provides for issuance of taxable Build America Bonds by municipal entities.

^aMedian ratings shown for Public Power Utilities are senior unsecured debt ratings.
Source: Fitch.

economy, consistent with the defensive reputation of the sector.

In general, companies in the UPG sector entered 2009 in reasonably sound financial condition; some drew down their bank credit facilities during the banking crisis in late 2008 and repaid the loans as the bank and financial markets stabilized during 2009.

Rate-regulated utilities benefited during the market disruption from bond investors' preference for low-risk infrastructure investments. Regulated utilities and holding companies with higher investment-grade ratings had adequate to robust bond and commercial paper market access throughout 2009, and the bond market became more open to funding companies with speculative-grade ratings at progressively lower spreads during the second half of 2009.

Electric and gas utilities' sales volumes were reduced as a result of cyclical sales declines, especially lower industrial consumption of gas and power, with greatest impact in the Midwest. Residential demand was also lower, particularly in markets with the greatest impact from the housing collapse. While reduced sales hurt cash flow, lower costs of natural gas and power purchases, combined with timing differences in cost recoveries and collections of prior fuel deferrals, helped support operating cash flow and reduced working capital needs. Some integrated electric utilities that rely on spot sales of excess power into the wholesale market and rely on profits from wholesale sales suffered from a material decline in spot market prices.

Competitive generators and midstream gas processors were exposed to oversupply of natural gas and declines in power and gas spot and forward prices to the extent production was unhedged. However, generators and midstream processors that entered 2009 with their sales significantly hedged avoided most of the impact of lower margins.

Key Drivers of the 2010 Outlook

Fitch's 2010 credit outlook for the Utilities, Power, and Gas sector incorporates the following framing economic and capital market assumptions:

- General economic recovery continues over the course of 2010.
- Capital market conditions are expected to be open and the bank market to have a gradual improvement in spreads.
- Interest rates are expected to rise over the course of the year from very low levels.
- Weather-adjusted power demand expected to return to growth in 2010–2011. Power is expected to form a longer-term growth trend averaging about 1.4% to 1.6% per annum. Recovering industrial and commercial demand for natural gas should offset increased efficiency, resulting in flat sales overall for gas.

Fitch's 2010 U.S. economic outlook is for a slow recovery, with a projected modest 1.8% rise in GDP. Industrial production and GDP appear to be gaining, albeit from a low base. Fitch expects the pace of expansion to remain weak by the standard of prior recoveries. While job losses are slowing, unemployment is not improving, and could weigh on consumer sentiment and spending for several quarters. While there is a risk of a double-dip recession, which would continue to suppress sales growth in the sector and would result in a more adverse near-term credit environment, this is not Fitch's base case.

Interest Rates

U.S. Treasury interest rates in 2009 were at historically low levels, with short-term rates near zero for the first half of the year. Later in 2009, the long end of the yield curve began to move up. In the low rate environment, utilities achieved low-cost long-

term debt financing, with 20- to 30-year taxable utility operating company issues at 5.50%–6%. As long as U.S. Treasury policy keeps rates low, the dollar would remain under pressure. Assuming that the economic recovery takes hold, the Federal Reserve would have to devise an exit from its easy-money monetary policy, allowing short-term interest rates to revert to a more normal level, and long-term rates to move up as well.

Access to Capital and Credit Markets

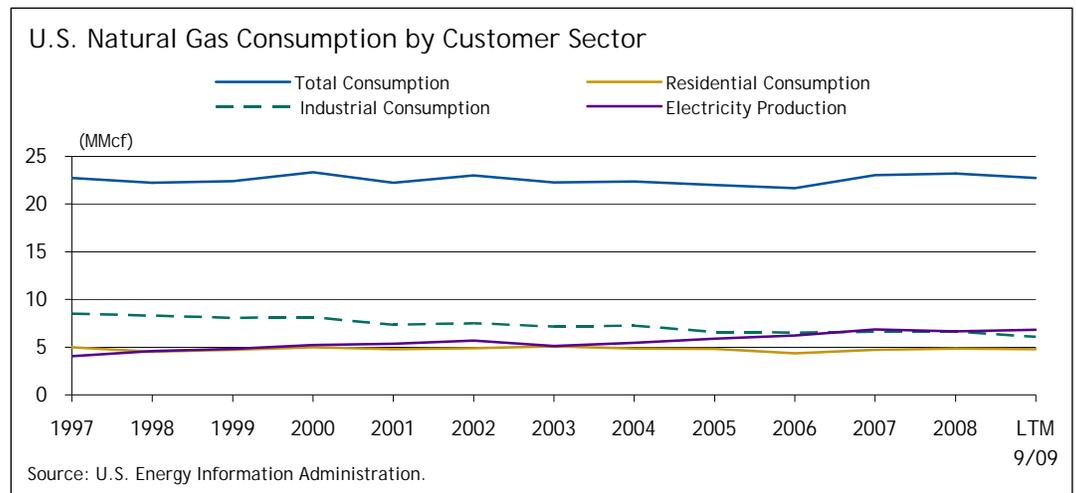
Access to the debt capital market is expected to remain open to the UPG sector issuers in 2010–2011.

Access to equity capital in addition to debt will be critical for utilities and utility holding companies to maintain stable credit profiles, given the forecast for capital expenditures in the sector in excess of internal cash flow. The utility sector will have difficulty to satisfy equity investors' expectations for growth in a general economic recovery. Companies with strong market valuations or better growth fundamentals are better positioned to raise equity without excessive dilution. Many utilities are considering the use of hybrid securities to minimize dilution.

Fitch is monitoring expiring bank credit facilities and the pricing, covenants and terms of new and replacement facilities. A recent Fitch study tallied approximately \$163 billion of credit facilities of companies in the UPG sector expiring in 2010–2014, with approximately 40% (\$65 billion) of maturities concentrated in 2012. Fitch concluded that expiring credit facilities are not likely to create a liquidity issue for the sector, although credit costs are likely to be higher than prior to the credit crisis. Fitch expects that companies with expiring credit facilities will close the gap by means of alternatives such as diversifying credit providers and using new types of credit facilities, relying more on capital market debt and less on bank facilities for direct funding or back-up, and altering collateral-intensive business practices to reduce needs for back-up credit. *(For more on this topic, please refer to "Fitch Review of Bank Credit Facilities in the Utilities, Power, and Gas Sector," published on Oct. 28, 2009.)*

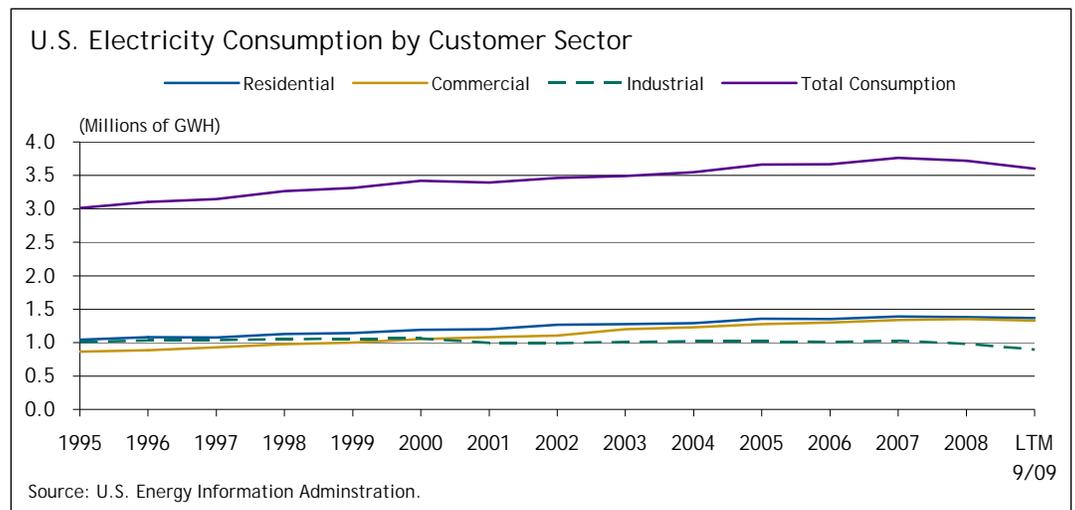
Gas and Power Demand

The trend over the past decade has been for declining natural gas consumption by industrial users to be offset by higher usage for power generation. In 2009, extremely low natural gas prices caused the dispatch of gas combined-cycle units to displace some production by less-efficient coal plants. Assuming somewhat higher gas prices in 2010, gas is likely to give back some share to coal at the margin. Beyond 2010, Fitch expects



that use of natural gas for power generation will be growing and taking share away from coal, offsetting shrinkage in primary demand for gas as a fuel for residential, commercial, and industrial applications. On balance, weather-adjusted sales of natural gas are forecasted to be approximately flat.

On a weather-adjusted basis, Fitch expects that U.S. electricity sales will rise in 2010 by 1% to 2%, largely due to a rebound in industrial usage straddling 2010–2011 that would recover some but by no means all of the industrial demand lost in 2008–2009. Longer run, Fitch foresees U.S. power consumption growing at 1.4%–1.6% annually. Growth in U.S. per capita electricity consumption has been in a long-term secular decline since 1960, and that trend is likely to continue as state and federal policies increasingly favor energy-efficiency and demand-reduction programs. In those states with aggressive policies promoting demand reduction, electric utilities are likely to press for tariff decoupling mechanisms to replicate those already in effect for many natural gas distributors and in a few jurisdictions for electricity.

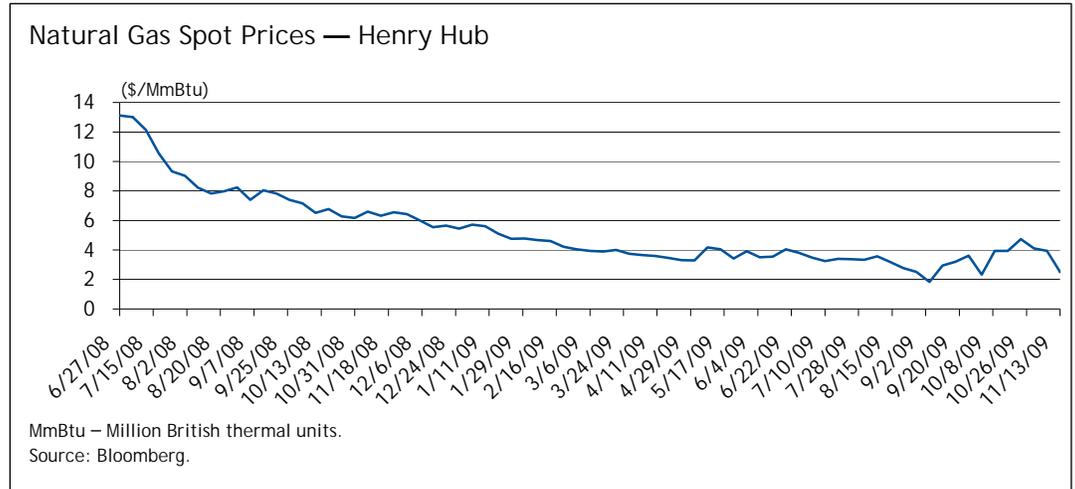


Commodity Prices

While market prices of gas and electric power are expected to rise from the 2009 trough, prices are likely to remain well below the levels that prevailed in early 2008. Relatively low gas and power prices are a favorable element in the credit outlook of most electric and gas distribution utilities and many integrated electric utilities, but form a more challenging market environment for competitive generators with conventional power generation assets and midstream gas processors to the extent that sales are dependent on market prices rather than contracts signed at more favorable prices.

Producers of steam coal remain in a pinch between their own rising production and pension costs and the gas-on-coal competition at the margin for power production. Coal stockpiles at power plants will enter 2010 materially above historical levels. While demand and prices for met coal can rise with global economic recovery, steam coal prices are likely to be constrained.

Prices of steel, cement, and other construction materials are up somewhat from their trough in early 2009, and prices are expected to increase over the course of 2010, especially due to the weak U.S. dollar. However, we see no basis for a return in 2010 to the runaway inflation of construction materials of early 2008.



Natural Gas Price Environment

Natural gas supply has exceeded demand for much of 2009, reflecting a combination of lower consumption, high production, and historically high gas inventory levels. Rapid expansion of shale gas production as well as greater accessibility to Rockies’ gas production contributed to the 2008–2009 collapse of U.S. gas prices as the recession depressed industrial demand. Fitch believes that price weakness will continue throughout 2010 as the industry works through high inventory levels and demand remains weak; the dramatic reduction in rig count during 2009 may only gradually reduce the gas oversupply, especially since new shale production tends to have very high initial production levels.

Weather is a dominant factor in natural gas demand in the residential and commercial markets. Fitch does not forecast the weather; however, given the drops in natural gas demand in the industrial sector of the economy, it is not clear that even a colder-than-normal winter would be enough to support materially higher natural gas prices in 2010.

Wholesale Electricity Prices

As a result of the decline in U.S. power consumption in 2009 along with some new power capacity coming on line, capacity reserve margins have increased to the extent that all U.S. power regions are currently oversupplied, with capacity reserve margins in excess of 30% in most regions. Additions of renewable resources (largely wind) and a few large coal plants that came on line in 2009 or will enter service in 2010 also tend to prolong the industry overcapacity. Excess power capacity will only gradually be absorbed by the modest increase in power demand.

The relatively low band of natural gas prices foreseen for 2010–2011 is expected to combine with high capacity reserve margins to keep electric power and capacity prices in a moderately low range in 2010 compared with the prices that prevailed in 2007 through mid-2008. Increasing output of wind and solar generation over the next several years will also play a role in reducing round-the-clock energy prices and market clearing heat rates, especially in those markets with the most abundant resources of wind (Midwest and Plains, Texas) if transmission is adequate to move power to load centers. In 2010–2013, 30% or more of the new power generation coming on line in the U.S. will be wind, solar or other renewable generation, stimulated by tax subsidies, state renewable portfolio standards, and feed-in tariffs in some states. Finally, construction of new electric transmission facilities in New England and PJM and in ERCOT over the next five years is expected to begin to lower electricity prices in congested zones and

to raise prices outside the congestion zones.

Capital Expenditures

Overall, companies in the UPG sector responded to the recessionary environment and reduced gas and power demand by deferring capital expenditures (capex) budgeted for 2009 and 2010 or cutting out discretionary projects, but the effects differ by segments within the sector. Overall, capex in the sector will remain well in excess of depreciation charges relating to the existing asset base.

- Capex for the competitive power generation sector remains in excess of depreciation charges, despite more limited access to capital by the independent generators as well as the court overturn of the Environmental Protection Agency's (EPA) Clean Air Interstate Rule (CAIR) and Clean Air Mercury Rule (CAMR) regulations, which caused some companies to delay environmental compliance projects. In 2010, capex will include more environmental compliance work, investments in renewable power sources that carry abundant tax incentives and up-rates of existing nuclear plant capacity.
- Constrained by uncertain access to capital, gas midstream companies, and master limited partnerships (MLPs) reduced capex very sharply in 2009, cutting back to maintenance levels and completion of major projects already under construction. Some major pipeline infrastructure projects are under construction, and these have put some stress on credit ratios of their sponsors. In 2010, companies will spend to complete major pipeline projects and to extend gathering lines to new shale-producing areas, and could ramp up discretionary capex if funding is available and market conditions improve with enhanced economic activity.
- Gas distribution utilities generally have modest capex budgets, averaging around 1.5x annual depreciation charges. Spending is expected to decline year on year in 2010.
- Electric utilities have been in a pattern of increasing capex from 2005–2008 and had budgeted to continue to grow in 2009. In 2009, the investor-owned electric utilities reduced their aggregate capex by 10% from the originally budgeted 2009 levels, and cut their 2010 plans by 9% from the original plans for 2010. After those cuts, 2010 capital expenditures for the segment as a whole are now budgeted to be essentially flat with the record \$84 billion level of 2008, and Fitch expects to see some growth in capex in 2011. The ratio of capex to annual depreciation and amortization charges will on average be higher for integrated utilities than for utilities that are pure transmission and distribution (T&D) providers. Fitch notes that there is considerable divergence in capital investment among the T&D utilities, including some that are investing heavily for advanced metering or transmission and grid reliability projects and several with very minimal capex. (*For more information on this topic, please refer to "Electric Utility Capital Expenditures: The Show Will Go On," published on Oct. 14, 2009*).

Ratio of Capital Expenditures to Depreciation and Amortization

(12 Months Ended Sept. 30, 2009)

	Average	Minimum	Maximum
Parent Companies (Consolidated)	2.3	0.7	4.9
Electric Integrated Utilities	2.7	0.8	6.7
Electric Distribution Utilities	1.5	0.3	4.6
Gas Distribution Utilities	1.5	0.9	3.0
Competitive Generators	2.8	0.9	7.0
Pipeline and Midstream Gas	2.5	1.0	7.6

Source: Fitch Ratings, company financial statements.

Public Policy Will Drive Fundamental Changes

While it is still uncertain whether a major energy bill will be enacted in 2010, the presidential administration and Congressional leadership are intent upon enacting a law to address climate change, including limits on GHG emissions using a cap-and-trade program, implementing standards for energy efficiency and conservation, and promoting investments in renewable resources. However, it has so far proven difficult to find bipartisan support or to muster sufficient support within the Democratic majority to pass a Senate bill that will raise costs for consumers and disadvantage some states more than others.

If the Congress is unsuccessful in passing new laws on these matters, the EPA has the authority to take a more vigorous approach to carry out the federal court mandate defining carbon dioxide and other GHGs as dangerous pollutants subject to regulation under the Clean Air Act. Compliance with an EPA rule is likely to be more difficult and costly for electric power generators and integrated utilities than a compromise bill crafted by Congress; thus, the electric industry has united to support Congressional action. Also, EPA is expected to act on new regulations to replace vacated Clean Air Interstate Rule and Clean Air Mercury Rule with important effects on coal-fired generating units, though not likely to have material effect in 2010.

Fitch assumes that there will either be a national law within the next two years that will regulate carbon emissions, or the EPA will step in with new regulations with more severe impact. If the EPA establishes rules, they are likely to take several additional years of litigation and implementation. Fitch conducts sensitivities of the effects of possible emissions prices or a tax on carbon emissions in its credit reviews of power generators, but has not developed stress cases around potential EPA regulations.

Renewable Energy and Technology Innovation

Roughly half the states have adopted renewable portfolio standards (RPS) requiring utilities to source a larger share of their electric power from defined renewable sources, and more continue to jump on the bandwagon. There is growing pressure in some states to establish feed-in tariffs and/or net metering of electricity. The longer-term effect of these requirements may be adverse for electric utility credit if utilities become loaded up with costly and inflexible power purchase obligations, akin to the problems that occurred in the 1980s–1990s following the implementation of the Public Utility Regulatory Policy Act of 1978. As higher costs of renewable resources and related transmissions are pushed into consumer tariffs, it could make it more difficult for utilities to achieve base rate increases to recover other rising cost elements and maintain satisfactory equity returns.

In 2009, significant tax incentives (*see the Federal Tax Matters section on page 9*) have begun to stimulate a sharp increase in investments in wind, solar, biomass, and other resources defined as renewable power. Federal loan guarantees for renewable resources, advanced clean energy technologies, and electric transmission, as well as grants from the Department of Energy for advanced metering and Smart Grid projects are additional sources of stimulus.

We have entered a period of high technology innovation in renewable energy resources, demand reduction, energy efficiency, and electric power transmission networks. A significant amount of work is underway to prepare for potential charging of plug-in electric vehicles, a development that would require substantial new investments in the utility distribution grid. The industry is testing technologies for carbon capture and storage, integrated gasification with combined cycle electric production (IGCC), battery storage, and pursuing licensing of new nuclear reactor designs. The U.S. has increased federal funding for energy-related research at the national laboratories. Burgeoning

and often conflicting policies and technology changes will lead to fundamental and largely unpredictable changes in the energy and electricity sector over the next five to 10 years, but with relatively small impact in 2010.

Federal Tax Matters

Many companies in the UPG sector will lower their tax bills for 2009 and 2010 as a result of a host of economic stimulus tax provisions. Tax credits for investments in renewable energy and extended tax loss carry-backs will temporarily turn the tax return into a profit center for several companies in the sector.

The American Recovery and Reinvestment Act of 2009 (ARRA), an economic stimulus package, extended and expanded tax benefits available to specific project investments, particularly for various renewable energy technologies:

- **Renewable Energy Production Tax Credits (PTC):** ARRA extended eligibility dates of a tax credit for facilities producing electricity from wind, biomass, geothermal energy, municipal solid waste, and qualified hydropower and marine renewable energy. The “placed in service date” for wind facilities was extended to Dec. 31, 2012, and for the other types of facilities to Dec. 31, 2013.
- **Election of Investment Tax Credits in Lieu of PTC:** Businesses that place in service facilities that produce electricity from wind and some other renewable resources can choose either the energy investment tax credit (generally a 30% tax credit for investments in energy projects) or the PTC, which provides a credit per kWh for electricity produced from renewable sources. A business may not claim both credits for the same facility. A taxpayer electing the ITC in lieu of PTC receives a cash payment 60 days after achieving the commercial operation date.
- **Bonus Depreciation:** Businesses can deduct half the adjusted basis of qualifying property in the year it is placed in service. The extension applies to qualifying property placed in service in 2009 (2010 for long production period property and certain transportation property).

Net operating loss (NOL) carry-back was extended for a maximum carry-back of 5 years rather than the normal two-year period applicable to nearly all companies, except for recipients of TARP relief, as a provision of the Homeownership and Business Assistance Act of 2009 (November 2009). The carry-back can be applied to NOLs generated in either 2008 or 2009 but not for both years. The effect is an immediate increase in available cash for the taxpayer.

Meanwhile, the prior administration’s dividend tax cut is scheduled to expire at the end of 2010, and there is wide speculation that additional taxes or higher tax rates will be applied to fund the federal deficit, including eliminating the current favorable treatment of capital gains and dividend income. Given the sector’s heavy capex requirements, Fitch would consider any such changes in federal income and capital gains tax rates to be unfavorable developments that would likely lower equity valuations of regulated utilities and utility holding companies.

Pension Funding

Many companies that entered 2009 with severe erosion in the value of their pension funds relative to projected benefit obligations opted to make cash contributions to comply with the U.S. Pension Protection Act of 2006, as moderated by the Worker, Retiree, and Employer Recovery Act of 2008. Cash contributions in 2009, combined with the recovery in bond and stock market values, have reduced the gap, but a number of companies will need to continue cash contributions in 2010 (absent a significant run-up in market values of investments).

Bankruptcy and Restructuring

There were no notable defaults or bankruptcy filings in the UPG sector in 2009. That stands in sharp contrast to the upswing in defaults and bankruptcy filings in other corporate sectors as a result of the severe national and global recession. A peak default period in the UPG sector was from 2001–2003.

SemGroup restructured and emerged from bankruptcy as a new public company in early December 2009, approximately 16 months after the company and its major wholly owned subsidiaries filed a bankruptcy petition on July 22, 2008. Pre-petition lenders were estimated to recover 100% on some secured obligations and secured trading exposures, an estimated 55% on one secured working capital loan facility, and 75% on a secured revolving credit. Unsecured lenders and general creditors were estimated to recover 5% to 10% of their exposure via the allocation of 5% of the equity in the new public company to the unsecured class.

SemGroup's 2008 insolvency resulted from its inability to post required margin collateral to trading counterparties. The company adopted a trading strategy based on the sale of naked call and put options that did not adhere to the SemGroup risk management policy and violated the terms of its pre-petition credit agreement. When SemGroup experienced trading losses, it increased and rolled forward its options positions, causing increased losses and occasioning growing demands for margin collateral that the company could not satisfy.

Utility Parent Companies

2010 Outlook — Stable

Longer-Term Outlook — Negative

The utility parent companies (UPCs) are poised for an improved economic and financial environment as compared to that of a year ago. With economic activity picking up, industrial sales have shown signs of stabilization in the third quarter. As industrial sales recover, it is likely that the commercial sales, which have been weak in certain regions, could follow suit. However, with revenue growth rates well below historical levels, Fitch expects UPCs to continue their cost-cutting focus in both their regulated and unregulated businesses to drive earnings and cash flow growth or support stability.

UPCs have withstood the credit crisis well. Overall, the companies were in a financially sound situation before the credit crisis hit, and liquidity during 2009 was bolstered by reduced working capital needs due to falling commodity prices, reduction in discretionary capex, and capital market issuances. Access to capital markets remains open and relatively low cost for creditworthy borrowers. Fitch expects UPCs to extend their conservative balance sheet stance in 2010, given the current fragile nature of economy and recovering credit markets, combined with the stated intentions of most management teams to maintain a stable credit profile. For regulated businesses, Fitch expects the utility parent companies to use a judicious mix of debt and equity to finance high levels of planned investments, most of which is mandated and earmarked for reliability, environment compliance, and renewable energy projects. For unregulated businesses, UPCs will need to balance the capital structure against rising business risk due to lower cash flows brought on by a fall in commodity prices and increasing proportion of unhedged output in the outer years.

Fitch expects climate change to remain a predominant focus for most UPCs despite the uncertainty around the contents and timing of passage of a national law. While some UPCs have been more proactive than others, Fitch expects more and more companies to pursue low/zero carbon technologies more aggressively than before. This could be

manifested in both regulated and unregulated businesses investing a greater proportion of total capex in clean technologies and renewable generation as well as associated transmission, energy efficiency, and smart grid investments, and in retirements of older coal-fired power plants that cannot be economically retrofitted.

Parents of utilities are generally taking advantage of opportunities to invest in regulated rate base, driven by legislative/regulatory mandates as well as a strategic pursuit of cleaner technologies as highlighted above. Fitch expects UPCs to seek out those investment opportunities where prospects of cost recovery are high and the prospect is for a reasonable return on equity (ROE).

As of late November 2009, utility stocks as measured by the Philadelphia Utility Index (UTY) have declined 3% in 2009 and underperformed the S&P 500 by 18%. The increase in risk appetite among investors clearly worked against the defensive utility sector as signs of economic recovery emerged. Utility stocks that have a greater proportion of unregulated businesses have lagged their regulated peers due to a sharp fall in commodity prices. The sunset of reduced dividend tax rates on Dec. 31, 2010 further reduces the investment appeal of utility equity and is expected to increase the cost of equity capital.

Notwithstanding the turmoil in the economy and the adverse capital market conditions, especially in the early part of 2009, ratings in the UPC sector have remained generally stable. The UPC's median 'BBB' issuer default rating (IDR) and senior unsecured ratings are the same as a year ago. Year to date, there have been three upgrades and seven downgrades in the sector. Approximately 82% (37 of 45 observed companies) of Fitch's UPC issuers have Stable Rating Outlooks and 16% (seven of 45) have Negative Outlooks, while only 2% (one of 45) has a Positive Outlook.

Sector downgrades in 2009 reflect a challenging operating and financial environment due to both weak industrial sales and rising operating costs (NISource Inc.; IDR 'BBB-/Stable), financial pressure, and associated execution risk from plans to build new nuclear plants (SCANA Corp.; IDR 'BBB+/Stable), weak commodity prices, and lower profitability of the unregulated generation portfolio (PEPCO Holdings Inc.; 'BBB-/Negative), and reassessment of financial and liquidity risk (Constellation Energy Group, Inc. (CEG); 'BBB-/Stable) among others. Fitch upgraded only three IDRs of parent holding companies in 2009. Two reflected gradually improved financial ratios and favorable state regulatory developments (Avista Corp.; IDR 'BBB-/Stable and DPL Inc.; IDR 'A-/Stable), and one resulted from demonstration of support by a foreign parent (Energy East Corp.; IDR 'BBB+/Stable).

Ratings are not anticipated to change meaningfully in 2010. Fitch expects the overall ratings for the UPCs to be stable primarily due to modestly rising economic activity, and managements' relatively conservative financial and business strategies. Concerns would be a fall in economic activity and power demand, an increase in populist regulatory decisions, volatile commodity prices, adverse climate change mandates, and shareholder-friendly decisions that result in increased leverage.

Mergers, Acquisitions, and Divestitures

Fitch expects limited merger & acquisition (M&A) activity in the near term given uncertainties that remain around economic recovery, commodity prices, state regulatory responses, and carbon legislation, combined with the high costs of bank financing and relatively low equity valuations. Exelon Corporation's (EXC) failed bid to acquire NRG Energy, Inc. (NRG) in 2009 highlights the difficulty in pulling off a hostile deal. The ongoing delay for Entergy Corp.'s spinoff of Enexus is reflective of the difficult state regulatory environment related to M&A activities. Electricité de France's

investment in a 49.99% joint venture interest in Constellation Energy Group's nuclear fleet was consummated late in 2009, after a controversial state regulatory proceeding that highlighted the regulatory hazards of merger/divestiture activity. That said, the case for industry consolidation remains strong given the fragmented industry, the scale of capital investments needed relative to the size of the companies, and the potential for operational synergies to drive down rates for consumers.

Fitch expects a majority of the UPCs to focus on organic growth, especially as regulated businesses take advantage of the attractive incentives for renewables and transmission development to drive rate base growth. As demands on capital increase, some UPCs could shed non-core assets, including businesses that are collateral intensive.

On the unregulated generation side, while there are good arguments for consolidation of smaller gencos, we see greater potential for asset acquisitions given low valuations. This could be driven by unregulated generators seeking "tuck-in" acquisitions or utilities short of generation seeking to grow their rate base. An emerging trend seems to be for unregulated generators to acquire renewable assets, such as the recent announcements by NRG to acquire an offshore wind developer and a solar farm in California and CEG to purchase wind assets in Maryland. It is quite possible that different forms of partnerships develop between traditional utility companies and the new generation clean technology companies to exploit relative strengths. Finally, a weaker dollar could spur cross-border asset acquisitions by foreign buyers or joint venture investments with foreign participants. Notable recent announcements of cross-border partnerships are AES Corporation selling a 15% stake to China Investment Corporation and Duke Energy signing agreements with several Chinese companies to develop a variety of renewable and clean energy technologies.

Electric Utilities

2010 Outlook — Stable

Longer-Term Outlook — Stable to Negative

Fitch's near-term outlook for the utility sector is stable, despite some challenges. The combination of high capital expenditures and relatively weak electricity demand will continue to pressure credit quality and require base rate increases in 2010 and beyond. Favorably, most regulated utilities are entering 2010 on sound financial footing. Moreover, overall rate pressures are mitigated by low fuel prices, strong capital market access, and low interest rates. Fitch's stable outlook assumes most states will continue the constructive regulation of recent years. However, given the lingering rate of unemployment and voter concerns about the economy, there could well be pockets of adverse rate decisions, and those companies with little financial cushion could suffer adverse effects.

Regulation

Decisions by state regulators will continue to be a key driver of individual company credit ratings in 2010. In general, state regulation is likely to continue to be even-handed; however, there could be isolated cases of adverse regulatory or politically motivated decisions on utility rates in an election year, which is considered to be event risk rather than a sector trend. Positively, low fuel costs should largely offset the impact of rising base rates in 2010. However, even with modest electricity demand growth next year, total customer demand is expected to remain below 2007 levels, and under-earning seems likely, even in the case of some companies that have base rate cases decided in 2009 and 2010. Some of the rate requests filed in late 2008 or early 2009 and still pending were made prior to the recognition of the full impact of recessionary load loss on demand; consequently, utilities are already playing catch up

by seeking ways to cut operating costs and/or defer capex.

Numerous electric utilities have filed for base rate increases to recover costs of investments in system growth and reliability, as well as to adjust the allocation of operating and maintenance costs and capital recovery to lower demand levels. In addition, a number of multi-year rate settlement periods will end, enabling these utilities to deal with the rising costs and loss of load. Numerous state commissions are expected to reach decisions on new base rates in 2010. (See the "Electric Rate Case Pending 2010 Decision" table below.)

Electric Rate Cases Pending 2010 Decision

Arizona Public Service Company
Atlantic City Electric Company
Black Hills Power, Inc.
Central Hudson Gas & Electric Corp.
Connecticut Light and Power Co.
Consolidated Edison Co. of New York^a
Delmarva Power & Light Co.
Duke Energy North Carolina
Empire District Electric Company (MO and AK)
Florida Power and Light Co.
Florida Power Corp.
Georgia Power Company
Illinois Power Company

Indiana Michigan Power Company
Monongahela Power Company
New York State Electric & Gas Corp.
Northwestern Corporation
PacifiCorp
Potomac Edison
Potomac Electric Power Company
Public Service Co. of New Hampshire
Public Service Electric and Gas Co.
Rochester Gas and Electric Corp.
Southwestern Electric Power Company (AK and TX)
Union Electric Co.
Western Massachusetts Electric Co.

^aA settlement proposal is pending.
Source: C Three Regulatory Database, Fitch Ratings.

An emerging regulatory trend for integrated electric utilities is the initiation of electricity revenue decoupling in response to the recent softness of demand and state policies that include ambitious energy-efficiency targets. Tariff mechanisms that mitigate the effect of variances in sales are common among gas utilities, which have experienced declining demand for many years and whose sales have an extreme weather sensitivity; in gas distributors, this may take the form of minimum bills that recover a large part of fixed costs, fixed/variable tariff components, or explicit weather normalization or volume decoupling mechanisms. While such tariffs have not been common for residential consumers of electric utilities, Fitch sees states beginning to implement some mechanisms of this sort on the electric side, although in a few cases at a pilot scale. States that allow or initiated electric decoupling programs include: California; Ohio (Ohio utilities can request decoupling under existing rules), Vermont, New York (Consolidated Edison of NY, Orange & Rockland Utilities, Central Hudson Gas and Electric), Maryland (Baltimore Gas & Electric); and pilot scale programs in Wisconsin and Idaho. In Fitch's view, volume decoupling reduces cash flow volatility and lowers business risk, and will be particularly meaningful in states that have set aggressive energy reduction goals.

For electric T&D utilities in states that restructured their electricity markets, staggered power auctions or other competitive power procurement processes are becoming more customary and standard. Staggered contracts for up to three years create realized prices that are a blend of past and future prices, which moderates single-year commodity price volatility for customers. Most states that deregulated generation supply have already completed or are nearing completion of full transition to market-based generation rates. Solicitations for energy, capacity, and/or other services in the next six months are expected to include Duquesne, Metropolitan Edison/Penelec, Penn Power, PPL Electric Delivery, Philadelphia Electric Co., Illinois Power Agency, West

Penn Power, and the New Jersey Basic Generation Service auctions for the state's electricity utilities. While in prior years' outlooks, Fitch noted significant uncertainty regarding the ability of electric T&D utilities to obtain full and timely pass-through of generation costs in tariffs, this risk has subsided as auctions that place the price risk with consumers have become routine; the significant decline in wholesale market power prices has also helped to make the transition less controversial than in prior years.

Capital Spending

While many utilities responded to the economic downturn and court decisions that set aside the CAIR and CAMR by reducing or deferring capital spending budgets for 2009 and 2010, capital spending remains high relative to historical trends. In many cases, utility managements responded to weak demand by adjusting budgeted expenditures to accommodate lower demand curves and deferring, but not cancelling, new generation projects; however, projects to enhance distribution reliability generally were not delayed. Despite these deferrals, Fitch forecasts spending will continue to run at more than double depreciation on average. To fund the system investments, internal cash flow will need to be supplemented with external capital, and management will face choices of increasing leverage or shoring up the capital structure with new equity issuance.

Drivers of 2010 capital spending levels for electric utilities include: increasing environmental compliance mandates; new transmission lines needed to serve intermittent renewable power sources located far from load, reduce basis differentials within regional transmission organizations (RTO), or improve system reliability; advanced metering; and self-building for renewables mandates. Fitch notes that for integrated utilities with responsibility for generation as well as power distribution, 2009 capital spending averaged approximately 2.7x depreciation of existing assets, while for restructured electric T&D utilities, capex averaged a more manageable 1.5x depreciation charges (see the "Capital Spending Relative to Depreciation Charges" table on page 6). Fitch notes that utilities have good track records for full and timely recovery of environmental spending and that recovery of the transmission investments is often supported by RTO orders to build and constructive Federal Energy Regulatory Commission (FERC) tariffs, which are both significant spending categories for 2010.

Fitch believes capital investments will remain elevated for several years. Global climate change and GHG legislation is going to present enormous challenges to the industry over the intermediate to longer term, as utilities consider their options to comply with anticipated reductions in emissions, such as carbon capture and sequestration, integrated gasification combined-cycle power generation (IGCC), up-rates of existing nuclear plants or new-build nuclear, or renewable energy resources (27 states, and counting, have enacted RPS standards). While the low gas price environment makes power generation with natural gas an easy choice for near-term capacity needs and to back up intermittent wind or solar power, utility managements and state regulators are leery of renewed gas price volatility if eventually the oversupply of natural gas should self-correct. Moreover, gas is not a carbon-free choice, and longer term carbon goals under a national energy bill would not be met if load growth is mainly met through gas-fired capacity additions. Uncertainty about what to build and when is exacerbated by unknown impacts of energy efficiency and electric car efforts, and when pressures on customer bills from carbon allowances will ramp up to a meaningful level. The rating impact of these longer-term developments will be case by case, based on legislative and regulatory integrated resource plans and cost recovery decisions. For example, Ohio passed a law requiring future costs of carbon laws to be passed through to customers in the fuel adjustment mechanism, an encouraging sign for the credit of integrated electric utilities in the state.

Natural Gas Distributors

2010 Outlook — Stable

Longer-Term Outlook — Stable

Fitch's 2010 outlook for local gas distribution companies (LDCs) remains stable with expectations for continued operating, regulatory, and financial stability within the space in the long term. Natural gas prices have moderated as the quantity of gas in storage has hit historic highs heading into the 2009–2010 winter heating season. This will mean lower rates for consumers, alleviating some concern regarding rising bad debt expense given high unemployment and weakness in the economy. Additionally, state regulatory relations continue to be constructive for gas LDCs; many LDCs continue to successfully pursue progressive rate design crafted to stabilize financial exposure to changes in volumes sold.

Overall, gas LDCs weathered last year's capital market turmoil maintaining liquidity and access to capital markets. Gas prices were well off their mid-2008 highs by the start of the 2008–2009 heating season, and LDCs had delayed building inventory. Also, Fitch's concerns about increased bad debt expense in 2009 did not meaningfully materialize. Sales growth for the sector slowed significantly as the recessionary economy and a weak housing market slowed customer growth across the board. Continued weakness in the housing sector will constrain demand throughout 2010. Sales volumes have also been affected by a significant decline in industrial demand, particularly in the U.S. Midwest.

Fitch expects that moderate economic growth should help return industrial demand to more normalized levels in the second half of 2010. As a result of slower growth and slackened demand, LDC capital expenditures are expected to be focused on system maintenance rather than expansion and should remain fairly low (averaging approximately 1.5x depreciation charges), so there is not a need for significant external funding. The relatively low capital spending, coupled with lower rates charged to consumers via purchased gas cost adjustment mechanisms, will reduce the chance for any potential rate shock to customers and limit LDC exposure to adverse regulatory developments. Additionally, competitive energy sources, including fuel oil and propane, are correlated to crude oil prices and thus remain priced well above natural gas, limiting the potential for fuel-switching during 2010.

Conservation and the impact of weather on usage remain industry-wide concerns for natural gas LDCs, many of which have pursued rate designs in their regulatory jurisdictions intended to help address usage volatility. Currently, 18 states have approved the implementation of revenue decoupling, which helps prevent margin erosion stemming from declines in customer usage due to conservation or energy-efficiency increases. Additionally, more than half of U.S. states have some form of either full decoupling or weather normalization, which helps stabilize revenues from the effects of weather. These rate designs help insulate the utility's cash flow from changes in volume of sales, providing earnings and cash flow consistency and stability. Fitch continues to view the implementation of rate mechanisms that reduce cash flow volatility favorably; more predictable cash flow translates to lower business risk for LDCs.

Competitive Generation Companies

2010 Outlook — Negative

Longer-Term Outlook — Stable

Fitch's 2010 outlook for competitive generation companies is negative, as continued demand and price weakness will weigh on cash flow and credit metrics. Fitch typically

views the competitive generators in two distinct subgroups: affiliated generators, which are subsidiaries of large utility holding companies or financial institutions and typically have investment-grade IDRs; and independent generators, which are standalone companies that typically have speculative-grade IDRs. Fitch's 2010 outlook is negative for both subgroups. Fitch expects that continued power price weakness, slack demand, and uncertainty surrounding carbon legislation will all weigh on the credit outlook for the competitive generating space throughout 2010. Fitch believes that earnings and cash flow, while likely improved over 2009 results, will continue to be muted, barring any significant recovery in commodity prices or industrial demand.

Last year proved to be a challenging environment for competitive generators across the spectrum. Lower demand and wholesale power prices pressured earnings and cash flow, particularly for some of the more highly levered independent generators, who in some cases were forced to sell assets, pay down some debt, and amend credit facility covenants. Dynegy Inc., for example, amended the covenants under its secured credit agreement and announced an agreement with LS Power to sell assets in exchange for cash and LS Power's class B units in Dynegy. These moves precipitated a negative rating action by Fitch in August when the transaction was announced. Negative rating and Outlook actions, in fact, were prevalent for many of the independent generators and affiliated generators under Fitch coverage, with a downgrade to Dynegy Inc. (DYN; IDR: 'B-/Negative Outlook) and Outlook changes to Ameren Energy Generating Co. (IDR: 'BBB+/Negative Outlook), Brookfield Renewable Power (BRPI; IDR 'BBB-/Negative Outlook), Edison Mission Energy (EME; IDR: 'BB-/Rating Watch Negative), Midwest Generation (IDR: 'BB'/Rating Watch Negative), RRI Energy (RRI; IDR 'B'/Negative Outlook) and Texas Competitive Electric Holdings (TCEH; IDR: 'B'/Negative Outlook).

Despite the discouraging fundamentals for this business segment, Fitch believes that the competitive generators have taken steps that will tend to mitigate further downside should wholesale power prices continue to languish through the year. The independent generators, in particular, have focused on cutting operating costs and hedging or contracting significant amounts of their expected generation for 2010 and 2011, actions that some of the companies had not previously taken in a more robust wholesale power pricing environment. Liquidity across the space remains adequate with most companies possessing sizable cash balances and revolver availability. Fitch also notes that despite declines in value from the peak in early 2009, enterprise valuations for most power generators are strong relative to outstanding indebtedness, which would lead to strong recoveries for secured debt for all but the most highly leveraged competitive generator issuers in a case of default.

Capital spending will remain muted as generators continue to take a conservative approach to growth spending, and environmental spending is delayed given the uncertainty surrounding carbon legislation and absent new mercury and sulfur dioxide rules. Notable exceptions include NRG, which continues to pursue its Repowering NRG capex program and has recently been an active investor in renewable resources; TCEH, which is in the process of completing the third of three large baseload power plants; and Exelon Generation Co., which is pursuing a large-scale nuclear up-rate program. Additionally, Fitch sees the potential for opportunistic asset sales and acquisitions, as more highly leveraged generators look to shore up balance sheets or more stable names look to grow and diversify their portfolios. With equity prices not reflecting the value of underlying assets, Fitch continues to believe there is a compelling argument for consolidation and acquisition within the space.

Longer term, looming carbon legislation remains a key operating and credit issue for the competitive generating space. The financial impact could be significant depending on the individual company's generation portfolio, as well as the specific form and cost

assigned to emissions under proposed legislation and the direction of commodity prices. While the impacts of carbon legislation will vary for individual companies and in different power regions, it is reasonable to assume that less-efficient coal-fired generation will begin to be displaced first by gas-fired generation and, in the longer term by renewable projects, new nuclear, and potentially by carbon capture and sequestration clean coal technology (should that technology prove to be economically viable). Emission-free competitive generators with low variable-costs will be the biggest beneficiaries of carbon legislation. More-efficient natural gas-fired competitive generators are likely to see their generation dispatched more frequently as well.

Longer-term concerns include debt, credit facility, and term loan B maturities in the 2013–2016 timeframe; the roll off of current hedges; and the ability of competitive generators to recontract expected generation at levels that would support ratings. Debt maturities in 2010 are manageable, as most issuers do not face any significant refinancing. Additionally, with capital markets returning to a more normal pattern, access to capital should be open. However, particularly for the speculative-grade independent generators, capital will likely be significantly more expensive than prior to the financial crisis, reflecting changes in the bank market conditions, higher financing costs and weak equity valuations.

Public Power Utilities

2010 Outlook — Stable

Longer-Term Outlook — Stable to Negative

Fitch's Public Power and Electric Cooperative 2010 Outlook — Stable

Fitch's 2010 outlook for the public power and electric cooperative sectors continues to be stable despite the pressures that correspond with the national economic recession. After a rocky first half of 2009, capital market access has stabilized. However, there appears to be a lagging ripple-effect from the economic downturn that is working its way through local governments and creating downward rate pressure on public power utility systems that will persist well into 2010. Other credit pressures on the sector include: declining energy consumption related to the economic downturn, the need for rate increases in a difficult economic climate, limited/costly access to external liquidity, and state specific mandates — with the potential for federal mandates in 2010–2011 — regarding renewable energy sources and GHG emissions.

These pressures coincide with declines in natural gas and purchased power prices that have reduced the expenditure levels and provided some relief to many retail utilities. However, a softening of power market prices has resulted in lower-than-budgeted revenues from surplus power sales for several utilities. Growth levels have favorably slowed to more manageable levels in certain regions, providing an opportunity to adjust and re-evaluate system capital needs. While these current trends have not resulted in significant changes to the credit quality of the overall public power and electric cooperative sectors, Fitch intends to monitor variations specific to regions. Fitch notes that events in the next five to 10 years primarily related to expected environmental legislation could increase the cost structures of many electric utilities and potentially place pressure on credit ratings. Decisions regarding timely rate recovery of increased costs and the subsequent change in a utility's competitive position within its regional market will be key credit drivers. Fitch believes that the public power business model will continue to allow these utilities to perform well in 2010 and provide investors with a generally stable credit sector. Fitch's outlook for the sectors over the long term remains stable yet recognizes that increasing negative pressures are affecting the industry, primarily due to environmental mandates related to increased renewable energy resource requirements and GHG emissions restrictions. The possibility of carbon

legislation being enacted looms over the public power industry and the specter of the proposed legislation is already impacting decisions on whether to build additional fossil-fuel baseload generation.

Short-Term Public Power Outlook

While there have been noticeable downward trends in financial metrics such as debt service coverage, cash-on-hand, and operating margins for both wholesale and retail public power systems, overall the sectors continue to benefit from solid credit fundamentals, including: essentiality of electric service, local control over rate-setting without state commission oversight, a cost advantage compared to neighboring investor-owned utilities, and benefits associated with a predominantly residential and commercial customer bases. Fitch expects that the average ratings for wholesale and retail utility systems, including electric cooperatives, will continue to be 'A' and 'A+', respectively. Fitch has noted in certain regions an increase in efforts by local governments to slow electric rate increases and boost transfers from the utility system to replace lower tax revenues and to fund the growing local government pension obligations. If unchecked, this trend could result in public power utilities with reduced liquidity and credit protection.

While varying in degree from region to region, overall the economic downturn and financial market disruptions have not yet resulted in material credit pressure on public power utilities. Public power and electric cooperatives have continued to have access to the capital markets, although borrowing costs have been higher than budgeted. Construction costs have declined and, in some cases, capital spending has been delayed. Generation investment is continuing, albeit at a slower pace, both through direct ownership and long-term bilateral contracts. Supply-related investments have been designed not only to meet load growth but increasingly to comply with local and state renewable resource requirements. Many utilities continue to realign their debt structure by reducing outstanding variable-rate exposure, given the disruptions in that market and the contraction/costliness in available liquidity facilities.

The economic contraction in many markets resulted in slower growth levels and consumption declines. Collection delinquencies and turn-off actions have increased only slightly despite the negative economic conditions, rising unemployment levels, and home foreclosures. Public power and electric cooperative utilities that are commodity purchasers have benefited from the recent decline in natural gas and wholesale power prices. However, several utilities that typically sell excess power into these markets have experienced lower-than-budgeted revenues from surplus sales, but many have maintained their financial margins through the use of conservative forecasting and budgeting practices, given the volatility of these revenue sources.

Long-Term Public Power Outlook

Fitch's long-term outlook for the sectors is stable but recognizes increasing negative credit pressures. Approval of national environmental mandates is still pending; however many utilities already face pressure from state or locally established renewable portfolio standards and must assess how to meet long-term load growth within an evolving environmental and generally more restrictive and costly regulatory framework. The growing pressure to enact carbon emissions restrictions to combat global climate change is expected to result in the enactment of national carbon legislation in the near future, but the structure, timing, and implementation schedule is still uncertain. Utilities, however, are already making decisions based on the anticipated legislation. Several large, baseload coal-fired power plants have been cancelled, and some of this planned future capacity is being replaced by natural gas and renewable generation. To the extent public power utilities rely mainly on natural gas-fired resources going

forward, Fitch believes there could be a renewed risk of over-reliance on natural gas and the associated volatile fuel price exposure.

While Fitch believes that the public power and electric cooperative business models will continue to allow these utilities to perform well and prove to be stable credit sectors, increasingly negative market and industry factors could adversely impact some regions more than others. The utilities with greater credit exposure are those that have large capital improvement needs, relatively high leverage, below-average financial and rate flexibility, and a heavy reliance on fossil fuel generation. Conversely, systems that show stable to improving financial metrics, have limited new capital needs, and have a greener generation portfolio are expected to maintain Stable Outlooks and in some cases realize improved credit profiles.

Pipeline and Midstream Sector

Companies in the Pipeline/Midstream segment in 2009 faced the following pressing concerns: adequacy of liquidity, access to capital markets, the oncoming recession and its effects on demand for energy products, ability to defer capital spending, and commodity price trends. In response to these difficult operating conditions, companies overwhelming "played defense" and adopted cautious financial practices. In the face of a weakening economy and constrained capital markets, companies issued high-cost debt and equity to shore up their liquidity positions. Discretionary spending was cut to sustainable levels. Many MLPs adopted more conservative distribution practices to increase cash retention.

Entering 2010, business fundamentals are better than they were six or 12 months ago, but many challenges remain. Growth has slowed. Several large pipeline projects, burdened by increased construction and capital costs, will generate lower-than-expected, single-digit returns. The economy remains fragile. Given this backdrop, Fitch expects companies to stay the course by avoiding excess leverage and maintaining disciplined operating and growth strategies.

Natural Gas Pipelines

2010 Outlook — Stable

Longer-Term Outlook— Stable

Fitch foresees stable short-term and longer-term outlooks for interstate and intrastate natural gas pipelines. However, credit measures for companies funding large expansion projects will likely remain under pressure through 2010.

During 2008, completions of new natural gas pipelines and expansions of existing pipelines in the U.S represented the greatest amount of pipeline construction in more than 10 years. The added capacity for each of the top 15 projects exceeded 1 billion cubic feet per day (Bcf/d). The U.S. Energy Information Administration (EIA) reports that the number of proposed projects suggests construction activity will remain strong through 2011, with 2009 potentially showing the second-highest level of capacity additions in the decade. More than 10,200 miles of potential new gas pipelines are scheduled to be added in 2009–2011, but a portion of these projects will likely be delayed or canceled.

Even with cuts in discretionary spending by sponsor companies, weak commodity prices, and a slowly recovering economy, there is still a demand for new pipeline infrastructure to access unconventional resources, particularly natural gas from shale formations. Additionally, the costs of steel pipe, equipment, labor, and financing have declined from 2008–2009 highs, which will help companies attain adequate returns on their investments.

New North American Pipeline Capacity

	Proposed for 2010			Proposed for 2011		
	Added Capacity (MMcf/d)	Estimated Cost (\$ Mil.)	Miles	Added Capacity (MMcf/d)	Estimated Cost (\$ Mil.)	Miles
Central	3,655	1,820	871	1,528	491	290
Midwest	0	0	0	2,067	1,416	254
Northeast	2,491	1,276	249	4,318	2,465	599
Southeast	9,911	2,006	601	9,364	3,748	1,000
Southwest	6,283	577	293	13,915	2,162	688
Western	345	107	27	5,276	5,377	1,686
Mexico/Canada	1,920	N.A.	29	980	49	41
Total	24,605	5,786	2,070	37,448	15,707	4,528

N.A. – Not available.

Source: Energy Information Administration.

Products Pipelines

2010 Outlook — Stable

Longer Term — Stable

The pace of the economic recovery will affect demand for oil products and transportation volume, affecting crude oil and refined products pipelines. However, following reduced throughput in 2009, Fitch expects product demand to stabilize.

Midstream Services

2010 Outlook — Stable

Longer Term — Stable

For natural gas gatherers, both the short-term and long-term outlooks are stable, while for gas processors the short-term outlook is negative. After several years of high processing margins, in late 2008 natural gas liquids (NGL) unit margins dropped. While margins have recovered back to more historical norms, future commodity margins are uncertain. Financial performance for some companies will also be affected by hedging practices and their economic sensitivity to natural gas prices. Fitch expects natural gas to trade in a relatively low price range, which is unfavorable to most processors. Moreover, in some production basins, price-induced drilling reductions are expected to lower gathering volumes until demand recovers, an adverse trend for both processors and gatherers.

Retail Propane

2010 Outlook — Negative

Longer-Term Outlook— Negative

Fitch maintains a modestly negative short- and long-term outlook for the retail propane sector. Given propane's strong correlation to crude oil prices, Fitch remains concerned that retail propane prices could spike, particularly with a weak dollar, and margins could contract from current levels. Additionally, continued weakness in housing starts and a warmer winter could weigh on volumes sold. If sales volumes show a greater post-recession recovery and product margins hold up, the credit outlook would move toward stable.

For more information on the credit outlook for these businesses, please refer to Fitch's report, "Pipeline/Midstream/MLP 2010 Outlook," published on Dec. 3, 2009.

Appendix: Ratings and Rating Outlooks by Segment

Utility Parent Companies

Company Name	IDR	Rating Outlook	Senior Unsecured Rating
Above Segment Median Rating			
WGL Holdings, Inc.	A+	Stable	A+
FPL Group, Inc.	A	Stable	A
NICOR Inc.	A	Stable	A
OGE Energy Corp.	A	Stable	A
Sempra Energy	A	Stable	A
Southern Company	A	Stable	A
AGL Resources, Inc.	A-	Stable	A-
DPL Inc.	A-	Stable	A-
KeySpan Corporation	A-	Stable	A-
Laclede Group, Inc.(The)	A-	Stable	NR
MDU Resources Group, Inc.	A-	Negative	A
National Fuel Gas Company	A-	Stable	A-
NSTAR	A-	Stable	A
Wisconsin Energy Corporation	A-	Negative	A-
Ameren Corporation	BBB+	Stable	BBB+
Consolidated Edison, Inc.	BBB+	Stable	BBB+
Dominion Resources, Inc.	BBB+	Stable	BBB+
Energy East Corporation	BBB+	Stable	NR
Exelon Corporation	BBB+	Stable	BBB+
MidAmerican Energy Holdings Co.	BBB+	Stable	BBB+
Public Service Enterprise Group Inc	BBB+	Stable	BBB+
SCANA Corporation	BBB+	Stable	BBB+
Xcel Energy Inc.	BBB+	Stable	BBB+
At Segment Median Rating			
American Electric Power Company	BBB	Stable	BBB
Black Hills Corp.	BBB	Stable	BBB
DTE Energy Company	BBB	Negative	BBB
FirstEnergy Corp.	BBB	Stable	BBB
IDACORP, Inc.	BBB	Negative	NR
Northeast Utilities	BBB	Stable	BBB
PEPCO Holdings	BBB	Negative	BBB
PPL Corporation	BBB	Stable	BBB
Progress Energy, Inc	BBB	Stable	BBB
Below Segment Median Rating			
Allegheny Energy, Inc.	BBB-	Stable	BBB-
Avista Corporation	BBB-	Stable	BBB
CenterPoint Energy Inc.	BBB-	Stable	BBB-
CILCORP, Inc.	BBB-	Stable	BBB-
Constellation Energy Group, Inc.	BBB-	Stable	BBB-
Edison International	BBB-	Stable	NR
IPALCO Enterprises, Inc.	BBB-	Stable	BBB-
NISource Inc.	BBB-	Stable	BBB
Otter Tail Corporation	BBB-	Stable	BBB-
Pinnacle West Capital Corporation	BBB-	Negative	BBB-
TECO Energy, Inc.	BBB-	Stable	BBB-
CMS Energy Corporation	BB+	Stable	BB+
PSEG Energy Holdings, Inc.	BB+	Stable	BB
PNM Resources	BB	Stable	BB
NV Energy Inc.	BB-	Positive	BB-
Energy Future Holdings Corp.	B	Negative	B
Energy Future Intermediate Holding Company LLC	B	Negative	B+

NR – Not rated. Note: Bold indicates senior secured.
Source: Fitch.

Investor-Owned Electric Utilities

Integrated Electric Utilities

Company Name	IDR	Rating Outlook	Senior Unsecured Rating
Above Segment Median Rating			
Mississippi Power Company	A+	Stable	AA-
Oklahoma Gas and Electric Company	A+	Stable	AA-
Alabama Power Company	A	Stable	A+
Dayton Power & Light Company	A	Stable	AA-
Florida Power and Light	A	Stable	A+
Georgia Power Company	A	Negative	A+
Wisconsin Electric Power Company	A	Negative	A+
Carolina Power & Light Co.	A-	Stable	A
Florida Power Corp.	A-	Stable	A
Gulf Power Company	A-	Stable	A
MidAmerican Energy Company	A-	Stable	A
Northern States Power Company (MN)	A-	Stable	A
Northern States Power Company (WI)	A-	Stable	A
Pacific Gas and Electric Company	A-	Stable	A
Southern California Edison Company	A-	Stable	A
AEP Texas North Company	BBB+	Stable	A-
Columbus Southern Power Company	BBB+	Stable	A-
Public Service Company of Colorado	BBB+	Stable	A-
South Carolina Electric & Gas Co.	BBB+	Stable	A-
Union Electric Co.	BBB+	Stable	A-
Virginia Electric and Power	BBB+	Stable	A-
At Segment Median Rating			
AEP Texas Central Company	BBB	Negative	BBB+
Black Hills Power, Inc.	BBB	Stable	BBB+
Central Illinois Light Company	BBB	Stable	BBB+
Detroit Edison Company (DECo)	BBB	Stable	A-
Idaho Power Company	BBB	Negative	BBB+
Ohio Power Company	BBB	Stable	BBB+
Otter Tail Power	BBB	Stable	BBB+
PacifiCorp	BBB	Stable	BBB+
Public Service Company of New Hampshire	BBB	Stable	BBB+
Public Service Company of Oklahoma	BBB	Stable	BBB+
Southwestern Electric Power Company	BBB	Negative	BBB+
Southwestern Public Service Company	BBB	Stable	BBB+
Tampa Electric Company	BBB	Stable	BBB+
Below Segment Median Rating			
Appalachian Power Company	BBB-	Stable	BBB
Arizona Public Service Company	BBB-	Stable	BBB
Consumers Energy Company	BBB-	Stable	BBB
Empire District Electric Company	BBB-	Negative	BBB
Indiana Michigan Power Company	BBB-	Stable	BBB
Indianapolis Power & Light Company	BBB-	Stable	BBB
Kansas Gas and Electric Company	BBB-	Stable	BBB+
Kentucky Power Company	BBB-	Stable	BBB
Monongahela Power Company	BBB-	Stable	BBB-
Northern Indiana Public Service Co.	BBB-	Stable	BBB
Northwestern Corporation	BBB-	Stable	BBB
Westar Energy, Inc.	BBB-	Stable	BBB
Nevada Power Company d/b/a NV Energy	BB	Positive	BB
Public Service Company of New Mexico	BB	Stable	BB+
Sierra Pacific Power Company d/b/a NV Energy	BB	Positive	BBB-
Tucson Electric Power Company	BB	Positive	BB+

Note: Bold indicates senior secured. *Continued on next page.*
Source: Fitch.

Investor-Owned Electric Utilities (Continued)

Electric Distribution Companies

Company Name	IDR	Rating Outlook	Senior Unsecured Rating
Above Segment Median Rating			
NSTAR Electric Co.	A+	Stable	AA-
San Diego Gas & Electric Company	A+	Stable	AA-
American Transmission Company	A	Stable	A+
Central Hudson Gas & Electric Corp	A-	Stable	A
Orange and Rockland Utilities, Inc.	A-	Negative	A
Rockland Electric Co.	A-	Negative	NR
Consolidated Edison Co. of New York	BBB+	Stable	A-
Delmarva Power & Light	BBB+	Stable	A-
PECO Energy Company	BBB+	Stable	A
Potomac Electric Power Company	BBB+	Stable	A-
Public Service Electric and Gas Co.	BBB+	Stable	A
At Segment Median Rating			
Atlantic City Electric	BBB	Stable	BBB+
Baltimore Gas and Electric Company	BBB	Stable	BBB+
CenterPoint Energy Houston Electric, LLC	BBB	Stable	BBB+
Connecticut Light and Power Co.	BBB	Stable	BBB+
Jersey Central Power & Light Co.	BBB	Stable	BBB+
New York State Electric & Gas Corp	BBB	Negative	BBB+
PPL Electric Utilities Corporation	BBB	Stable	A-
Western Massachusetts Electric Co.	BBB	Stable	BBB+
Below Segment Median Rating			
Central Illinois Public Service Co.	BBB-	Stable	BBB
Illinois Power Company	BBB-	Stable	BBB
Metropolitan Edison Company	BBB-	Stable	BBB
Ohio Edison Company	BBB-	Stable	BBB
Oncor Electric Delivery Company	BBB-	Stable	BBB-
Pennsylvania Electric Company	BBB-	Stable	BBB
Pennsylvania Power Company	BBB-	Stable	BBB
Potomac Edison Company (The)	BBB-	Stable	BBB+
Rochester Gas and Electric Corp	BBB-	Stable	BBB
West Penn Power Company	BBB-	Stable	BBB-
Cleveland Electric Illuminating Co.	BB+	Stable	BBB-
Commonwealth Edison Company	BB+	Stable	BBB-
Texas New Mexico Power Company	BB+	Stable	BBB-
Toledo Edison Company	BB+	Stable	BBB-

NR – Not rated. Note: Bold indicates senior secured.
Source: Fitch.

Competitive Generation Companies

Company Name	IDR	Rating Outlook	Senior Unsecured Rating
Above Segment Median Rating			
AmerenEnergy Generating Company	BBB+	Negative	BBB+
Exelon Generation Company, LLC	BBB+	Stable	BBB+
PSEG Power, LLC	BBB+	Stable	BBB+
Southern Power Company	BBB+	Stable	BBB+
FirstEnergy Solutions Corp. (FES)	BBB	Stable	BBB
PPL Energy Supply	BBB	Stable	BBB+
Allegheny Energy Supply Company	BBB-	Stable	BBB-
Allegheny Generating Company	BBB-	Stable	BBB-
Brookfield Renewable Power, Inc.	BBB-	Negative	BBB
Midwest Generation, LLC	BB	RWN	BBB-
At Segment Median Rating			
Edison Mission Energy	BB-	RWN	BB-
Mission Energy Holding Co.	BB-	Stable	BB-
Below Segment Median Rating			
AES Corporation	B+	Stable	BB
Mirant Americas Generation, LLC	B+	Stable	B
Mirant Corporation	B+	Stable	NR
Mirant Mid-Atlantic, LLC	B+	Stable	BB+
Mirant North America, LLC	B+	Stable	BB-
NRG Energy, Inc.	B	RWE	B+
Reliant Energy Inc	B	Negative	B+
Texas Competitive Electric Holdings	B	Negative	B
Dynegy Holdings, Inc.	B-	Negative	B
Dynegy, Inc.	B-	Negative	NR

NR – Not rated. RWN – Rating Watch Negative. RWE – Rating Watch Evolving. Note: Bold indicates senior secured.
Source: Fitch.

Pipeline and Midstream Companies

Company Name	IDR	Rating Outlook	Senior Unsecured Rating
Above Segment Median Rating			
Northern Natural Gas Co.	A	Stable	A
Centennial Energy Holdings, Inc.	A-	Negative	A-
LOOP LLC	A-	Stable	A-
EQT Corporation	BBB+	Stable	BBB+
Texas Eastern Transmission, LP	BBB+	Stable	BBB+
Texas Gas Transmission, LLC	BBB+	Stable	BBB+
Boardwalk Pipelines, LLC	BBB	Stable	BBB
CenterPoint Energy Resources Corp.	BBB	Stable	BBB
DCP Midstream LLC	BBB	Stable	BBB
Enogex Inc.	BBB	Stable	BBB
Kinder Morgan Energy Partners, L.P.	BBB	Stable	BBB
Northwest Pipeline Corporation	BBB	Stable	BBB
Rockies Express Pipeline LLC	BBB	Stable	BBB
Transcontinental Gas Pipe Line Corp	BBB	Stable	BBB
At Segment Median Rating			
Colorado Interstate Gas Co.	BBB-	Stable	BBB-
El Paso Natural Gas Co.	BBB-	Stable	BBB-
Energy Transfer Partners, L.P.	BBB-	Stable	BBB-
Enterprise Products Operating, LLC.	BBB-	Stable	BBB-
NGPL PipeCo LLC	BBB-	Stable	BBB-
NPOP (Kaneb Pipe Line Operating Partnership, L.P.)	BBB-	Stable	BBB-
NuStar Logistics, L.P.	BBB-	Stable	BBB-
Panhandle Eastern Pipeline Co.	BBB-	Stable	BBB-
Southern Natural Gas Co.	BBB-	Stable	BBB-
Southern Union Company	BBB-	Stable	BBB-
Tennessee Gas Pipeline Co.	BBB-	Stable	BBB-
TEPPCO Partners L.P.	BBB-	Stable	BBB-
Williams Companies, Inc.	BBB-	Stable	BBB-
Below Segment Median Rating			
AmeriGas Partners, L.P.	BB+	Stable	BB+
El Paso Corp.	BB+	Stable	BB+
El Paso Exploration & Production Co.	BB+	Stable	BB
Kinder Morgan Inc.	BB+	Stable	BB+
Williams Partners, LP	BB	Stable	BB
Energy Transfer Equity, L.P.	BB-	Stable	BB
Enterprise GP Holdings L.P.	BB-	Stable	BB
Star Gas Partners L.P.	B	Stable	BB-

Note: Bold indicates senior secured.
Source: Fitch.

Natural Gas Distribution Companies

Company Name	IDR	Rating Outlook	Senior Unsecured Rating
Above Segment Median Rating			
Southern California Gas Company	A+	Stable	AA-
Washington Gas Light Company	A+	Stable	AA-
Brooklyn Union Gas Co.	A	Stable	A+
Nicor Gas Company	A	Stable	A+
Wisconsin Gas Company, LLC	A	Stable	A+
At Segment Median Rating			
Atlanta Gas Light Co.	A-	Stable	A
Cascade Natural Gas Corporation	A-	Negative	A
KeySpan Gas East Corporation	A-	Stable	A
Laclede Gas Company	A-	Stable	A+
NSTAR Gas	A-	Stable	A
UGI Utilities, Inc.	A-	Stable	A
Below Segment Median Rating			
Berkshire Gas Company	BBB+	Stable	A-
Central Maine Power Company	BBB+	Stable	A-
Connecticut Natural Gas	BBB+	Stable	A-
Public Service Company of North Carolina	BBB+	Stable	A-
Atmos Energy Corporation	BBB	Stable	BBB+
Southern Connecticut Gas	BBB	Negative	A-
Southwest Gas Corporation	BBB	Stable	BBB
Michigan Consolidated Gas Company	BBB-	Stable	BBB+
Mountaineer Gas Company	BB-	Stable	BB

Note: Bold indicates senior secured.
Source: Fitch.

Public Power Companies — Retail Segment

Company Name	Rating Outlook	Senior Unsecured Rating
Above Median (A+)		
Chelan County Public Utility District No. 1 (Wash.)	Stable	AA+
San Antonio (Texas) (CPS Energy)	Stable	AA+
Chattanooga — Electric Power Board (Tenn.)	Stable	AA
Colorado Springs Utilities	Stable	AA
Grant County Public Utility District No. 2 (Wash.) — Electric System	Stable	AA
Lincoln (Neb.) — Electric System	Stable	AA
Memphis (Tenn.) — Memphis Light, Gas & Water	Stable	AA
Nashville (Tenn.) — Electric System	Stable	AA
Omaha Public Power District (Neb.)	Stable	AA
Orlando Utilities Commission (Fla.)	Stable	AA
Springfield (Mo.) — City Utilities (Electric)	Stable	AA
St. Cloud (Fla.) — Utility System	Stable	AA
Anaheim Public Utilities Department (Calif.)	Negative	AA-
Austin Combined Utility System (Texas)	Stable	AA-
Austin Energy (Texas)	Stable	AA-
Concord (N.C.) Utilities System	Stable	AA-
Hydro-Quebec	Stable	AA-
JEA (Fla.) — Electric	Stable	AA-
Los Angeles Department of Water and Power (Calif.)	Stable	AA-
New Braunfels Utilities (Texas)	Stable	AA-
Pasadena (Calif.) — Water and Power Department	Stable	AA-
Richmond (Va.)	Stable	AA-
Riverside Public Utilities (Calif.)	Stable	AA-
Rochester Public Utilities (Minn.)	Stable	AA-
Snohomish County Public Utility District No. 1 (Wash.)	Stable	AA-
Tallahassee (Fla.) — Energy System	Stable	AA-
At Median (A+)		
Anchorage Municipal Light & Power (Alaska)	Stable	A+
Bryan, Texas Utilities	Stable	A+
California Department of Water Resources	Positive	A+
Dover (Del.)	Stable	A+
Eugene Water and Electric Board (Ore.)	Stable	A+
Farmington (N.M.) Utility System	Stable	A+
Garland Power & Light (Texas)	Stable	A+
Glendale (Calif.) — Water and Power	Stable	A+
Georgetown (Texas)	Stable	A+
Greer (S.C.) — Commission of Public Works	Stable	A+
Imperial Irrigation District (Calif.)	RWN	A+
Jacksonville Beach (Fla.) — Combined Utility System	Stable	A+
Kansas City (Kan.) — Board of Public Utilities	Stable	A+
Kerrville Public Utility Board (Texas)	Stable	A+
Lakeland Energy System (Fla.)	Stable	A+
Muscatine Power & Water (Iowa)	Stable	A+
Ocala (Fla.)	Stable	A+
Pedernales Electric Cooperative, Inc. (Texas)	Stable	A+
Redding (Calif.)	Stable	A+
Roseville Electric System (Calif.)	Stable	A+
Tacoma Power (Wash.)	Stable	A+
Turlock Irrigation District (Calif.)	Stable	A+
Below Median (A+)		
Benton County Public Utility District No. 1 (Wash.)	Stable	A
Brownsville Public Utility Board (Texas)	Stable	A
Bryan, Rural Electric	Stable	A
Floresville (Texas) — Electric Light and Power System	Stable	A
Gallup (N.M.) — Utility System	Stable	A
Granbury (TX)	Negative	A
Grays Harbor County Public Utility District No. 1 (Wash.)	Stable	A
Kissimmee Utility Authority (Fla.)	Stable	A
Modesto Irrigation District (Calif.)	Stable	A

RWN – Rating Watch Negative. *Continued on next page.*
Source: Fitch.

Public Power Companies — Retail Segment (Continued)

Company Name	Rating Outlook	Senior Unsecured Rating
Below Median (A+) (Continued)		
Overton Power District No. 5 (NV)	Stable	A
Paducah (Kent.)	Stable	A
Reedy Creek Improvement District (Fla.)	Stable	A
Sacramento Municipal Utility District (Calif.)	Stable	A
Silicon Valley Power (Calif.)	Stable	A
Vero Beach (Fla.)	Stable	A
Winter Park (Fla.)	Negative	A
Alameda Power & Telecom (Calif.)	Positive	A-
Batavia (Ill.) — Electric Utility	Stable	A-
Boerne Utility System (Texas)	Stable	A-
Chugach Electric Association, Inc. (Alaska)	Stable	A-
Cowlitz CO Public Utility District	Stable	A-
Fort Pierce Utilities (Fla.)	Stable	A-
Klickitat County Public Utility District No. 1 (WA)	Stable	A-
Long Island Power Authority (N.Y.)	Negative	A-
Los Alamos County (N.M.) — Utility System	Stable	A-
Lubbock Power & Light (Texas)	Stable	A-
Pend Oreille County Public Utility District No. 1 (Wash.)	Stable	A-
Seguin (Texas)	Stable	A-
Leesburg (Fla.) — Electric System	Stable	BBB+
Lodi (Calif.) — Electric Utility	Positive	BBB+
Puerto Rico Electric Power Authority	Stable	BBB+
Virgin Islands Water & Power Authority	Negative	BBB
Vermont Electric Cooperative Inc.	Stable	BBB-
Guam Power Authority	Positive	BB+

Source: Fitch.

Public Power Companies — Wholesale Segment

Company Name	Rating Outlook	Senior Unsecured Rating
Above Median (A)		
Tennessee Valley Authority	Stable	AAA
Associated Electric Cooperative Inc. (MO)	Stable	AA
Energy Northwest (Wash) — Bonneville Power Agency	Positive	AA
Grant County Public Utility District No. 2 (Wash.) — Hydro Projects	Stable	AA
New York Power Authority	Stable	AA
Platte River Power Authority (Colo.)	Stable	AA
South Carolina Public Service Authority (Santee Cooper)	Stable	AA
Basin Electric Power Cooperative	Stable	AA-
Intermountain Power Agency (Utah)	Stable	AA-
Western Minnesota Municipal Power Agency	Stable	AA-
Arkansas Electric Cooperative Corp.	Stable	A+
Connecticut Municipal Electric Energy Cooperative	Stable	A+
Florida Municipal Power Authority — All Requirements Project	Stable	A+
Florida Municipal Power Authority — Stanton I	Stable	A+
Florida Municipal Power Authority — Stanton II	Stable	A+
Florida Municipal Power Authority — Tri-City Project	Stable	A+
Illinois Municipal Electric Agency	Stable	A+
Indiana Municipal Power Agency	Stable	A+
Lower Colorado River Authority (Texas)	Stable	A+
Municipal Electric Authority of Georgia (CC/CT Proj)	Stable	A+
Municipal Electric Authority of Georgia (General Res)	Stable	A+
Municipal Electric Authority of Georgia (Project One)	Stable	A+
Municipal Electric Authority of Georgia (Telecom)	Stable	A+
Nebraska Public Power District	Stable	A+
Walnut Energy Center Authority (Calif.)	Stable	A+
Wisconsin Public Power Inc.	Stable	A+
Buckeye Power, Inc (Ohio)	Stable	A+
At Median (A)		
American Municipal Power — Issuer Rating	Stable	A
American Municipal Power-Inc. — Joint Venture No. 5	Stable	A
American Municipal Power-Inc. — Prairie State Project	Stable	A
Berkshire Wind Power Cooperative Corporation (MA)	Stable	A
Brazos Electric Power Cooperative, Inc. (Texas)	Stable	A
Florida Municipal Power Authority — St. Lucie Project	Stable	A
Grand River Dam Authority (Okla.)	Stable	A
Massachusetts Municipal Wholesale Elec Co. (Nuclear Mix No. 1)	Stable	A
Massachusetts Municipal Wholesale Elec Co. (Project 3)	Stable	A
Massachusetts Municipal Wholesale Elec Co. (Project 4)	Stable	A
Massachusetts Municipal Wholesale Elec Co. (Project 5)	Stable	A
Massachusetts Municipal Wholesale Elec Co. (Project 6)	Stable	A
Massachusetts Municipal Wholesale Elec Co. (Stoney Brook Intermediate)	Stable	A
Massachusetts Municipal Wholesale Elec Co. (Wyman)	Stable	A
Missouri Joint Municipal Electric Utility Commission (Iatan 2 Project)	Stable	A
M-S-R Public Power Agency (Calif.)	Stable	A
Municipal Energy Agency of Nebraska	Stable	A
North Carolina Municipal Power Agency No. 1	Stable	A
Northern California Power Authority — Geothermal Project	Stable	A
Northern California Power Authority — Hydroelectric Project	Stable	A
Oglethorpe Power Co. (Ga.)	Stable	A
Oglethorpe Power Co. (Ga.) — Scherer Facilities	Stable	A
Old Dominion Electric Cooperative (Va.)	Stable	A
Texas Municipal Power Agency	Stable	A
Tri-State Generation & Transmission Association, Inc. (Colo.)	Stable	A
Below Median (A)		
American Municipal Power-Inc. — Joint Venture No. 2	Stable	A-
Central Iowa Power Cooperative	Stable	A-
Delaware Municipal Electric Cooperative	Stable	A-
Energy Northwest (Wash.) — Wind Project	Stable	A-
Golden Spread Electric Cooperative, Inc. (Texas)	Stable	A-
Great River Energy (MN)	Stable	A-
Missouri Joint Municipal Electric Utility Commission (Plum Point Project)	Stable	A-
Missouri Joint Municipal Electric Utility Commission (Prairie State Project)	Stable	A-
Northern Illinois Municipal Power Agency	Stable	A-
PowerSouth Energy Cooperative, Inc.	Stable	A-
South Texas Electric Cooperative	Stable	A-

Continued on next page.
Source: Fitch.

Public Power Companies — Wholesale Segment (Continued)

Company Name	Rating Outlook	Senior Unsecured Rating
Wholesale Segment — Below Median (A) (Continued)		
Western Farmers Electric Cooperative (Okla.)	Negative	A-
Central Valley Financing Authority (Calif.)	Stable	BBB+
North Carolina Eastern Municipal Power Agency	Positive	BBB+
Piedmont Municipal Power Agency (S.C.)	Stable	BBB+
Sacramento Cogeneration Authority (Calif.) — P&G Project	Stable	BBB+
Sacramento Power Authority (Calif.) — Campbell Project	Stable	BBB+
Sacramento Municipal Utility District Financing Authority (Calif.) — Cosumnes Project	Stable	BBB
Big Rivers Electric Corporation (Kent.)	Stable	BBB-
Sam Rayburn Municipal Power Agency (Texas)	Stable	BBB-

Source: Fitch.

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November 9, 2010



Equity Research

Ameren Corp.

AEE: Adjusting EPS Outlook; Reiterate Market Perform

- Summary.** Based on 2010 YTD results, revised rate relief assumptions, updated hedging disclosures and current forward power prices, our revised our '10-14 EPS estimates are \$2.70, \$2.15, \$2.05, \$1.70 and \$1.95 vs. \$2.65, \$2.10, \$2.15, \$1.65 and \$1.95, previously. We reiterate our Market Perform rating and increase our valuation range to \$28-29 from \$26-27 reflecting a higher valuation for the Regulated Utility business.
- 2010 Outlook.** Following a strong 3Q, AEE raised the lower end of its 2010 core earnings guidance range by \$0.10 resulting in a revised range of \$2.60-2.80, including \$2.25-2.35 from the Regulated Utilities (vs. \$2.15-2.30 previously) and \$0.35-0.45 from Merchant Generation (vs. \$0.35-0.50 previously). Excluding the return of Noranda Aluminum's smelter plant, 3Q industrial sales were +10% and residential and commercial sales were +28% and +11%, respectively. We are increasing our 10E EPS to \$2.70 from \$2.65.
- EPS Outlook.** Our revised 11E-14E EPS are \$2.15, \$2.05, \$1.70 and \$1.95 versus \$2.10, \$2.15, \$1.65 and \$1.95, previously. The changes reflect AEE's updated hedging disclosures, adjustments to our power price assumptions and revised rate relief assumptions related to the IL rehearing order and the Missouri electric rate case filing. Our estimates assume the Merchant Generation business loses \$0.22/share in '12 and \$0.61/share in '13, which embed open ATC prices of roughly \$35.00/MWh and \$37.50/MWh, respectively, including a small adder for various ancillary products. See Figure 1 for key merchant assumptions.
- Merchant Impairment.** In 3Q, AEE took a \$485mm non-cash goodwill and asset impairment charge related to the company's merchant assets. The out-of-cycle impairment was triggered by Blackstone's proposed acquisition of Dynegy, which resulted in a lower industry market multiple, potentially more stringent environmental rules related to the EPA's July 2010 Clean Air Transport Rule (CATR) proposal and a continued decline in power prices. The impairment highlights the challenging environment for AEE's Merchant Generation business, in our view.
- Reiterate Market Perform.** We reiterate our Market Perform rating and raise our valuation range to \$28-29 from \$26-27 largely based on a higher Regulated Electric median P/E multiple. We remain concerned about the long-term outlook for the Merchant Generation business.

Valuation Range: \$28.00 to \$29.00 from \$26.00 to \$27.00

Our sum-of-the-parts valuation analysis includes \$29-30 for Regulated Operations (apply a 13X multiple to Regulated 2012E EPS of \$2.27) and \$0-(1) for Merchant Generation, resulting in our \$28-29 valuation range. Risks to our valuation include unfavorable regulatory outcomes, a further deterioration in power prices and a material rise in interest rates.

Investment Thesis:

Despite a favorable outlook for the regulated business and an attractive dividend yield, we rate the shares Market Perform based on the current poor outlook for the merchant generation business and valuation considerations.

Please see page 5 for rating definitions, important disclosures and required analyst certifications

Wells Fargo Securities, LLC does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of the report and investors should consider this report as only a single factor in making their investment decision.

Market Perform

Sector: IPP/Regulated Electric Utilities
Market Weight

Earnings Estimates Revised Up

EPS	2009A		2010E		2011E
			Curr.	Prior	Curr.
Q1 (Mar.)	\$0.54	\$0.40 A	NC	NC	NE
Q2 (June)	0.75	0.73 A	NC	NC	NE
Q3 (Sep.)	1.16	1.40 A	1.22		NE
Q4 (Dec.)	0.37	0.17	0.30		NE
FY	\$2.79	\$2.70	2.65	\$2.15	2.10
CY	\$2.79	\$2.70		\$2.15	
FY P/E	10.6x	10.9x		13.7x	
Rev.(MM)	\$7,090	\$8,262		\$8,210	

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters
NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful
V = Volatile, * = Company is on the Priority Stock List

Ticker	AEE
Price (11/09/2010)	\$29.54
52-Week Range:	\$23-30
Shares Outstanding: (MM)	239.2
Market Cap.: (MM)	\$7,066.0
S&P 500:	1,213.40
Avg. Daily Vol.:	1,835,640
Dividend/Yield:	\$1.54/5.2%
LT Debt: (MM)	\$6,859.0
LT Debt/Total Cap.:	45.0%
ROE:	7.0%
3-5 Yr. Est. Growth Rate:	(7.0)%
CY 2010 Est. P/E-to-Growth:	NM
Last Reporting Date:	10/29/2010
	Before Open

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters

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Together we'll go far



Utilities

Company Description:

(St. Louis, MO) Ameren's primary businesses are regulated electric and natural gas utility services and merchant generation. The company's four regulated subsidiaries serve 2.4 million electric customers and one million natural gas customers in Missouri and Illinois. AEE's regulated rate base by jurisdiction is as follows: Missouri-60%, Illinois-35% and Federal Energy Regulatory Commission (FERC)-5%. The regulated utilities include AmerenUE (Missouri) and the Ameren Illinois Utilities (AIU) comprised of AmerenCILCO (CILCO), AmerenCIPS (CIPS) and AmerenIP (IP). Merchant Generation owns approximately 6,400 MW of capacity in Illinois, including over 4,600 MW of coal-fired generation.

Figure 1: Key Assumptions Underlying Merchant Generation Earnings Outlook, 2010E-14E

	2010E	2011E	2012E	2013E	2014E
Key Generation Assumptions					
Capacity (MW)	6,421	6,421	6,421	6,421	6,421
Plant Output (mm MWhs)	30,508	30,508	30,508	30,508	30,508
Hedged Output (mm MWhs)	29,898	24,407	15,864	3,051	0
Avg Realized Price (\$/MWh)*	\$46.50	\$46.00	\$51.00	\$39.30	\$42.11
Revenues (mil.)	\$1,390	\$1,123	\$809	\$120	\$0
Unhedged Output (mm MWhs)	610	6,102	14,644	27,458	30,508
Avg Realized Price (\$/MWh)	\$30.98	\$32.28	\$34.82	\$37.43	\$40.11
Revenues (mil.)	\$19	\$197	\$510	\$1,028	\$1,224
Non Full-Requirements Capacity Revenues (mil.)	\$63	\$49	\$39	\$88	\$88
Other Revenues (mil.)	\$15	\$15	\$15	\$15	\$15
Total AER Revenues	\$1,488	\$1,384	\$1,373	\$1,250	\$1,327
Key Coal Fuel Cost Assumptions					
Tons (mil.)	14	14	14	14	14
\$/ton	\$48.36	\$54.09	\$56.34	\$57.07	\$57.31
\$/MWh	\$22.50	\$25.16	\$26.20	\$26.54	\$26.66
<i>Guidance</i>	<i>\$22.50</i>	<i>\$25.00</i>	<i>\$26.00</i>	<i>N/A</i>	<i>N/A</i>
Fuel Costs	\$686	\$768	\$799	\$810	\$813
% Coal Hedged**	95%	66%	40%	N/A	N/A
% Transportation Hedged**	100%	95%	90%	N/A	N/A
Gross Margin & EBITDA (mil.)					
Total Revenues	\$1,488	\$1,384	\$1,373	\$1,250	\$1,327
Fuel Costs	\$686	\$768	\$799	\$810	\$813
Gross Margin	\$801	\$616	\$573	\$441	\$513
\$/MWh	\$26.26	\$20.20	\$18.79	\$14.44	\$16.82
Operating & Maintenance Expense	\$281	\$289	\$298	\$307	\$316
Other Taxes	\$42	\$43	\$44	\$45	\$46
EBITDA	\$478	\$284	\$231	\$89	\$151

*2010-2012 hedged percentage & average hedged power price are per company guidance.

2013 & 2014 hedged percentage & average hedged power price are Wells Fargo Securities, LLC estimates.

**Percentages Based on AEE guidance for hedged coal and transportation (mm MWh) divided by an estimated 30 mm MWh annual output.

Source: Wells Fargo Securities, LLC Estimates and AEE guidance

WELLS FARGO SECURITIES, LLC
EQUITY RESEARCH DEPARTMENT

Ameren Corp.

Earnings Model (in millions, except per share data)	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Revenues	\$7,562	\$7,839	\$7,090	\$8,262	\$8,210	\$8,388	\$8,415	\$8,658
Operating Expenses								
Energy Costs	\$3,454	\$3,542	\$2,799	\$3,800	\$3,860	\$3,928	\$3,975	\$4,016
Operations & Maintenance	1,687	1,857	1,738	1,825	1,870	1,911	1,953	1,996
Depreciaton & Amortization	681	685	725	752	786	812	839	867
<u>Other Taxes</u>	<u>381</u>	<u>393</u>	<u>412</u>	<u>423</u>	<u>432</u>	<u>441</u>	<u>450</u>	<u>459</u>
Total Expenses	\$6,203	\$6,477	\$5,674	\$6,801	\$6,947	\$7,091	\$7,217	\$7,338
Operating Income	\$1,359	\$1,362	\$1,416	\$1,461	\$1,263	\$1,297	\$1,199	\$1,321
EBITDA	\$2,040	\$2,047	\$2,141	\$2,213	\$2,049	\$2,109	\$2,037	\$2,187
Other Income	50	49	48	70	66	41	31	25
Interest Expense	423	440	508	522	517	540	553	542
<u>Income Taxes</u>	<u>330</u>	<u>327</u>	<u>332</u>	<u>351</u>	<u>278</u>	<u>282</u>	<u>237</u>	<u>282</u>
Income before Minority Interest & Pfd. Div.	\$656	\$644	\$624	\$658	\$534	\$515	\$440	\$521
Minority Interest & Preferred Dividends	38	39	12	12	12	12	12	12
Net Income	\$618	\$605	\$612	\$646	\$523	\$504	\$428	\$509
Average Diluted Shares Outstanding	207	210	220	239	243	246	252	261
EPS	\$2.98	\$2.88	\$2.78	\$2.70	\$2.15	\$2.05	\$1.70	\$1.95
Non-Recurring Items	0.36	0.07	0.01	0.00	0.00	0.00	0.00	0.00
Operating EPS*	\$3.34	\$2.95	\$2.79	\$2.70	\$2.15	\$2.05	\$1.70	\$1.95

Supplemental Information	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
EPS By Segment								
<u>Regulated Utilities</u>								
Missouri				\$1.69	\$1.69	\$1.65	\$1.65	\$1.69
Illinois				0.58	0.54	0.62	0.65	0.65
<u>Ameren Transmission Company</u>				<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>0.01</u>	<u>0.03</u>
Total Regulated				2.27	2.24	2.27	2.31	2.37
<u>Total Non-Regulated and Parent</u>				<u>0.43</u>	<u>(0.08)</u>	<u>(0.22)</u>	<u>(0.61)</u>	<u>(0.42)</u>
Total				\$2.70	\$2.15	\$2.05	\$1.70	\$1.95
Dividend Information								
Dividend/Share Year-End Rate	\$2.54	\$2.54	\$1.54	\$1.54	\$1.54	\$1.54	\$1.54	\$1.54
Dividends Paid Per Share	2.54	2.54	1.54	1.54	1.54	1.54	1.54	1.54
Payout Ratio	76%	86%	55%	57%	71%	75%	91%	79%
Statistics								
Book Value Per Share - Year End	\$32.41	\$32.80	\$33.08	\$34.11	\$34.61	\$35.02	\$34.97	\$35.21
Average Book Value Per Share	16.21	32.61	32.94	33.60	34.36	34.82	35.00	35.09
ROE	21%	9%	8%	8%	6%	6%	5%	6%
EBITDA Per Share	9.84	9.74	9.71	9.25	8.44	8.57	8.08	8.37
Cash Flow Per Share	5.34	7.25	8.97	7.79	5.66	5.61	5.28	5.51
Free Cash Flow Per Share	(3.86)	(4.31)	(0.29)	1.40	(1.17)	(1.27)	(1.92)	(1.37)

*Operating EPS exclude non-recurring items.

Source: Wells Fargo Securities, LLC estimates and company filings

**WELLS FARGO SECURITIES, LLC
EQUITY RESEARCH DEPARTMENT**

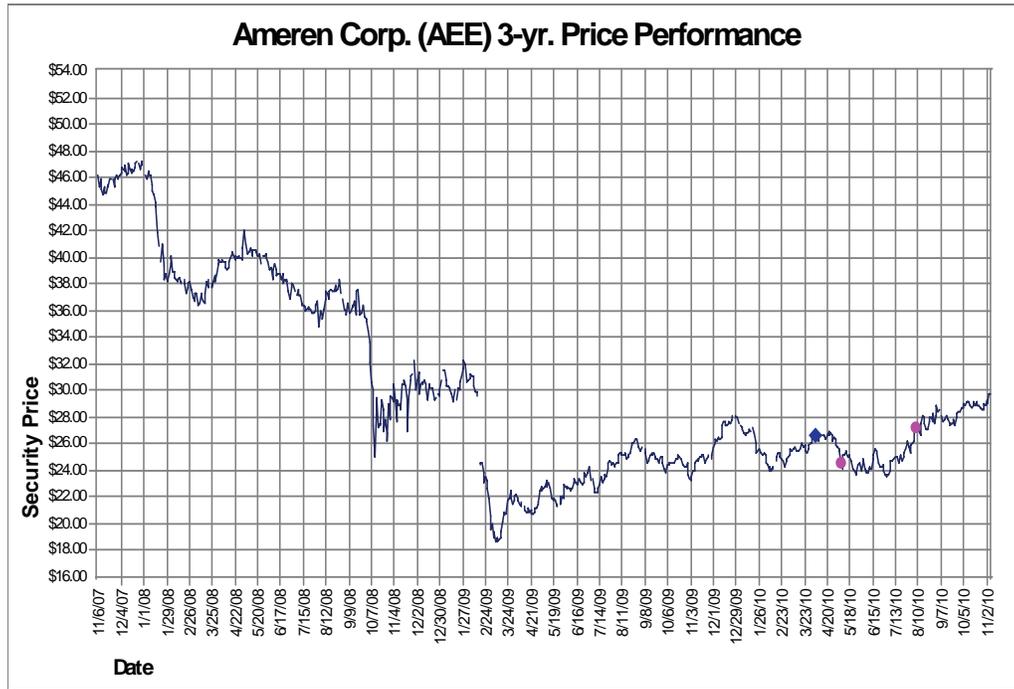
Utilities

Cash Flow Model (in millions)	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Operating Cash Flow								
Net Income	\$656	\$644	\$624	\$658	\$534	\$515	\$440	\$521
Depreciation & Amortization	(9)	187	427	400	0	0	0	0
Other	461	693	926	805	839	865	892	920
Net Operating Cash Flow	\$1,108	\$1,524	\$1,977	\$1,863	\$1,373	\$1,380	\$1,331	\$1,441
Investing Cash Flow								
Capital Expenditures	(1,381)	(1,896)	(1,704)	(1,160)	(1,283)	(1,315)	(1,427)	(1,395)
Other	(87)	(201)	(85)	(75)	(80)	(80)	(80)	(80)
Net Investing Cash Flow	(\$1,468)	(\$2,097)	(\$1,789)	(\$1,235)	(\$1,363)	(\$1,395)	(\$1,507)	(\$1,475)
Financing Cash Flow								
Net Change in ST Debt	860	(298)	(324)	0	0	0	0	0
Capital Issuance Costs	(4)	(12)	(65)	0	0	0	0	0
Issuance of LT Debt	674	1,879	1,021	0	400	312	547	323
Dividends Paid to Noncontrolling Interest Holders	(32)	(40)	(21)	(12)	(12)	(12)	(12)	(12)
Redemption/Purchase of LT Debt	(488)	(842)	(631)	(204)	(154)	(178)	(354)	(533)
Redemption of Preferred Securities	(1)	(16)	0	0	0	0	0	0
Issuance of Common Stock	91	154	634	90	90	90	250	300
Dividends on Common Stock	(527)	(534)	(338)	(368)	(374)	(379)	(388)	(402)
Generator Advances Received for Construction	5	19	66	0	0	0	0	0
Net Financing Cash Flow	\$578	\$310	\$342	(\$494)	(\$49)	(\$167)	\$43	(\$324)
Net Change in Cash	\$218	(\$263)	\$530	\$134	(\$40)	(\$181)	(\$132)	(\$358)
Cash at Beginning of Period	137	355	92	622	756	717	536	403
Cash at End of Period	\$355	\$92	\$622	\$756	\$717	\$536	\$403	\$45

Capital Structure	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Common Equity	\$6,752	\$6,963	\$7,853	\$8,221	\$8,460	\$8,675	\$8,965	\$9,372
LT Debt	5,689	6,554	7,113	7,113	7,359	7,493	7,686	7,476
ST Debt	1,695	1,554	1,054	850	850	850	850	850
Preferred Stock	211	216	207	207	207	207	207	207
Total Capital	\$14,347	\$15,287	\$16,227	\$16,391	\$16,876	\$17,225	\$17,708	\$17,905
Common Equity	47%	46%	48%	50%	50%	50%	51%	52%
LT Debt	40%	43%	44%	43%	44%	44%	43%	42%
ST Debt	12%	10%	6%	5%	5%	5%	5%	5%
Preferred	1%	1%	1%	1%	1%	1%	1%	1%

Source: Wells Fargo Securities, LLC estimates and company filings

Required Disclosures



	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
◆	4/6/2010	26.48	2	27.00	28.00	26.65
◆	5/6/2010	25.39	2	25.00	26.00	24.66
◆	8/6/2010	27.04	2	26.00	27.00	27.20

Source: Wells Fargo Securities, LLC estimates and Reuters data

Symbol Key

- ▼ Rating Downgrade
- ▲ Rating Upgrade
- Valuation Range Change
- ◆ Initiation, Resumption, Drop or Suspend
- Analyst Change
- Split Adjustment

Rating Code Key

- 1 Outperform/Buy
- 2 Market Perform/Hold
- 3 Underperform/Sell
- SR Suspended
- NR Not Rated
- NE No Estimate

Additional Information Available Upon Request

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Utilities

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2=Market Perform: The stock appears appropriately valued, and we believe the stock's total return will be in line with the market over the next 12 months. HOLD

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Ameren Corp.

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Global Credit Portal

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December 29, 2010

Ameren Illinois Co.

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Ameren Illinois Co.

Major Rating Factors

Strengths:

- A fully regulated electric and gas company;
- Lower risk transmission and distribution businesses; and
- Near-term improved financial measures.

Corporate Credit Rating

BBB-/Stable/NR

Weaknesses:

- Affiliation with the higher-risk operations and less dependable cash flows from Ameren's merchant generation business; and
- Rising regulatory risk in Illinois.

Rationale

The ratings on Ameren Illinois reflect Ameren Corp.'s (Ameren) consolidated credit profile. The ratings also reflect Ameren Illinois' excellent business risk profile and Ameren's consolidated significant financial risk profile. Ameren's subsidiaries include rate regulated utilities Ameren Illinois and Ameren Missouri, and merchant energy company AmerenEnergy Generating Co. (GenCo.) As of Sept. 30, 2010, Ameren had about \$7.7 billion of total debt outstanding. Based on the combination of future earnings, cash flow, capital expenditures, and credit risk exposure, we view Ameren as about 75% regulated and 25% merchant generation.

Ameren Illinois' excellent business risk profile reflects its lower-risk pure transmission and distribution (T&D) operations. The company serves about 1.2 million electric customers and 813,000 gas customers in central and southern Illinois, whose rates are regulated by the Illinois Commerce Commission (ICC). Additionally, the company's electric transmission lines, which constitutes about 13% of the company's total rate base and is regulated by the Federal Energy Regulatory Commission, provides some added diversification. Overall, we view the T&D businesses as lower risk than the generation businesses that are included in many fully integrated electric utilities.

Ameren Illinois' business risk profile is also affected by its ability to manage its regulatory risk. Earlier in 2010, Standard & Poor's revised its assessment of the Illinois regulation to 'less credit supportive' from 'least credit supportive'. The change reflected our view that the Illinois legislative and regulatory environment had returned to relative stability following the disruption during the state's transition to competition. Our revised assessment was partially based on the 13 constructive rate case orders from 2008 until the early 2010. These developments clearly pointed to a decreasing regulatory risk. However, in April 2010, Ameren received a \$4.7 million rate case order for its Illinois electric and gas businesses that we viewed as not conducive to credit quality. Since then, based on error corrections and a rehearing, Ameren's net rate order was increased to \$44 million. Overall, we view the company's regulatory risk as rising. Should this persist, it could pressure the company's business risk profile, which could harm its credit quality.

Ameren's consolidated satisfactory business risk profile reflects the combination of the excellent business risk profiles of Ameren's regulated businesses offset by the fair business risk profile of Ameren's merchant energy businesses.

Ameren Illinois Co.

Ameren Missouri's excellent business risk profile reflects its recent rate cases and regulatory mechanisms that overall indicate a decreasing regulatory risk. Ameren Missouri is a rate-regulated utility that serves 1.2 million electric and 126,000 gas customers in portions of central and eastern Missouri. The company also has 10,400 megawatt (MW) of generating capacity of which 5,400 MW is base load coal and 1,200 MW is nuclear generation. In 2009 and 2010, the company received credit supportive rate case orders from the Missouri Public Service Commission that includes more than \$390 million of base rate increases, a fuel adjustment clause, pension and OPEB trackers, and a cost tracker for vegetation management and infrastructure inspections. Recently, the company filed for a \$12 million gas revenue increase and a \$263 million electric rate increase. The commission's orders for the gas and electric rate cases are expected by April 2011 and July 2011, respectively. We expect that Ameren Missouri will continue to file rate cases on a frequent basis to reduce its regulatory lag.

GenCo.'s business risk profile is fair. Ameren has 6,500 MW of merchant generation, of which 4,600 MW represent base load coal generation. Although GenCo. has consistently implemented a three-year hedging policy, its long-term profitability is ultimately dependent on the market price of energy. While the unregulated businesses are considerably hedged for 2011, their margins already declined in 2010 due to weak market power prices and are expected to further decline over the intermediate term based on the forward curve. While the company continues to effectively manage those areas that it can directly influence, including reducing its O&M costs and capital spending, sustained weak energy power prices or increased mandated environmental capital expenditures would pressure the merchant business over the intermediate term.

For Ameren Corp. to improve its consolidated business risk profile, it must reduce its merchant business risks by either selling its merchant assets, committing its merchant generation to long-term contracts, or by completing the necessary environment capital expenditures at its merchant business.

Ameren's significant financial risk profile reflects management's proactive 2009 and 2010 decisions to reduce its dividend, issue equity, and reduce O&M costs and capital spending. More recently, the company's financial measures have improved reflecting warmer-than-expected weather, continued cost reductions, and rate case increases. For the 12 months ended Sept. 30, 2010, adjusted funds from operations (FFO) to total debt increased to 23.9% from 21.4% at the end of 2009, adjusted debt to EBITDA improved to 3.8x from 4.3x, and adjusted debt to total capital strengthened to 53.4% from 54.1%. While Ameren's financial measures are expected to remain improved for the short term, we expect that over the intermediate term the financial measures will weaken because of increasing environmental capital expenditures and gradually weaker cash flows from the merchant generation business.

Liquidity

The short-term rating on Ameren is 'A-3'. We view its liquidity as adequate under Standard & Poor's corporate liquidity methodology, which categorizes liquidity in five standard descriptors (exceptional, strong, adequate, less than adequate, and weak). Adequate liquidity supports Ameren's 'BBB-' corporate credit rating. Projected sources of liquidity--mainly operating cash flow and available bank lines--exceed projected uses, necessary capital expenditures, debt maturities, and common dividends by about 1.2x. Ameren's ability to absorb high-impact, low-probability events with limited need for refinancing, its flexibility to lower capital spending, its well established bank relationships, its general high standing in the credit markets, and prudent risk management further support our assessment of its liquidity as adequate.

As of Sept. 30, 2010, Ameren and its subsidiaries had more than \$1.6 billion available on its \$2.1 billion credit

Ameren Illinois Co.

facilities after reducing for outstanding borrowings. The company recently entered into the existing credit facilities and they do not terminate until September 2013. The credit facilities require Ameren and its subsidiaries to maintain a maximum debt-to-capital ratio of 65% and as of Sept. 30, 2010, the company was in compliance with this financial covenant.

Ameren's current positive discretionary cash flow is expected to turn negative over the intermediate term as capital expenditures increase. Long-term maturities are manageable with \$155 million due in 2011 and \$199 million due in 2012. In the fourth quarter of 2010, GenCo. used cash on hand to pay down its \$200 million long-term debt maturity. We fundamentally expect that Ameren will continue to meet its cash needs in a manner that is credit neutral.

Recovery analysis

We assign recovery ratings to First Mortgage Bonds (FMBs) issued by investment-grade U.S. utilities, which can result in issue ratings being notched above a utility's corporate credit rating (CCR) depending on the CCR category and the extent of the collateral coverage. The investment grade FMB recovery methodology is based on the ample historical record of nearly 100% recovery for secured bondholders in utility bankruptcies and our view that the factors that supported those recoveries (limited size of the creditor class and the durable value of utility rate-based assets during and after a reorganization given the essential service provided and the high replacement cost) will persist in the future. Under our notching criteria, we consider the limitations of FMB issuance under the utility's indenture relative to the value of the collateral pledged to bondholders, management's stated intentions on future FMB issuance, as well as the regulatory limitations on bond issuance when assigning issue ratings to utility FMBs. FMB ratings can exceed a utility's CCR by up to one notch in the 'A' category, two notches in the 'BBB' category, and three notches in speculative-grade categories.

Ameren Illinois FMBs benefit from a first-priority lien on substantially all of the utility's real property owned or subsequently acquired. Collateral coverage of about 1.3 times supports a recovery rating of a 1 and an issue rating one notch above the CCR. The FMB of the former Central Illinois Light Co. are covered by a separate indenture that enhances its collateral coverage to about 1.7 times that supports a recovery rating of a 1+ and an issue rating two notches above the CCR.

Outlook

The stable outlook on Ameren reflects Standard & Poor's baseline forecast that its adjusted FFO to debt and adjusted debt to total capital will, over the intermediate term, approximate 21% and 50%, respectively. Fundamental to our forecast is the outcome of the company's rate case filings and the market power prices. However, because of the business risk pressures that Ameren Illinois and GenCo. are currently facing, there is less of a cushion at the 'BBB-' corporate credit rating. A downgrade could result if the company is unable to effectively manage its regulatory risk or dark spreads continue to compress so that FFO to debt drops to below 20% on a sustained basis. An upgrade is possible if management decides to no longer support its merchant business.

Ameren Illinois Co.

Table 1.

Ameren Corp. -- Peer Comparison*						
Industry Sector: Combo						
	Ameren Corp.	Allegheny Energy Inc.	Dominion Resources Inc.	Edison International	PPL Corp.	
Rating as of Dec. 21, 2010	BBB-/Stable/A-3	BBB-/Stable/--	A-/Stable/A-2	BBB-/Stable/--	BBB+/Stable/--	
--Average of past three fiscal years--						
(Mil. \$)						
Revenues	7,491.7	3,260.6	15,690.5	13,108.7	3,174.5	
Net income from cont. oper.	611.7	400.2	1,942.7	1,057.0	351.1	
Funds from operations (FFO)	1,671.8	793.3	2,278.0	2,660.8	992.0	
Capital expenditures	1,785.1	976.9	3,085.4	3,150.8	999.8	
Debt	9,055.8	4,288.6	17,740.2	17,398.6	4,834.9	
Equity	7,305.2	2,844.1	11,113.6	10,001.5	2,758.6	
Adjusted ratios						
Oper. income (bef. D&A)/revenues (%)	28.5	32.3	26.9	34.1	31.4	
EBIT interest coverage (x)	3.1	3.2	2.8	2.3	2.8	
EBITDA interest coverage (x)	4.4	3.9	3.9	3.3	3.7	
Return on capital (%)	8.1	10.7	8.9	9.3	9.2	
FFO/debt (%)	18.5	18.5	12.8	15.3	20.5	
Debt/EBITDA (x)	4.3	4.0	4.3	4.1	5.0	

*Fully adjusted (including postretirement obligations).

Table 2.

Ameren Corp. -- Financial Summary*						
Industry Sector: Combo						
	--Fiscal year ended Dec. 31--					
	2009	2008	2007	2006	2005	
Rating history	BBB-/Stable/A-3	BBB-/Stable/A-3	BBB-/Stable/A-3	BBB/Watch Neg/A-3	BBB+/Watch Neg/A-2	
(Mil. \$)						
Revenues	7,090.0	7,839.0	7,546.0	6,880.0	6,780.0	
Net income from continuing operations	612.0	605.0	618.0	547.0	628.0	
Funds from operations (FFO)	2,006.6	1,581.5	1,427.2	1,384.8	1,225.4	
Capital expenditures	1,784.0	2,086.3	1,485.0	1,131.5	1,010.2	
Cash and short-term investments	622.0	92.0	355.0	137.0	96.0	
Debt	9,379.0	9,457.8	8,330.8	7,336.6	6,723.6	
Preferred stock	97.5	97.5	97.5	195.0	195.0	
Equity	7,962.5	7,081.5	6,871.5	6,794.0	6,172.4	
Debt and equity	17,341.5	16,539.3	15,202.3	14,130.6	12,896.0	
Adjusted ratios						
EBIT interest coverage (x)	2.8	3.1	3.3	3.6	4.3	
FFO int. cov. (x)	4.7	4.4	4.2	4.7	4.7	
FFO/debt (%)	21.4	16.7	17.1	18.9	18.2	

Ameren Illinois Co.

Table 2.

Ameren Corp. -- Financial Summary* (cont.)					
Discretionary cash flow/debt (%)	(1.1)	(11.1)	(10.6)	(5.1)	(4.4)
Net Cash Flow / Capex (%)	92.6	50.5	61.0	76.2	70.7
Debt/debt and equity (%)	54.1	57.2	54.8	51.9	52.1
Return on common equity (%)	7.6	8.7	9.0	8.4	10.1
Common dividend payout ratio (un-adj.) (%)	59.6	89.7	86.8	95.4	81.4

*Fully adjusted (including postretirement obligations).

Table 3.

Reconciliation Of Ameren Corp. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. \$)*									
--Fiscal year ended Dec. 31, 2009--									
Ameren Corp. reported amounts									
	Debt	Shareholders' equity	Operating income (before D&A)	Operating income (before D&A)	Operating income (after D&A)	Interest expense	Cash flow from operations	Cash flow from operations	Dividends paid
Reported	8,167.0	8,060.0	2,141.0	2,141.0	1,416.0	508.0	1,977.0	1,977.0	359.0
Standard & Poor's adjustments									
Operating leases	243.3	--	38.0	16.3	16.3	16.3	21.7	21.7	--
Intermediate hybrids reported as equity	97.5	(97.5)	--	--	--	5.0	(5.0)	(5.0)	(5.0)
Postretirement benefit obligations	761.2	--	28.0	28.0	28.0	--	44.9	44.9	--
Accrued interest not included in reported debt	110.0	--	--	--	--	--	--	--	--
Share-based compensation expense	--	--	--	15.0	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	48.0	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	(29.0)	--
US decommissioning fund contributions	--	--	--	--	--	--	(3.0)	(3.0)	--
Total adjustments	1,212.0	(97.5)	66.0	59.3	92.3	21.3	58.6	29.6	(5.0)
Standard & Poor's adjusted amounts									
	Debt	Equity	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid
Adjusted	9,379.0	7,962.5	2,207.0	2,200.3	1,508.3	529.3	2,035.6	2,006.6	354.0

*Ameren Corp. reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

Ameren Illinois Co.

Related Criteria And Research

- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009.
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008.
- Changes To Collateral Requirements For '1+' Recovery Ratings On U.S. Utility First Mortgage Bonds, Sept. 6, 2007

Ratings Detail (As Of December 29, 2010)*	
Ameren Illinois Co.	
Corporate Credit Rating	BBB-/Stable/NR
Preferred Stock (12 Issues)	BB
Senior Secured (7 Issues)	BBB
Senior Secured (6 Issues)	BBB+
Senior Secured (3 Issues)	BBB/Developing
Senior Unsecured (4 Issues)	BBB-
Corporate Credit Ratings History	
11-Sep-2008	BBB-/Stable/NR
29-Aug-2007	BB/Positive/NR
23-Apr-2007	BB/Watch Neg/NR
05-Oct-2006	BBB-/Watch Neg/NR
Business Risk Profile	Excellent
Financial Risk Profile	Significant
Related Entities	
Ameren Corp.	
Issuer Credit Rating	BBB-/Stable/A-3
Commercial Paper	
<i>Local Currency</i>	A-3
Senior Unsecured (2 Issues)	BB+
AmerenEnergy Generating Co.	
Issuer Credit Rating	BBB-/Negative/--
Senior Unsecured (3 Issues)	BBB-

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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Rating Action: **Moody's affirms ratings of Ameren Illinois Company upon reorganization**

Global Credit Research - 05 Oct 2010

Approximately \$1.8 billion of long-term debt ratings affirmed

New York, October 05, 2010 -- Moody's Investors Service affirmed the Baa1 senior secured, Baa3 senior unsecured and Issuer Rating, and Ba2 preferred stock ratings of Ameren Illinois Company upon the closing of a corporate reorganization combining Ameren's three Illinois utilities into one utility on October 1, 2010. The reorganization was accomplished by merging Central Illinois Light Company (AmerenCILCO) and Illinois Power Company (AmerenIP) with and into Central Illinois Public Service Company (AmerenCIPS), which has been renamed Ameren Illinois Company (AIC), conducting business as "Ameren Illinois". The debt and other obligations of AmerenCILCO, AmerenCIPS, and AmerenIP are now debt obligations of AIC. The rating outlook of AIC is stable.

Moody's assigned a Baa3 senior unsecured bank credit facility rating to three separate bank credit agreements totaling \$2.1 billion dated as of September 10, 2010 among Ameren and Union Electric Company (Ameren Missouri, \$800 million, the "Missouri Credit Agreement"), Ameren and AIC (Ameren Illinois, \$800 million, the "Illinois Credit Agreement"), and Ameren and Ameren Energy Generating Company (\$500 million, the "Genco Credit Agreement") and a bank group led by JPMorgan Chase Bank, N.A. as Agent.

Moody's upgraded three issues of Union Electric Company pollution control revenue bonds (Series 1998 A, B & C) totaling \$160 million to A3 from Baa1 to reflect the security provided by utility first mortgage bonds and the fact that the underlying rating on the bonds is higher than that the rating of the financial guarantor.

Ratings affirmed:

All debt ratings of Ameren Illinois Company (including all debt of the former Central Illinois Light Company, Central Illinois Public Service Company, and Illinois Power Company); including its senior secured debt at Baa1; senior unsecured debt and Issuer Rating at Baa3; and preferred stock at Ba2.

Ratings assigned:

Ameren/Ameren Missouri Credit Agreement -- Unsecured bank credit facility rating of Baa3;

Ameren/Ameren Illinois Credit Agreement -- Unsecured bank credit facility of Baa3;

Ameren/Ameren Energy Generating Credit Agreement -- Unsecured bank credit facility of Baa3.

Ratings upgraded:

Union Electric Company Pollution Control Revenue Bonds 1998 Series A, B, C rating to A3 from Baa1.

RATINGS RATIONALE

AIC's ratings reflect improved financial metrics exhibited by Ameren's Illinois utility subsidiaries resulting from higher electric and gas delivery service rates implemented in late 2008 and what Moody's had considered to be an improving political and regulatory environment for Ameren in Illinois. However, Moody's views the most recent Illinois rate case outcomes as unsupportive of credit quality, which could put pressure on the utility's financial metrics going forward, although they are expected to remain adequate to support current ratings. A rehearing of the rate cases is pending, with the Illinois Commerce Commission (ICC) staff recently recommending an additional rate increase of approximately \$11 million, and a final decision due from the ICC in November. The rate case outcomes have also renewed our concern about political and regulatory risk for the company in Illinois and the stability of AIC's ratings over the long-term is highly dependent on the outcomes of future rate cases and the overall regulatory environment for utilities in Illinois.

AIC maintains an adequate liquidity profile that was recently strengthened on September 10, 2010 when Ameren and its three Illinois utility subsidiaries entered into a new, three-year \$800 million, unsecured bank credit agreement, which is now available to AIC following the reorganization. The credit facility is shared with the parent company, which has a maximum borrowing capacity of \$300 million. In addition to this credit facility, AIC also participates in a utility money pool arrangement with the parent, giving it access to additional funds, if necessary.

As part of its Illinois utility corporate reorganization, Ameren Energy Resources Generating Company (AERG, unrated) was transferred from AmerenCILCO to Ameren Energy Resources Company, Ameren's unregulated generation holding company. Ameren completed the reorganization to better align its legal structure with its business segment structure, to lower costs, and to generate operational and other efficiencies.

The rating outlook of AIC is stable reflecting Moody's expectation that financial metrics will remain adequate to support its current ratings and that political and regulatory risk for AIC will not increase significantly. The most recent rate case outcomes should be sufficiently mitigated by additional recovery resulting from the pending rehearing process and by management actions to reduce costs and capital expenditures and should not result in a material degradation of these financial metrics. The stable outlook is contingent on future rate case outcomes being more supportive of credit quality.

The AIC ratings could be raised if there is an improvement in the regulatory and political environment for AIC in Illinois; if there are credit supportive distribution rate case outcomes going forward; and if financial metrics remain strong following the reorganization including CFO pre-working capital interest coverage above 3.5x and CFO pre-working capital to debt in the high teens on a sustainable basis. Ratings could be lowered if future distribution rate cases do not provide sufficient rate relief to maintain financial ratios; if there is political intervention in the regulatory process; or if rising costs and other factors put pressure on financial metrics including CFO pre-working capital interest coverage below 3.0x and CFO pre-working capital to debt below 15% for an extended period.

The principal methodologies used in rating these issuers were Regulated Electric and Gas Utilities published in August 2009, and Global Unregulated Utilities and Power Companies published in August 2009. Other methodologies and factors that may have been considered in the process of rating these issuers can also be found on Moody's website.

Ameren Corporation is a public utility holding company headquartered in St. Louis, Missouri. It is the parent company of Union Electric Company (Ameren Missouri), Ameren Illinois Company (Ameren Illinois), Ameren Energy Generating Company, and AmerenEnergy Resources Generating Company.

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This process will return a rate equivalent to the before-tax discount rate. This is the desired method of calculating the true effect of taxes on the discount rate. Several things are occurring here that lead to a result on a before-tax basis. Generally, the reason for calculating the IRR is that inconsistent growth rates between net cash flow and before-tax income are difficult to model in an easy-to-understand formula. Unfortunately, the downside to this process is that it is more complex and a little more difficult to explain.

Multiplicative Value Adjustments

Ad Valorem Tax Addback

The most common multiplicative value adjustment in ad valorem assessment is the addback of ad valorem taxes. Many assessors want to remove the historical bias resulting from prior valuations. Therefore, they may prefer to account for property tax within the discount rate. They do so by adding back to the discount rate the percent relationship of tax to market value. This adjustment is most similar to the linear adjustment in income. The difference is that the adjustment is a direct function of value. In other words, if the value increases, the adjustment increases directly with the value, and vice versa. This can be demonstrated by the next formula:

Formula 20.19

$$k_q = k + (o \times PV) \div PV = \frac{1 + (o \times PV)}{PV}$$

thus, $k_q = k + o$

where:

o = Percent of tax to value

And with the addition of a growth component (g), the formula expands to:

Formula 20.20

$$k_q - g = k - g + o$$

thus, $k_q = k + o$

The same formula can be used for any adjustment that is equal to a percentage of value. This holds true even in random changes in value. The only caveat is that the percent relationship to value must remain constant. This adjustment is quite powerful and easy to demonstrate, which is likely the reason for its popularity.

Flotation Costs

Another type of multiplicative value adjustment is flotation costs. Flotation costs occur when new issues of stock or debt are sold to the public. The firm usually incurs

several kinds of flotation or transaction costs, which reduce the actual proceeds received by the firm. Some of these are direct out-of-pocket outlays, such as fees paid to underwriters, legal expenses, and prospectus preparation costs. Because of this reduction in proceeds, the firm's required returns on these proceeds equate to a higher return to compensate for the additional costs. Flotation costs can be accounted for either by amortizing the cost, thus reducing the cash flow to discount, or by incorporating the cost into the cost of capital. Because flotation costs are not typically applied to operating cash flow, one must incorporate them into the cost of capital.

The cost of flotation is a function of size and risk. The larger the issuance, the lower the cost as a percentage of the issuance price. Flotation costs are the greatest for equity issuance and the least for debt issuance. Preferred stock flotation costs tend to be somewhere in between. The next table shows examples of the relation of flotation cost to size of an issuance of stock that occurred during 1996 and 1997.

Company	Total Issuance	Total Flotation
Excite	39,100,000	9.46%
Team Rental	52,000,000	6.76%
Amazon	54,000,000	8.57%
IXC	89,600,000	8.67%
General Cigar	108,000,000	8.28%
Ciena	115,000,000	7.96%
Capstar	166,500,000	7.68%
General Cable	354,900,000	5.94%
Sabre	545,400,000	5.77%
Hartford Life	649,750,000	6.50%

OTHER ADJUSTMENTS TO THE COST OF CAPITAL

In the property tax arena, traditional techniques are king. Any new approaches are met with skepticism, because the results of many new techniques tend to lower the market value of the project and, thus, the taxes. This is true despite the validity of such approaches. The next paragraphs identify four "newer" techniques introduced in the ad valorem arena in the 1990s.

Ex Post and *Ex Ante* Risk Premia

The expected equity risk premium is unobservable in the market and must be estimated. For both the Capital Asset Pricing Model (CAPM) and the build-up method, *ex post* and *ex ante* risk premia are used to obtain estimates for the cost of equity.

An *ex post* risk premium is based on the assumption that historical returns are the best predictor of future returns. It is calculated by subtracting the long-term arithmetic average of the income return on long-term government bonds for the CAPM or