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# Exelon Corp. *(EXC)*

Sanford C. Bernstein Strategic Decisions Conference

## CORPORATE PARTICIPANTS

**Christopher M. Crane***President, Chief Executive Officer & Director, Exelon Corp.***Ravi Ganti***Vice President-Investor Relations, Exelon Corp.***Jonathan W. Thayer***Chief Financial Officer & Executive Vice President, Exelon Corp.*

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## OTHER PARTICIPANTS

**Hugh de Neufville Wynne***Analyst, Sanford C. Bernstein & Co. LLC*

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## MANAGEMENT DISCUSSION SECTION

**Hugh de Neufville Wynne***Analyst, Sanford C. Bernstein & Co. LLC*

Okay. Good afternoon. Thank you all very much for joining us. We're very pleased today to have Chris Crane, the Chief Executive Officer of Exelon, with us today. Just one quick word on Chris's background, he is Mr. Nuclear. He has come up through the nuclear operations at Exelon running that fleet, and then took position of Chief Operating Officer and finally of Chief Executive Officer. But I think he's most at home inside probably boilers and control rooms, but now he's running the whole shooting match.

So, let me turn it over to him. He will give a brief presentation providing an overview of the company. Then we'd invite you to submit your questions using the 3x5 cards, and we can incorporate them into the Q&A. Thank you very much.

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**Christopher M. Crane***President, Chief Executive Officer & Director, Exelon Corp.*

Thank you, and appreciate the opportunity. And I know some of you in the room and – but for others that don't know about Exelon, I'll provide a brief overview. And for your reading pleasure, we have the forward-looking statement.

Exelon is one of the nation's – or is the nation's largest competitive integrated energy company with our 35,000 megawatts of generation. 52% of that is baseload nuclear; 28% natural gas; about 10% renewable, hydroelectric and renewable; and then there's the other, a very small portion of coal.

We merged with Constellation last year, giving us the leading competitive energy provider in the U.S. Exelon as a standalone was very heavy baseload, long on generation. Constellation had established a very good platform for wholesale and retail sales, and they were short, so the marriage really put us together to be able to better get to market with our products.

And the other part of Exelon is our regulated business – those first two are competitive – is our regulated businesses where we hold Commonwealth Edison, the utility in the Northern Illinois area; PECO, the Southeast Pennsylvania, Philadelphia Electric; and Baltimore Gas and Electric in Baltimore. We're serving 6.6 million customers across three diversified areas. And we have an opportunity, I'll talk a little bit more about, on some significant investments there with quality returns on our investments.

We are probably the largest from a national presence. We're selling gas or electricity in 47 states and also the province of Alberta, small holdings there. We serve about two-thirds of the Fortune 100 companies through our Constellation business. And as I said, the utilities give us that large urban presence for operating in across the states.

We have a unique combination of scale and scope in the industry. You couldn't create the diversity that we have today. We have some small upstream business in exploration; that's mostly strategically done for market intel, understanding the costs, and since gas is setting our margins, staying close to the gas and oil industry helps us out there. We have our conventional generation, as I mentioned, the 52% nuclear, low-cost, baseload, clean generation with gas after that.

A couple of years ago, we started to move into the renewable area, acquisition of John Deere Wind. We've continued to grow that out. We have about 1,500 megawatts of wind. And we're continuing to grow in solar in the southeast part of the country.

The electricity, the gas and the electric business is the annuity in the portfolio. What we've done a lot of work around, better rate recoveries on that, our retail, and then beyond the meter.

But we create value through some core values on operational excellence. We are an operations-focused organization not only on the nuclear side but driving the discipline for safe, reliable and repeatable operations across our fleet. A discipline in growth and in investment. We've made some significant investments over the last couple of years that have paid off for us. And we continue to approach that. Financial discipline is a core competency of ours, as is regulatory advocacy, working within the markets. And I'm sure we'll talk about the latest capacity auction. So we'll talk about our actions around that in one of the questions.

We currently have significant investment opportunities in the out-years. The current five-year plan has \$16 billion of growth investments that are currently in the plans: \$13 billion at the utilities and \$3 billion at the Genco. With our operational excellence and our financial discipline, we believe we'll be creating 5% to 6% annual growth rate at the utilities and continuing to make investments in mostly contracted renewable generation that de-risk the portfolio over the next couple of years.

If you look at the incremental growth drivers including the operational efficiency, we have the intrinsic value creation and we have the opportunistic value creation. The intrinsic, we continue to pursue a strong balance sheet. As some of you may know, at the first part of the year we reset our dividend policy to be more in line with the current market. We had a 40% reduction in our dividend. We stressed that dividend reduction to make sure it was sustainable in all market scenarios, ups and downs, and it really is pegged at by 2017 after a significant spend-out in the utilities, that the utilities would carry the burden of the dividend, allowing us to use the balance sheet and the growth capital on the growth side of the business for other opportunities.

We continue to work on productivity improvements, investing in the utilities. And we have some – one uprate that's under work now which should complete within a year or so. And we have a few other uprates on our nuclear reactors that we've suspended just because of market conditions doesn't warrant the investment at this point.

The opportunistic, with having the scale and the scope and the access to be able to take advantage of our portfolio, we can continue to work on contracted generation and potentially conventional. Merchant generation, if it's in an attractive market and we see it as accretive. The regulated is not something that we would be working on right now. We think that the sole – or the total regulated utilities are trading at a premium and we think we're undervalued. So you would not want to be trading your equity at that time. But on a fairly – on a fully open basis, \$1 of gas increase equates to about \$5 of megawatt hour. And that, for us, the upside is \$1 billion in gross margin on a fully open position. So, as it's been pointed out, we have the most sensitivity to the recovery in the gas and electric markets than any other in the sector.

So, our company and our value proposition, we believe in clean energy and competitive markets. We have our challenging days. We have our ups and downs. It's a market that we're in and we'll be staying in. Our management model for our fleet operations is world-renowned, not only in the nuclear side, but as we continue to develop our skills on the – running the wires business. With the Constellation merger, we do have, as I mentioned, the leading retail and wholesale platform. And we do have a track record of making sound investments for growth over the last few years, and we'll continue it.

So we are focused on value return to the shareholders, sustaining the dividend with opportunities of growth in the future, pursuing opportunities of earnings growth, either with business efficiencies or opportunistic or intrinsic investments, and, as I said earlier, an unparalleled upside to the commodity price recovery.

So that's a quick overview there.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

Thanks, Chris. So again, if you have any questions, just hold up your cards. We'll collect them and add them to the Q&A.

So maybe we'll just attack the PJM capacity auction results, get them out of the way first thing. The RTO capacity price fell from \$136 a megawatt-day in 2015-2016 to \$59 a megawatt-day in 2016-2017, MAT capacity prices fell from \$167 to \$119. Maybe you could talk to us a little bit about the expected gross margin impact of that. Is that more or less the magnitude of the gain that you've enjoyed from higher forward prices since the beginning of the year or how do you think about it?

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

We're disappointed in the auction. It seems like every couple of years we learn something new in an auction and then we go to work to make sure we can either adjust the rules or better model for the change. We, like everybody else, did not anticipate the imports that came in and 35% of them not having transmission, and I don't think we fully appreciated the desire for risk to be taken on developing new assets, unsubsidized assets, in the RTO.

That said, it's disappointing but not devastating. We'll look at it. We'll analyze it. We'll see if there's anything to work on in the stakeholder process. And as the weeks come ahead, we'll learn more about it.

We do believe that it did not disrupt the upside that we see in the energy markets. As we said at the first of the year, we saw a \$3 to \$5 upside as the coal units retire and as supply tightens the coal to gas switching, new capacity having to come on in some areas to cover that. That will improve the market. Although there may be some small effect of the new capacity coming in, we don't think it will have a significant effect on those prices. So now we're thinking, so that we've seen a dollar plus come in since the first of the year on those forward prices as

more liquidity turns into 2015 – or comes into 2015, we should see the rest of the upside. And again, from the first of the year on a fully opened position, that would be about \$1 billion, about twice the amount that we lost in a single year, but it would be repeatable year-over-year. So, still feel like it's a solid upside and we've got the right position for it with our fleet.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

Do you see – I don't know if you could hazard a guess this far out, but do you see capacity prices continuing to hover in this relatively low range that we've seen over the last three to four years or?

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

I'd qualify this. We need to do more of an analysis and get more details. But from what we've looked at over the weekend, we do not think it's sustainable. You cannot get a return on your capital at \$60 a megawatt-day on a newbuild. And if you look at the basis differential on the energy costs where – or the energy market where these inputs are coming from, they're actually leaving higher priced markets to come into a lower priced market to take advantage of a capacity payment; not sure of the arbitrage there when you're wearing the risk of transmission. So we'll have to learn more.

I have not heard who won or if anybody has issued a press release congratulating themselves on the win, but \$60 a megawatt day is not sustainable from our modeling on either newbuild in the RTO or imports of existing assets with the transmission risk in some of the locations we heard they might be coming from.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

Just to press that a little bit further, is the cost of newbuild really the relevant benchmark any longer, or is the success for the auction in keeping capacity prices low evidence that the marginal cost of supply is set by something else, demand response, uprates, imports from the plants that are relatively close by?

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

Well, it did show that this year that there was bidding behavior that entities were willing to take more risk. Again, this is just on a couple of days review. We do not think it's sustainable. We think that cost of new entry is a pertinent number. There's some variation around it. If you own a brownfield site that a switchyard is already in, is it the \$180 a megawatt-day or is \$120 a megawatt-day? So there could be some variation that makes it relatively relevant, if that's the right way to phrase it. But at \$60, we don't understand how; you're just throwing capital away.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

For folks that may be a little bit less familiar with your long-term energy price forecast, maybe you could just take us through the key drivers of your view that in 2015-2016 we'll be looking at materially higher energy prices than those that are embedded in the forward curves.

## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

Keeping it on a higher level, more simplistic level, we have – because of natural gas prices and environmental rules, there's 20,000 megawatts retiring – we believe will be retiring out of the system by 2015. And that date is set by the implementation of the EPA MATS rules. And we've seen 16,000 megawatts of those announced. We know in this auction 10,000 megawatts of coal did not clear. So we see that our 20,000 number, we believe, is a realistic number and it could be slightly more than that. That retiring and what the cost is of the marginal producer after that would put it into that range in a high level. There's many more variables in it. You can talk about where the new plants are being built versus where the plants are being retired, transmission constraints, other things, but that's where our confidence comes from.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

What are the other elements of your power supply business? You're running an important retail power marketing business. I don't know maybe if you could comment for us a little bit on how that complements your wholesale generation. And then maybe we can talk a little bit later about just the profitability of that business and the direction of those profits.

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

Sure. We have – with Constellation being part of the portfolio in Exelon Generation, it creates optionality for us that we did not previously have. We were building a retail organization, but we're in it – it was in its infancy and mostly supplying to C&I customers, commercial and industrial customers, versus residential. Having the ability to take the baseload and in some of the mid-market peaking assets into that portfolio management concept, that we have the optionality of moving the power either through the wholesale markets or into the higher margin C&I market or into the mass market, which is the residential. We have transfer pricing mechanisms within that organization that build in risk each step of the way. It's less risky to sell a baseload-based product into a wholesale market than it is to sell to a C&I on a shaped basis or into a residential on a shaped basis, which means it goes with the weather cycles, the daily curve of demand and how you have to cover that or hedge for it.

So if we see the margins tightening, which they have in the retail market, we can stay more in the wholesale side through portfolio optimization. As we see the margins continue to improve, we can move power into the other segments.

What we've seen in the last year, and it's actually started to improve, is very tight margins on the residential side. There's been a lot of competition. There was a – more of a land-grab philosophy, we think, in the competitiveness of the market. Some of the states like Illinois opened up to municipal aggregation where the city actually went out and bid with competitive suppliers to supply the electricity at a discounted price. There was some very competitive pricing put in on that. We won a very small fraction and we're okay with that. We don't want to wear that risk or have those tight margins. As that process was going on and we started to see more reasonable pricing come in – but still, we – the last big one was the city of Chicago. We were down selected to the two finalists and we did not win that one. And we're okay with it. We understand the margins that we have and the profitability around it.

And so we like the business, we like the margins when the option is there, but we'd prefer the optionality of moving the power to where we feel we're getting the best return.

**Hugh de Neufville Wynne***Analyst, Sanford C. Bernstein & Co. LLC*

What type of retail power margins are you seeing now? Where do you think they will normalize over time?

**Christopher M. Crane***President, Chief Executive Officer & Director, Exelon Corp.*

So they've stepped down over the past couple of years. I think we quoted at the first of the year the \$2 to \$4 margin area that we thought was in retail, and we're seeing that on the lower side right now. As we are going to market in providing pricing to new business or to sign up existing business, we're coming in with higher prices as our competitors and we're seeing a slowing of signup or re-sign. So I think we're in that transition phase that the prices would start coming back up and what the new business and the customer base will look like. The customers have enjoyed for the past five years a constantly decreasing price, and this is going to be the first time where we've hit the floor and start to come up on the back side.

So it will change and it will tighten I think a little bit more. Our folks are having to make the decision, do we go for lower margins with higher signup rates. That has – depends on basis differential, depends on weather opinions, it depends on the risk parameters that we want to put into it. We do not intend on going in and losing money on these, so we're maintaining the discipline.

**Hugh de Neufville Wynne***Analyst, Sanford C. Bernstein & Co. LLC*

Is there a – you mentioned that, I think, every dollar on the gas price was about \$5 on the round-the-clock power price and about \$1 billion of gross margin...

**Christopher M. Crane***President, Chief Executive Officer & Director, Exelon Corp.*

On a fully open position.

**Hugh de Neufville Wynne***Analyst, Sanford C. Bernstein & Co. LLC*

Fully open position. How does it work with retail margins? You say you're at the bottom of a \$2 to \$4 range. What would happen to your gross margin if you went to the top of that range?

**Christopher M. Crane***President, Chief Executive Officer & Director, Exelon Corp.*

I'd have to look at those numbers. Jack is here.

**Jonathan W. Thayer***Chief Financial Officer & Executive Vice President, Exelon Corp.*

[indiscernible] (21:23)

**Christopher M. Crane***President, Chief Executive Officer & Director, Exelon Corp.*



Okay. That was \$60 million to \$80 million. I got the brains over here, our CFO. So \$60 million to \$80 million on every dollar of margin.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

Okay. Now, that's a business – retail power supply, or let's say supplying full requirements retail electricity, is a business that in many ways is fraught with risk because you've got to accurately predict load profiles and supply – or procure and supply the power to meet that load profile. And a number of competitive retail suppliers have incurred significant losses when they did that incorrectly. For example, Gexa in the very hot Texas summer two years ago, and there are other examples sprinkled around the industry of estimates that proved to be wrong simply because of unusual weather.

So what's your estimate of the risk of that business? You've been hanging back from some opportunities where the margins were too low. Do you think that at current margins you're being adequately protected against the risk of some of these misestimates and consequent losses incurred in the supply of power?

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

So, first of all, we are quite experienced on covering shaped loads. We did it for PECO during the transition. We did it at BGE. We did at ComEd. So we wore the risk and covered the shaped product.

We look at each region a little bit differently. Texas is the most volatile. You have to understand your position in Texas. We try to match the load with our generation and maintain margins. We have some high heat rate units that are our insurance in Texas. So but you keep some length and you prepare for that. We do make sure we have our anticipated hedge, but we understand the volatility's there and how to protect it. If you go to – if you had gone to New England, typically – and I think this summer – or this winter changed that a little bit, you don't have the volatility in the summer that you've seen in other places. In the winter, we're starting to see more volatility. So how we cover the winter load and commitments in gas with the gas constraints coming into New England and New York is somewhere in the middle. So I think we manage it well.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

One of the sort of fascinating things, in a way, about Exelon is that you run this very low-cost, very high-capacity factor portfolio but it's comprised of a bunch of plants that nobody could afford to build today, particularly in a competitive environment. So you can't grow your business by adding that type of capacity. You've got to grow your business, if you grow it at all, by adding capacity that's competitive today, which might be combined cycle gas turbine, and I take it from your earlier comments that you think even that's not rewarded by current energy and capacity prices. So how do we think about opportunities for growth on the generation side of the business? Is it purely a matter of energy and capacity prices recovering or are there things that you can do to – that contribute to higher gross margin through uprates or efficiency improvements or anything else?

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

So your first point is right on. There is no way to duplicate the portfolio that we have ownership in, the 24 nukes, low-cost basis and we do operate them very well. You can think about them as mines with about 30 years left in them. So they've got a long runway, but they have a defined life in that one day they'll be tapped out. So we watch the investments closely to maintain those and we continue to analyze opportunities to take that free cash flow and



put it to work. And if it's growing in renewables space or it's growing in natural gas, it would not be growing a generation – or a conventional generation in PJM. Right now, the 2016 auction shows there's a 21% reserve margin. It's not the time to be building with a \$60 a megawatt-day price put on capacity. You're not getting the signals to build or – and we understand there's no need based off of the reserve margin.

There are other markets to grow into. Texas, if we have some resolution this summer on a potential capacity market, I think that will give us more clarity on investing, either buying or someday maybe even building in Texas. But it would be CTs, CCGTs, lower capital intensity, faster to market, lower – or shorter dilutive period. I do not see in the competitive market with the current technology, and I'd say in my lifetime might be too long – I hope it's too long, but the ability to spend \$16 billion on a six-year capital cycle to install a dual unit 2,400 megawatt nuclear site. It just – the market's not designed for it. We wouldn't be able to take the risk.

That said, we do see technology being developed in the small modular reactor where the capital cycle is much shorter it's much smaller. And you buy the units, you put them in, you start ganging them and you can build it up if the market signal's there. So that will be the savior to nuclear when demand comes back in the competitive market. Otherwise, you would just build gas, or if there's a coal technology that becomes competitive and clean, that's a potential, but we don't foresee that. So we have to look at opportunities, one, outside of PJM where we do have some market power issues; two, in a market that it will reward you for a newbuild or for growth. But it's not a looming crisis. As I said, we have a pretty good runway on the majority of our fleet, and if they're run safely and reliably, they would be the last things to come out of the stack on conventional generation in the right market design.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

It is a fleet, however, that has fairly significant CapEx requirements. Despite the fact that it's not growing, it's a fleet that requires a fairly high level of maintenance CapEx. You may – I guess this is a question for you. You may face some additional environmental compliance costs associated with 316(b) and the cooling water intake regulations. Can you talk about that at all? I mean, what is the level of capital expenditure that you see is required to maintain this fleet at its current capacity and what might be required incremental to that for environmental compliance?

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

So over the last 10 years we've been putting more capital into the assets to prepare them for plant life extension. A nuclear asset, they're originally licensed for a 40-year life. There is a provision that you can extend them by 20 years, but when you extend them by 20 years, you need to replace turbines, replace – rewind generators, replace transformers, pipes, valves, control systems. So we've been going through a spending plan that actually does increase the value of the asset. So it's not just maintenance. It's extending the life out.

We're coming to an end on that period. We just filed for two more license extensions at our Byron and Braidwood plant in Illinois. We'll only have two license extensions left to file, on our newest plants, which are LaSalle County and the Clinton plant in Illinois, and we'll be working on those over the next couple of years.

So we anticipate the maintenance capital to start to go down across the fleet. We see that, excluding nuclear fuel, which we buy on the capital side and amortize it over the utilization of the fuel, we see that going down below \$700 million, which will be a reduction in what we've been averaging which is over \$1 billion for the past years. And as the units age and they come closer to the end of the life, we have one plant that will come offline in 2019, we analyze that capital spend to make sure it's still accretive and we get a return on it. You get to start to pull back

on the capital, as we have on the unit, because it's coming to the end of life in New Jersey, and we try to keep that in balance. Something happens towards the end of the life that's a large capital expenditure, you make the decision to shut it down early or not, and that's in our models also. 316(b) – I'm sorry.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

Yeah, sure.

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

316(b) is a cooling water for entrainment and impingement of fish – aquatic life at cooling plants across the country. We have worked closely with the industry groups and with the EPA. We think the rule will be finalized at the – in June timeframe. We've had a couple of iterations on it. We feel that there will be capital to be spent, but we don't think it's going to be material. That's contingent on the definition of best available technology, and not deeming that cooling towers are best available technology. So some very technical phrases that we're in one of the iterations of that that I think we have worked well with the EPA to fix. We'll spend money, but it won't be to the point that we're questioning the viability of plants.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

Okay. One regulation that's looming is EPA regulation of CO<sub>2</sub>. They have proposed a standard for CO<sub>2</sub> emissions from new fossil fuel plants. When that's finalized, which may occur this year, they'll be obligated under the Clean Air Act to propose emissions limits for existing plants. Do you have a view on how those regulations are likely to play out, what the implications might be for energy prices in PJM?

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

Nobody has a bigger upside to a CO<sub>2</sub> rule on existing plants than Exelon. The position we're taking at this point is we need to stop all regulation changes. Let's let this market settle out. But included in that is stop the production tax credits in subsidizing one generation over the other. We're all having a very difficult time looking at where we should be putting our capital. We think we need to understand what the goal is. If we've had a coal to gas switching, what's the CO<sub>2</sub> loading on the country, what should the rule be, how should it be constructed. Disadvantaging one over the other on the production tax credits has had a – has a negative effect. So we're saying let's have a holiday. We don't need the distraction. We need the market to settle, we need those to retire that are going to retire, we need those that are being subsidized to stop being subsidized and for future growth and figure out what the new norm is so we can create some predictability.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

You may get a holiday on the PTCs and ITCs because those are sort of subject to annual renewals. And if I remember correctly, the last renewal was for projects that broke ground by the end of 2013. So it might capture some projects that come online in 2014. It seems unlikely that you would get a holiday on this particular regulation, the CO<sub>2</sub> regulation, because to obtain a holiday would require some amendment to the Clean Air Act, and right now, Congress isn't in a mood to get much done. So maybe I could press a little bit harder and ask you to say what you think the outcome is likely to be there and whether that's a potential upside or not.

## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

I'd have to go back and look at it. My understanding is, under the Clean – I did not believe, and I could be wrong, and Ravi or [ph] Andy (34:28), jump in here, that CO2 was part of the Clean Air Act. I think it was an add-on or it's a conceptual add-on. But again, I could be wrong on that, and we'll verify.

I think it will be a terrible distractive fight right now to try to push it through on this Congress, and it creates some lack of predictability. If we could have a bipartisan conversation on a clean air standard that could take into consideration all the sources and what the desire was for the sources – we're looking at projections in California of potentially negative pricing during the middle of the day because an over-application of renewables. We see in Illinois 8% of the time at a few of our plants negative pricing because when the demand is down, the wind turbines are blowing. We're trying to make decisions on investments and reliability not only transmission, but on the generation side for a stack that exists today and a market that exists today. So, like I said, we could step back and say let's have the fight for CO2 because we have the biggest upside, but I don't know if that's the right thing for the market at this point. And are you guys checking on that CO2? Yeah.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

We have a few questions from the audience here that – some have to do with the capacity results – capacity auction results. Some have to do with the price of natural gas. Let me just put these ones on natural gas to you first. The first question points out that there are large and increasing natural gas resources being developed in the Marcellus and Utica shales and in the – underlying the PJM power market. The questioner points out that that could continue to pressure prices in the power markets. Can you restructure your business model to live with low prices for energy, and now apparently on the PJM side, for capacity over, say, a five-year timeframe?

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

So we have stressed that we don't anticipate that this is the case, but we have stressed the balance sheet on a fully open position, with the restructuring we've done on the dividend, we survive at long-run, fully open position \$3 gas. We don't see \$3 gas as being a long-run number. As we look at it, to gain the return on the capital for the E&P folks, depending on what the location, wet or dry, it goes from \$4 to \$6 depending on if it's offshore, and even higher. So we believe the price that today is in play, we still see the upside. Today, that's probably about \$4.30 on the spot market. We use the forward strip as our base case. We don't use the belief that we're coming up another \$1 in natural gas or another \$1.50, the new norm is going to be \$5.80. But we just deal with what it is currently on the strip and stress it's what we think is an unreasonably low number on a fully open position, and it's sustainable. Not advantageous but sustainable.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

Next question is kind of related to the prices of gas and power. The questioner asked, could you please walk through your hedging strategy and, in general terms, your hedge book, the positions hedged for 2013, 2014, 2015, et cetera.

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

Sure. We do have a belief that there's – we have a ratable hedging strategy, and so what we're doing is selling a third, third, third of our forward capacity into the market. So when we come into a prompt year, January 1, that year is usually about 90% sold forward, 60 some-odd percent the following year out, and 30 some-odd percent after that. So it's a ratable strategy.

We have – within our risk tolerance have some parameters where we can go ahead or behind that ratable by some 8% to 10% based off of our view of the markets. If we think the market is really strong in the forwards, we may capture some of that upside and go above ratable. If we think the market's weak and doesn't reflect, we can go slightly below ratable. And right now in the forward years, the out years, we are slightly below ratable. We've protected, in some cases, using gas options, put options. We've protected the floor on some of that length that we have and we preserve the upside, so we're probably using more options now than we have in the past, but slightly behind, use some more options, we hope to capture the upside on the out years.

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## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

A couple of questions go to the kind of integrity of the PJM capacity market. One questioner points out that FirstEnergy believes that the PJM capacity market is broken, asked if you share that view.

The second question is a little bit more specific and goes to whether the penalties in the PJM capacity market for generation and demand response that clears but does not show up are sufficiently stringent.

And so I guess the folks are kind of asking your perception of the quality of the market and whether it needs to be reformed in important ways.

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

So I don't think it's broken. We're disappointed in this auction, but we participate in all the competitive RTOs and, by far, the PJM capacity auction is the best structure. We have, over the years, had to work on elements. It's only an 11-year old or 12-year old market. We've had to take lessons learned, if it was demand response, and have that evaluated and rules adjusted around that through a stakeholder process that has all the – not only the generators but the end users involved in it.

We most recently made some significant improvements on the minimum offer price rule on subsidized generation. And I think that has helped. And this is – it's very early in the review to say it, but this is an unanticipated, I think, auction where more inputs came in and maybe we're bidding zero and have a very tough time to secure the transmission. We'll have to evaluate this circumstance and, like before, if there's things to change or adjust – if you're Terry Boston and you're PJM, you'd say I had a very successful auction. I have a 21% reserve margin. I was able to lower the cost for the consumers. And that would be their opinion. It very well may be they're right, and then we have to reevaluate what we think the circumstances are to change. But I personally believe that the \$20 a megawatt-day penalty may not be enough versus the optionality that it creates.

My understanding of the intent of the capacity market is to ensure there's adequate capacity three years out, and that capacity is directly tied to reliability and you do not want any games being played with that. It needs to be delivered and the commitments should be there to deliver it. It shouldn't be a speculative market that you're looking for optionality. And then if that is the case, I think the rules need to be adjusted for that.

## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

Just to be kind of 100% clear, I guess you're basically saying that you think that perhaps the penalties for generation and demand response does not show up, may not be quite stringent enough. What are the penalties right now? You have to disgorge your capacity payment and pay a \$20 per megawatt-day penalty or?

## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

Yeah. It's the 20% or \$20 a megawatt-day, whichever is higher. And so, on a \$60 megawatt or \$59 megawatt-day clearing price, if you don't deliver on day one and you haven't procured in the aftermarket capacity auctions, if you haven't procured to cover that, you would pay \$80 back. There's an optionality play depending on the size and the megawatts, we have to evaluate it. I don't want to indict the process until we know more about it. But definitely, it's not – it shouldn't be structured for optionality. It should be structured for true delivery to create the confidence and reliability.

## Hugh de Neufville Wynne

*Analyst, Sanford C. Bernstein & Co. LLC*

We're getting close to the end of our time, but I wonder if you could just have a quick look at the regulated business. About half of your \$5.5 billion in annual CapEx goes to the regulated business. With the exception of PECO, those businesses have for years earned returns that are below Exelon's cost of capital. Can those businesses be restored to acceptable levels and how and over what period of time?

## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

I think we've done that. I think we've accomplished that in the last year. In Illinois, we've worked with the state legislature to come up with not only an investment plan to install smart meters to upgrade the grid to have better intelligence on the operation and the optimization of the grid, storm hardening, and we're putting a significant amount of capital to work under a newly structured formula rate. We had that passed. There was some issues that we had to deal with at the commission level. We had to go back to the legislature. We were able to fix that. So now it's essentially 580 basis points above the Treasury. As interest rates increase, as they should, our returns increase, and so we feel much better about Illinois than we have in the past.

Pennsylvania is a fairly robust regulatory environment and the riders that they have in the state allow us for those large expenditures on gas and electric, a way to recover.

In Maryland, things have improved greatly. Our last rate case gave us a much improved return on equity. I think you can say it's one of the best rate cases without any controversy around it in many years. It's understood that we'll be filing on a regular basis. We have filed again as we're putting in the capital. The capital – the larger capital that's being spent in Maryland is around the smart meter and storm hardening, and we have had support at the administration level and at the commission level on going forward with that.

So we think we're in a much better place than we were a year ago, two years ago and we'll continue to work on those relationships.

The number one thing that's going to be key there is no rate shock, which we think the lower energy prices, perversely, will help in that to allow us to make those equity investments, and a higher level of customer

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satisfaction through reliability. I think putting the three utilities together is helping us on that, sharing best practices. When the storm – when the Hurricane Sandy came, we rolled hundreds of trucks from Illinois. We positioned them at PECO and BGE. We were able to get our customers recovered, and in fairly quick turnaround, and then move on to help other affected areas. But the size and the scale that we can bring to bear to drive that reliability and customer satisfaction also is a key for us to have the right regulatory compact in the states.

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**Hugh de Neufville Wynne***Analyst, Sanford C. Bernstein & Co. LLC*

Good. Well, I'm afraid that's about all we have time for.

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**Christopher M. Crane***President, Chief Executive Officer & Director, Exelon Corp.*

Ravi?

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**Ravi Ganti***Vice President-Investor Relations, Exelon Corp.*

[indiscernible] (47:30)

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**Christopher M. Crane***President, Chief Executive Officer & Director, Exelon Corp.*

Okay. You had it right. We'll see how our flight goes.

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**Hugh de Neufville Wynne***Analyst, Sanford C. Bernstein & Co. LLC*

Thank you very much.

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**Christopher M. Crane***President, Chief Executive Officer & Director, Exelon Corp.*

Thanks.

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