

Energy Choice Matters

October 20, 2008

Exelon Makes Unsolicited, \$6.2 Billion Offer for NRG Energy

Seeking to capitalize on a 55% drop in NRG Energy's stock since July, Exelon made an unsolicited, \$6.2 billion offer to acquire NRG Energy in a deal that would create the nation's largest power producer.

The combined company's approximately 47,000 MW fleet, taking into account planned divestitures associated with regulatory approvals, would include 18,000 MW of nuclear generation.

The bulk of Exelon's capacity is in PJM (owning about 11,000 MW in Illinois and 11,000 MW in Pennsylvania), and includes former utility assets. Exelon does own about 2,000 MW in ERCOT (though no baseload capacity) and minimal capacity in New England.

NRG boasts nearly 11,000 MW in ERCOT, with some 7,000 MW in the Northeast and 2,100 MW in the West, with 450 MW in Illinois and some 2,400 MW in Louisiana.

Both Exelon and NRG are pursuing new nuclear units in ERCOT.

NRG sought to acquire Calpine earlier this year but was rebuffed. In 2006, Mirant offered \$7.9 billion in a hostile bid for NRG, but was met with fierce resistance.

The 40,000 MW range is seen by many analysts in the industry as the plateau which IPPs need to reach in order to weather volatility and ensure appropriate geographic and fuel diversity. However, although the target has been voiced by many analysts and executives, including Dynegy's Bruce Williamson, such mega-consolidations have either been opposed by the target IPP, or have run into regulatory hurdles due to underlying utility properties.

The failed FPL Group-Constellation Energy merger would have combined 45,000 MW of capacity, while the failed Exelon-PSEG marriage would have totaled 44,000 MW. A Calpine-NRG marriage

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MidAmerican Proposes Studying Ratebased Generation for BGE as Benefit of Acquisition

"The commitment to study the feasibility of BGE owning and operating a regulated generation facility in Maryland," is one of the benefits of the acquisition of Constellation Energy by MidAmerican Energy Holdings which is touted in testimony filed by the companies with the Maryland PSC as they seek approval of the transaction.

As a condition of the acquisition, Baltimore Gas and Electric would undertake an evaluation of the costs and benefits, including improvements to reliability, of BGE owning and operating a generation facility in Maryland. The evaluation will presume that the generation will be subject to the state's regulatory structure and earn a return on common equity at the level authorized by the Commission.

The evaluation will also assume that the site for the generation facility will be acquired at no cost to BGE's electric distribution customers. If, after assessment of the evaluation and the completion of necessary state approvals, the Commission authorizes construction of the generation facility as prudent and in the public interest, convenience and necessity, MidAmerican will contribute the site for the facility at no cost to BGE customers.

The study and recommendation would be brought before the PSC for review within 12 months after closure of the transaction.

MidAmerican also offered testimony stating it has "no particular preference" as to whether a state elects to permit retail competition, believing the question is a matter of policy for the state to determine.

As part of the transaction, BGE will offer on a pilot basis a home energy audit program to 500

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PUCT Staff Updates REP Certification Proposal

The PUCT Staff submitted an updated proposal for publication regarding REP certification standards, mostly reflecting discussion from the Commission's October 8 open meeting (Matters, 10/9/08).

The revised proposal removes the requirement that Commission approval is needed for a transfer of a REP certificate, as two Commissioners doubted the Commission had such authority under PURA. However, the latest draft does provide that any certificate transfer is defined as a "material change," and REPs would be required to inform the Commission of any material change to their certificate within 10 days of its occurrence. Such a filing will give the Commission the opportunity to ensure that the new holder of the certificate meets the certification standards. REPs are permitted to inform the Commission of a material change before the change actually occurs, allowing REPs to gain Commission approval for transfer before closing sale or merger agreements.

The new proposal also changes the labeling of REPs based on the type of financial qualification they use so that the terms "Tier 1" and "Tier 2" are not used, which Commissioners felt could be pejorative. As suggested at the open meeting, REPs' financial qualifications will simply be referred to as the relevant subsections of the rule -- (f)(1)(A) or (f)(1)(B).

Staff also included a series of questions for stakeholder comment regarding how customer deposits can be protected from a REP bankruptcy while still allowing the REP access to the deposits to cover nonpayment, and related issues.

DBS Energy Applies to Become Conn. Energy Efficiency Partner

Energy management consultant DBS Energy, which recently won an electric supplier license in Connecticut (Matters, 7/31/08), applied at the DPUC to become an Energy Efficiency Partner (EEP).

Legislators authorized the DPUC to spend up to \$60 million annually to fund projects that will reduce Connecticut's peak electric demand under the EEP Program. After a recent decision

in docket 07-06-59, the program will initially offer grants for gas-driven chillers and ice-based thermal storage.

DBS Energy, which sought qualification as a general partner and vendor partner of the program, intends to offer ice storage solutions, but not gas chillers. DBS is also seeking to have other services, including integrated building automation controls for peak load management and power factor correction systems, qualified under the program.

DBS intends to provide turn-key energy management solutions to customers, including education, installation, and ongoing management, monitoring and maintenance of programs and systems. DBS has a Network Operating Center (NOC) that is connected to each piece of equipment under management via ethernet communication and a dedicated Internet Protocol address, it told the DPUC.

DBS Energy's client portfolio for other energy management consulting services includes over 30 Connecticut municipalities and 600 C&Is.

PUCT Staff Doubts Market Benefit From Kelson Canal-Deweyville Line

Kelson Transmission has not demonstrated that the benefits from the proposed Canal to Deweyville 345-kV line are sufficient to justify granting a CCN, which would result in ERCOT customers bearing the project's cost, PUCT Staff said in testimony (34611).

Staff recommended that a CCN be denied for the \$290 million project, at least until the line is vetted and recommended through the ERCOT planning process. The line would connect the Deweyville switching station, near the Louisiana-Texas border outside of ERCOT, with the Canal switching station in Chambers County, Texas, just east of Houston.

Aside from reliability and storm hardening benefits, Kelson has touted the line as promoting wholesale and retail competition, particularly in accessing the congested Houston zone.

However, Staff cast doubts on whether any additional generation aside from the 1,200-MW Cottonwood plant near Deweyville would use the line. Staff also recommended abating the proceeding until the Commission rules on

Entergy's transition to competition plan, as Entergy's possible integration into ERCOT could open cheaper alternatives for transmitting Cottonwood's energy into ERCOT.

Staff noted ERCOT is addressing congestion and import limitations in its planning process, citing approved plans for three additional CenterPoint Energy substations to improve import capability, as well as ERCOT's long-term assessment for at least one additional major 345-kV line into the Houston area.

Staff downplayed the impacts of the Kelson line on the competitiveness of the market, noting that any impact that pivotal suppliers have in the market is declining, so the line would not offer much improvement in combating pivotal suppliers. The Kelson line is not needed for reliability reasons given the adequate reserve margins in ERCOT and robust level of generation under development within ERCOT, Staff added.

ISO-NE Sees Adequate Capacity Through 2014

New England is to have adequate capacity through 2014 if all the 34,077 MW of demand and supply resources that cleared New England's first Forward Capacity Auction are in commercial operation by 2010 and continue to clear in the FCA each year thereafter, ISO New England concluded in its 2008 Regional System Plan.

ISO-NE found a need for 360 MW of capacity resources in 2015, increasing to a cumulative need of 981 MW in 2017. "The success of the first Forward Capacity Auction, the submittal of qualification packages for over 12,000 MW of new resources for the second Forward Capacity Auction, and the over 14,000 MW of resources in the ISO Generator Interconnection Queue suggest that the capacity resource needs over the long term likely will be met," the ISO concluded.

Additionally, over 80% of the resources in the queue are in southern New England where they are needed, and, if successfully developed, will more than meet the region's capacity needs through 2017. These resources also potentially could postpone the need for major transmission projects.

However, when it comes to operating

reserves, the 301 MW of fast-start resources offered in the summer 2008 Forward Reserve Market (FRM) auction will not be sufficient to meet Greater Southwest Connecticut's summer operating-reserve requirement until Phase 2 of the Southwest Connecticut Reliability Project is implemented, which is expected in 2009. The project will reduce the need for operating reserves by approximately 500 MW in Southwest Connecticut.

The Greater Connecticut load pocket appears to need an additional 225 to 325 MW of fast-start resources from summer 2008 through 2012, a period preceding the expected addition of the New England East-West Solution (NEEWS) transmission project.

The Boston load pocket has approximately 225 MW of existing fast-start resources. Depending on load conditions, the Boston area will need a total of 100 to 450 MW of operating reserves during summer 2009, which will increase approximately 50 MW per year through 2012. An increase in fast-start resources in the Boston load pocket would help meet this need and would provide operating flexibility, ISO-NE said.

The system planning report also calls for greater fuel diversity, an assessment of the seasonal availability of gas-fired resources, and the enhancement of the planning process to meet FERC Order 890.

Likelihood of Downgrade, Bankruptcy Made MidAmerican Constellation's Only Option

Four unnamed suitors were pursuing a transaction to save Constellation Energy in addition to MidAmerican Energy Holdings and EDF, but only MidAmerican could provide the enormous cash infusion needed immediately by CEG to stave off bankruptcy, Constellation reported in a proxy filing detailing the days leading up to the agreement with MidAmerican.

EDF's initial offer of a \$450-500 million cash infusion would have been inadequate to stave off a ratings downgrade, as ratings agencies were demanding at least \$750 million in new liquidity to prevent a downgrade, Constellation said.

Absent new additional liquidity, a two-notch downgrade in Constellation Energy's credit

ratings to below investment grade would have required Constellation to post additional collateral in excess of amounts available from cash on hand and availability under existing, funded credit facilities, which would have rendered the company insolvent and would have forced Constellation to seek bankruptcy protection, CEG said.

That left MidAmerican's \$1 billion offer the only option to avoid Chapter 11, even though Constellation CEO Mayo Shattuck expressed "dissatisfaction" with MidAmerican's \$26.50 per share offer, and did not want to be acquired as part of a financing transaction.

MidAmerican's interest in CEG was unsolicited, with MidAmerican Chairman David Sokol calling Shattuck on Sept. 16.

Also on Sept. 16, Shattuck received a call from the CEO of an unnamed energy company interested investing in CEG. While the company was interested in acquiring specific limited assets of Constellation Energy, it would not be able to make the kind of rapid, substantial equity investment CEG needed.

Constellation advisor Morgan Stanley also received an unsolicited call from a private equity firm interested in a deal on Sept. 16. Two other unnamed energy companies met with CEG executives, but none of the suitors were either able to provide a definitive offer within the timeframe required by Constellation or were interested in a transaction that required the kind of substantial, immediate equity investment needed.

Although EDF later raised its offer to include a \$1 billion cash infusion, Constellation had doubts about whether the deal could be completed as quickly as necessary. While CEG wanted to explore the EDF offer further, MidAmerican would not waive its exclusivity provision, forcing Constellation into an immediate decision, which ultimately led to the acceptance of MidAmerican's offer.

Constellation also disclosed that in the wake of the Lehman Brothers bankruptcy, certain counterparties ceased trading with Constellation, and others requested "adequate assurance" of performance, including additional collateral.

Briefly:

Shell Energy Gets New Md. Licenses

The Maryland PSC granted Shell Energy North America licenses to competitively supply C&Is with electricity and natural gas (Matters, 6/5/08). New licenses were required after Staff concluded Shell's corporate re-organization was more than a simple name change from its former marketer, Coral Energy Gas Sales, and requested new applications be filed. Shell will market natural gas to non-residential customers whose loads are over 200 MMBtu/day at Baltimore Gas and Electric, Washington Gas Light, Columbia Gas of Maryland, and Chesapeake Utilities. Shell will market electricity to non-residential customers whose loads are over 1 MW at BGE, Pepco and Delmarva. The Commission also approved Shell's application to turn-in the old license of Coral Energy.

3 Phases Would Pay \$2,000 for Late Resource Adequacy Filing

3 Phases Renewables would be fined \$2,000 for filing a month-ahead Resource Adequacy filing three days late, in a draft resolution by the California PUC. 3 Phases filed its Resource Adequacy report for May 2008 on April 4, past the April 1 deadline. If approved, the fine would be \$500 lower than an original finding, with the PUC revising the amount on appeal to account for the fact that the report would have been one day earlier if electronic filing of Resource Adequacy reports had been implemented at the time, and because the PUC Staff, in its penalty notice, inconsistently cited what report 3 Phases had been late in filing -- showing that Staff can even err given the substantial amount of paperwork required by the Resource Adequacy compliance construct. However, given that the late filing was the fourth time that 3 Phases has received a citation for tardiness, the PUC would not lower the fine any further, and warned that it would not be inclined to look with favor upon appeals of citations issued on account of such behavior in the future.

Stanwich Energy Gets Conn. Aggregation License

The Connecticut DPUC granted Stanwich Energy Advisors an electric aggregator

certificate to serve commercial, industrial, municipal and governmental customers. Stanwich managing partner John O'Connell spent over two years as an account executive at Tradition Energy (Matters, 9/10/08).

PJM OKs Nearly \$2 Billion in Grid Improvements

PJM's board approved \$1.8 billion in electric transmission system additions and upgrades as part of the Regional Transmission Expansion Plan, though no new backbone transmission lines were included.

Exelon-NRG ... from 1

would have created an IPP with 45,000 MW. In 2006, a combination of Mirant and NRG would have boasted 38,000 MW domestically.

A combined Exelon-NRG would have an enterprise value of approximately \$60 billion and a market capitalization of \$40 billion.

Exelon's proposal is an all-stock transaction with a fixed exchange ratio valuing each NRG common share at \$26.43, representing a total equity value of approximately \$6.2 billion for NRG based on Exelon's closing price of \$54.50 on October 17. The offer represents a 37% premium to the October 17 closing price for NRG shares.

Exelon noted that NRG is "highly leveraged" with over \$8 billion of debt and a credit rating of Ba3/B+. The combination of Exelon and NRG would reduce the leverage associated with NRG's current business and enhance its credit rating, Exelon claimed. However, Exelon's credit rating is expected to be reduced by the transaction.

Citigroup Global Markets Inc. and Credit Suisse Securities (USA) LLC are serving as financial advisors to NRG, and Kirkland & Ellis LLP is serving as legal counsel to NRG.

BGE ... from 1

homes, modeled after MidAmerican's HomeCheck program in Iowa and Illinois. The free program would identify areas in the home where the most significant energy efficiency improvements can be made, with energy specialists checking the home's insulation levels, the efficiency of heating, cooling and water

heating equipment, and the condition of windows. Homeowners can then make cost-efficient decisions on improving energy efficiency around the home. The pilot's costs would not be borne by BGE ratepayers. Upon its conclusion, BGE will evaluate the results in considering proposing a broader program to the Commission.

Within 60 days after the close of the transaction, BGE will begin a dialogue on and evaluation of programs regarding energy efficiency and demand response offered by MidAmerican subsidiaries that might be prudent and cost effective for BGE customers. Within six months after the close of the transaction, BGE will file an application with the Commission to implement any programs that BGE reasonably believes will satisfy the state's standards for prudence and cost effectiveness. BGE will annually meet with other MidAmerican distribution companies to identify any incremental programs regarding energy efficiency, demand response, advanced metering and smart grid technology that might be prudent and cost-effective.

MidAmerican is not offering any rate credits or reductions as part of the transaction, since no synergies will be realized. BGE is not being merged with another utility, and will operate as a separate, autonomous "platform" in the MidAmerican family. Thus few cost savings are possible. BGE is also currently failing to earn its allowed returns on electric and gas operations and has not had an electric delivery rate case in more than a decade, the companies said. "Therefore, additional rate credits or reductions under such conditions would further undermine BGE's financial performance."

MidAmerican did say customers would benefit from \$70 million in various rate deferrals, including a reduction from 5% to 2.5% in the electric distribution rate increase cap from the Constellation-PSC settlement from this spring, and delays in filing electric and gas distribution rate cases until January 2011.

A new holding company would be placed between Constellation and BGE as a structural mechanism to provide ring-fencing for BGE, MidAmerican said.