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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.

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Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

MANAGEMENT DISCUSSION SECTION

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Good afternoon and thank you all very much for coming today. It's my pleasure to introduce Chris Crane, President and Chief Executive Officer of Exelon. Prior to Exelon's merger with Constellation in 2012, Mr. Crane was President and Chief Operating Officer of Exelon. And his background is on the power side of the business.

Chris became President of Exelon Generation in 2008, and became Chief Nuclear Officer in 2004. Including his 15 years at Exelon, Mr. Crane has accumulated over his career more than 30 years in the nuclear power business, having worked at nuclear power plants across the country including Browns Ferry, Comanche Peak and Palo Verde, which is the nation's largest.

So today, we're going to start off with a brief presentation by Mr. Crane followed by a fireside chat and questions. We have a lot of ground to cover. So I'd encourage you if you have very important specific issues you'd like us to address to write them down on your cards now. We'll have somebody pick them up after the presentation and that certainly won't preclude us from taking further questions later. Chris, come on in.

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

Thanks, Hugh. And thank you, everybody, for coming. I'll give you a – look at the forward statement, give you a little bit of an overview of Exelon first, and then go into some of the current themes or trends that we're seeing in the marketplace. We're what is referred to as a competitive integrated electric and gas supplier. Exelon Generation is made up of two business segments: the power generation segment and our retail sales organization. We have, as you see, over 35-gigawatts of capacity, a significant footprint on the nuclear side.

We're the largest nuclear operator in the country with responsibility over 24 assets and we're the third largest in the world. We have a significant gas generation, natural gas generation that we continue to optimize as the market changes. And we've been growing our renewable business, wind and solar, over the last five years or six years. So our Generation portfolio is contained within all competitive markets. On a Constellation side, Constellation came in as part of Exelon a few years back as you mentioned. It's the leading competitive energy provider.

We have over 1 million customers on the competitive side. A large part of that is our commercial – from a sales perspective, is commercial and industrial. We also have a retail division that handles supplying at the residential level. The portfolio of Generation assets allows our portfolio management organization and our Baltimore operations at Constellation to really optimize, and we're uniquely positioned to be able to take whether commodity cycles and different weather fronts going forward.

On the right-hand side, you'll see the Exelon utilities currently is ComEd, PECO and BGE. We're one of the largest electric and gas suppliers in the country. Those three utilities are primary urban-based Baltimore, Philadelphia, and Chicago is there's a significant investment we're making in our utility business over the next five years, \$15 billion of capital spend on that side that would not only provide good returns in the future for shareholders, but also improve reliability in the customer experience going forward.

What we've seen, if you follow our stock at all, there's been a marked improvement since the first of the year from what we've seen in the last couple of years. Previously, last two years recent, there's been a lack of volatility in the market. There hasn't been any significant weather events and it was driving most of the consumers to buy on the spot market. But as you can see from this very busy scattershot (sic) [scatterplot] (04:32), 2013, 2012 you're on the much lower side on pricing.

If you look at 2014 and this NiHub is – we're great on acronyms in this industry. But that's the Northern Illinois region of PJM, which is the regional transmission operator. You can see a whole lot of volatility that's come into the market. On the right-hand side you can see what's happened to the forward strip on the reaction of the volatility in the spot market. We think that the behavior changed during the polar vortex. We think it now is sustainable. We've been modeling this increase over the last couple of years and it was pushed faster out onto the forwards based off of what we saw during this winter.

Portfolio value and positioning, we have some sensitivities on the bottom. You can see what happens to our gross margins plus \$5 a megawatt hour, minus \$5 a megawatt hour. But since our last disclosure on March 30, we've seen our net hedge increases by \$430 million go up by \$350 million in 2015 to \$600 million in 2016. There has been some tempering on those prices, maybe about \$50 million to \$100 million off, respectively, in both years but they're still very positive.

Our hedging strategy has been, as we've announced it, somewhat more opportunistic. We're still stay within this, what we call, a ratable hedging strategy. We try to sell a third of our product through on the forward year, so as we come into a prompt year January 1, we're about 90% sold forward. And so you drive that through the forward three years and you would see a third, a third, a third of hedgeable strategy.

We're on that strategy or actually slightly ahead in a zone in PJM called West Hub. We see that the 2015 prices are fairly priced. We see upside in 2016 and beyond. But in NiHub, as I referenced earlier on that previous slide, Northern Illinois, we still see some upside. So instead of putting hard sales on, we're still using hedges with gas. We're about 10% of our sales in 2015 are on gas hedges right now. So that will protect any downside, but also allow us to get the upside.

Capacity markets, we earn money on our plants from two different revenue streams. One is the energy that I just showed you on the forward price strip; the other is capacity, having units available to meet the demand is an auction process to ensure that that's run through the different regional transmission operating groups. You can see the results between 2016, 2017, over to 2018. New England's auction cleared – this last auction cleared at a much higher level than we've seen.

I think it's a record high for that and we do believe that that will be sustainable for a few years until more infrastructure, either gas pipelines or transmission lines, come into the New England zone. PJM, the results were announced last Friday on its most recent auction. The prices doubled in that. There's a lot around that. I'm sure we'll get into the question and answer on our bidding strategies. So I won't forego your questions on that. But we've seen an improvement in bidding behavior overall, including ours.

We've seen a reduction in demand response, a limit of imports coming into the zone. All of that has driven to a much fairer price across the RTO [regional transmission organization], which is the terminology used for those market areas that don't breakout or have other constraints to drive prices up. So going forward on top of these more positive results with the auction, we're still working on different rules and different segments of the market. DR refers to demand response.

Demand response has been considered just like generation in the capacity market. So people are compensated at peak periods during the demand period to turn off their load and they get compensation for that. So it's looked at as a generator. There's been some interesting rulings that have come out on the courts on demand response. And that market, we think, has been turned on its ear for right now and we'll have to see how that comes out. But we expect it will be upside for true iron in the ground generators.

There's an issue with speculation in the capacity market, where demand response providers and individuals that potentially wanted to build new units, if they got the right clearing price, would do so. And they would, if the prices weren't right or they could see greater profitability, they would buy that back or sell that demand back in subsequent auctions, which is a speculative action that is not the place for the capacity market. So, we will continue to work on changes there. And we've also been very public about either getting the right compensation for our nuclear assets or we'll have to shut them down.

In this last auction at PJM, we had five units in PJM that did not clear. Overall, the clearing price was beneficial to the total fleet. Those units did not clear and that gives us an opportunity to work with the state and work with the RTO on the value that they provide not only as a firm fuel during any weather event, but also provide a clean energy source that if taken away, would be very difficult to meet the new mandates that will be coming out next week on the greenhouse gas law. And so, I'm doing everything at a high level because I know we're going to go much deeper into this as we go forward.

We announced most recently a strategic acquisition of Pepco holding company [Pepco Holdings, Inc.]. This acquisition was in a competitive bidding process. It was a 25% premium at a purchase price of \$27.25 per share. There's multiple strategic regions. We're not growing for the sake of growing, but this helps us in multiple ways. One, it drives a contiguous footprint between what we have now in the light blue and the green, which is the BGE zone and the PECO zone, two of the utilities we mentioned before. We got the Washington D.C. area, which is Pepco, which goes into Maryland also; the Delmarva Peninsula, which is, I guess, that's orange or something on the peninsula in Maryland and Delaware; and then Atlantic City Electric, which is South Jersey. The blue on the side is the Northern Chicago area.

But the way that this helps us, it does diversify our earnings flow, but previously we had been recognized by the rating agencies in a more conservative manner since our riskier business, the Generation Company, was servicing the dividend and the debt at the holding company by buying Pepco and continuing with the \$15 billion that we're spending in the utilities. That dividend and dividend policy will be shouldered by the regulated entities or it will be able to be theoretically serviced by the regulated entities, ensuring that we have the dividend at the right size and allowing us to use the earnings from the generating company to continue to grow a growth strategy.

So from a balance sheet perspective, it makes a very good strategic move. That opened up about \$4 billion of access to debt, while maintaining a significantly strong balance sheet and it also has a strategic and industrial logic by having this contiguous system that we can leverage operating experience and drive synergies and procurement contract utilization and efficiencies, mainly to drive the customer experience to a higher level. So that's the latest acquisition, you can see the transaction numbers here.

The accretion, even though it was on a higher range of premiums being paid lately, it's accretive in the first year and that accretion increases into the second year of \$0.15 to \$0.20 a share. You can see the rate base growth increase that we'll be able to achieve based off of adding it on. And our mix of operating earnings, unregulated Pepco in the existing – this is not a fixed formula that we want to have earnings of a certain percentage be one side or the other. The focus is truly at, if we have a dividend and we have debt at the HoldCo that the regulated – the profitability off the regulated entities, which is a goal of 65% to 70% of the earnings of dividend up to the HoldCo, will be the basis of the dividend. The remaining is always ploughed back through as capital, as required cash, as required returning shareholder equity into the capital spend plan.

We have been working on the regulatory approval process. You can see the run rates there. Long-term run rates roughly a \$120 million to \$140 million; 60% of the synergies will go to the rate payers, to rate cases. But in the meantime, it will allow us to shore up, getting much closer to the allowed versus the actual earned.

We have come up with regulatory concessions, pre-packaged for this, as we did with the Constellation and BGE acquisition. We expect to get into the regulatory approval process with our filings, dropping for most of the entities in the middle of June and start the proceedings from there. So, it's a transaction significantly accretive to EPS and it also helps us in rate base growth.

So, our long-term position that we're looking at, as you can see here, it's a diversification in assets, regions and business models. And a major portion of us looking forward is keeping abreast of major technology advances and macro trends that are happening in our industry.

The one thing that we are seeing in the last couple of years and we think we'll accelerate over the next decade is a significant advancement on what has been a pretty stable or stagnant industry as far as technology utilization, technology advancements and distribution equipment, transmission equipment and distributed generation. Our utility strategies need to continue to evolve to be supportive of all these coming in, while maintaining a fair return for our investors.

So that's the big picture, high level. And with that, we'll go to the fireside chat.

QUESTION AND ANSWER SECTION

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

Thank you. Does anybody have a question that they'd like us to pick up? If so, just raise your hand and we'll...so, Chris, just to kind of follow up on the company overview and for the benefit of folks who perhaps are evaluating this investment as a possibility for the first time; how should the portfolio manager think about Exelon? And what are the three positive drivers that could cause the stock to move materially higher?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

Well, on one side, we have our utility business that is continuing to grow. We have, as I said, \$15 billion of investments on highly-insured regulatory processes for return, which is always an issue with capital spending and earnings lag off of that spending. The other side, on the generating business, there's a couple of fronts. We still think that energy prices have upside. We've seen a good run-up, but we don't think that they're fully-priced in as of yet. There is, on the capacity side, there has to be recognition in the upcoming deliberation on the capacity market design issues around PJM and other capacity markets for the nature of the asset, the firm fuel on site and its ability to run.

During the polar vortex, there were many days that we could not get natural gas to our assets that were being called on to run because of low supplier or transmission constraints on natural gas. There is not a coordination between gas transmission and electric generation today. And we don't see that happening in the near future, although the conversation has started so for the grid to be maintained in a reliable state, especially with this new winter peak and high gas demand, dependency on gas, we see that there is changes that can have some upside for the assets.

One of the biggest things coming out next week, out of the administration, is finally a path forward on greenhouse gases. There was a move, as we were all involved a couple of years ago, to have a federal greenhouse gas legislative fix. And that failed miserably when bipartisan support eroded. We see what the EPA is doing now and instead of a legislative fix, going towards a regulatory mandate, as a positive. We know that has been tested in the Supreme Court and the Supreme Court's issued notice that that is the requirement and the responsibility of the EPA.

So next week, we'll get the first draft of what is called 111(d). It should be the regulation that dictates to the states how they should be looking at greenhouse gas reductions. It's been very closely held. So we don't have a lot of details on it, we have the high level. We know there will be a baseline of carbon emissions. There will be a demand on reduction of carbon emissions and there will be a period of time that these carbon emissions will have to be reduced from.

One thing that we know from our own models and from what we've seen in California, you can't maintain the current emissions levels unless you keep the nuclear units viable today. And you surely can't reduce if you start taking them off. Tens of billions of dollars have been spent in California on subsidizing renewable generation, two nuclear units come off, we retired prematurely and that carbon output from the state went up 35%. So we think we're uniquely positioned to be able to take and work through a state level design that will compensate the assets adequately for the support that they have, not only in capacity, but in environmental.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

And then looked at the other way, if someone were to buy Exelon stock what are the three things they should scanning the headlines for that could drive the value materially lower?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

We don't see it now, but regulation at the RTO or at the state level can cause concern. If we stay on the path to oversubsidize individual generating sources like the production tax credit for wind or an investment tax credit for solar, those can have a disruptive element on the generating stack as we've seen price suppression, artificial price suppression from overgeneration of subsidized assets within some of the areas around the plant, is one of our concerns that we've been voicing over the last couple of years. We see that situation improving, but still is a risk for us.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

Actually one of the questions that we receive goes to that, is Exelon better or worse -positioned than other utilities with respect to your exposure to subsidized wind or distributed solar generation?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

Well. On the wind, we are probably in a worse condition than most others. The concentration of wind development in the Midwest and heading up into the Upper Plains states flows across the seam from MISO into PJM at the Illinois border, where we have 11 nuclear plants. So we have been seeing more of an issue from our company than others, although others have been hurt, but not to the magnitude of us. Solar is not as prevalent in our areas as it has been in the Southwest. We expect more distributed generation to come in, including solar, but that one has not really had that much of an effect on us.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

The other questions we receive really goes to one of the upside. How should investors think about the potential earnings upside for Exelon in a CO₂-constrained environment? Does that depend on the form of the regulations that the state takes or what type of sensitivity of your earnings is there to that regulation?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A


There's two probable ways forward that the states could take on designing a market or a program that would allow compliance. There's probably more that will come out when more people come to the table. But the two that we've looked at is a clean energy standard that would compensate or have some clean energy credits for Generation, that is carbon-free. We think that that is a potential, probable path in some of the states, including Illinois.

There's also another methodology called Regional Greenhouse Gas Initiative, which states band together and combine their efforts by putting a price on carbon and that has a market effect of reducing carbon.

Some sensitivities: \$1 of carbon tax is about \$0.25 a megawatt hour. Right now, we see the RGGI that's operating in New England down to above \$5; that's \$1 per megawatt hour. We don't think that that's enough to sustain the

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 **Corrected Transcript**
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reductions that are required. New England's in a little bit different situation. We see a RGGI model being much more powerful. But when we first came out, the carbon tax was being looked at in Washington; it was an opener of \$25. I don't think a RGGI standard would be at \$25 but so, \$1 of carbon is \$0.25 a megawatt hour. You can do the math from there.

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

Q

Let's do the math a little bit. So, that's \$0.25 a megawatt hour on your competitors, I assume, right? That's what you're talking about.

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

A

Right.

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

Q

The coal and the gas-fired fleet? How many millions of megawatt hours of carbon-free generation do you have?

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

A

We have 200 million megawatt hours on an annual basis. Of that, most of it is nuclear. What is it? 175 million is carbon free. And if you pick up \$1, just in Illinois alone, \$1 would be \$100 million in gross margin increase. So there's simple rules of thumb to go by.

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

Q

Right. Okay. Now let's talk a little bit about your strategy. You mentioned, I think, in your 2014 segment earnings guidance that you expected the regulated businesses to contribute about half of earnings in 2014. And the acquisition of Pepco, when it closes in the middle of next year, could raise that to 60%. What's your preferred mix of regulated and competitive assets? And how is that influencing your annual capital budgeting and your acquisition and divestiture decisions?

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

A

It's not as much of a hard percentage any longer. What we're looking at is where we can put capital to work to create value. But stepping back from that, we want the utility earnings to be able to, theoretically, cover at a nominal dividend to the parent, a rate of 65% to 70%. We want the dividend to be covered, potentially be covered or theoretically be covered by the utilities. We were getting close to that on a standalone prior to Pepco. With Pepco coming into the Exelon utility families, we'll get there a year sooner. That allows the rating agencies to take a totally different look at us as a holding company and the subsidiaries.

And then any further dividend strategy would be really focusing on what's the growth of rate base and utility earnings that would support any advancement of the dividend going forward. It was, at the time, when the dividend was being covered by the generating company, the disruptive technology of fracking wasn't considered. The return of \$1 Btu of gas or \$2, as we got down to the bottom, was not considered. So, I think we've right-sized the dividend and we've got an investment strategy that maintains the dividend and any debt that's required from the regulatory entity.

If we went back to a 75/25 with the corporate holding company commitment still being made by the utilities or theoretically the utilities, I don't think we would spook the rating agencies again. It would be a good day for everybody. So it's looking at value.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

Let's follow-up on your comment that you're putting capital to work where the returns are highest. What is the practical implication of that? Is the regulated business absorbing virtually all your CapEx? Are there conditions where you can materially increase the amount of capital that you would expend on the nuclear fleet or is that not expected?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

As I said, we have \$15 billion of growth capital in the next five years going into the [ph] wires (29:31) business, mostly on pre-approved programs that are covering state mandates or legislative actions. We have about \$3 billion in growth CapEx going in on the generating side at this point today. Over the next five years, we have capacity to increase that as earnings increase and cash flows off of those assets increase, but it's all opportunistic. It's not growth for the sake of growth. It's growth that provides us a strategic diversification on that generating side and some counter-cyclical investments that can help dampen the commodity cycles.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

What type of generation assets are you targeting there?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

We have been looking, participating in natural gas assets that are coming to the market. We have assets that we see are coming economic to potentially build in ERCOT. So they're around those type of investments. We have an upstream gas strategy that we're implementing. Today, we're the tenth largest marketer of gas in the country. We handle about 1.2 trillion cubic feet of gas, some of that's for our Generation, some of it's for our retail gas sales, but also we manage it for others. So continuing on some upstream side of the gas and looking at all parts of the gas cycle is a strategic focus right now.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

Let's dig in a little bit on the Pepco acquisition. The agreed acquisition price values Pepco at almost \$7 billion. On the day you announced the deal, Exelon stock lost \$1 billion in market value, suggesting that the market disagreed with your valuation of Pepco. How do you think about the price you put on Pepco, what makes it a compelling acquisition for you?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

So the first day, it did go down, but then the second day it came back. So...

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

Well, mostly...

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

It's back. We did surprise people and it wasn't our intent to make the announcement on what was the pre-scheduled earnings call. We intended to make the earnings call to be able to show the upside. This was a competitive process that was run by the advisors of Pepco. We didn't hold the full control of the timeline.

So as we've explained this to shareholders, their appreciation of the strategic change, primarily around the balance sheet, was better understood in conversations with our largest shareholders today, that they do get it. It was opportunistic, it's strategic, it's not a view that our vision of the competitive market's dead and we have to diversify. This was not done with a gun to our head as others that had to diversify because of rating agency implications.

So it's the industrial logic of the contiguous footprint and what we can do around that. There's the strategic logic on what it changes the view for us with the rating agencies and how we can now access more capital than previously allowed. But it also is accretive and it does provide a good return for the price. Can we do more? We'll be working on trying to optimize more and ensure that we meet the synergies that we have committed to. It helps that some of those flow back to the consumer during rate cases. But some of them are retained at the merchant side also.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

But when I look at the return on invested capital at Pepco over the last couple of years, it seems to be somewhat below 5%. And that compares with the return on your assets in excess of 7%. You're increasing your invested capital through the acquisition by about 14%. So, I guess, my question here is given the financial logic in trying to put capital to work where returns are highest, what are you contemplating in the medium term to bring those returns up?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

We have modeled what Pepco has modeled which was getting up to an 8% ROE. We do believe there's opportunities, through driving synergies and operational efficiencies, to improve that. We, after acquiring BGE – they had historically over a 10-year period averaged 5% or less of the – 5% or less of the ROE which – the return on their equity and now we have it up to just about 9%.

So, the ability that we have as a larger entity to share best practices, to be able to drive efficiencies if it's in procurement, if it's in outage response, contracts negotiated, it has been our case that both ComEd and BGE, that more efficient operations helps you out in rate case recoveries. We had two very positive outcomes from our rate cases since we've acquired BGE. The model is drive reliability to higher levels, drive customer satisfaction to higher levels, be prudent in rate base adds, but also look at opportunities to drive efficiencies in expense. And we believe, we can improve as we have at the other two entities, with that model.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

One of our questions points out that the regulatory environment in Maryland and D.C. is quite challenging. Do you think that you can move the regulatory framework on which these companies operate in a positive direction or is it more a question of trying improve operations given the regulatory framework that exists?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

The regulators have a tough job in all their jurisdictions. They have to justify to the consumer that they're only allowing prudent expenditures and a fair return that's risk adjusted. We don't see any of these jurisdictions any more complicated than the ones that we currently operate in. We operate in Maryland today. We think Maryland's commission, as we saw act on our merger and also two regulatory filings for rate cases with BGE since then, has been a consistent commission. We have met and we'll continue to meet in Washington.

Washington provided one of the more progressive recovery mechanisms to drive a significant investment in capital for undergrounding. There's not many regulatory jurisdictions that we've taken that on. So there have been historic issues in most regulatory jurisdictions. Some stay above the radar or off the radar. But if reliability is not right, the customer satisfaction is low, that typically means you're going to have a bad rate case outcome. And so our job is to make quality rate case filings that are driven on the recovery of smart, efficient investments, while driving the customer experience to a higher level.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

Another question, what should we think are the – what are the principal risks associated with the Pepco regulatory approval process? Are there rate concessions, asset divestitures that could cause problems for you, and which state perhaps is the most problematic?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

So, one of the major differentiating factors between this merger, our acquisition in Constellation, there is no competitive or merchant generation. This is a straight regulatory approval on the basis of the test that the regulators have to satisfy, but it isn't a benefit of the consumer.

I think our regulatory filings will show through our – as we used in Maryland previously that the \$100 million contribution to the funds within the state's regulators for them to use as they wish. In Constellation, it was a rate rebate. We found that that makes it a little difficult for some of the regulators, but providing money for them to put into energy efficiency low-income programs, however they want to use it, it's \$50 per customer. And above and beyond that, we're committing to make reliability commitments that if we do not make the reliability numbers that they can hit us as a rate case. They can come back and disallow a portion of our allowed return.

So I don't think one is going to be more difficult than the other. I think they're all fairly professional organizations that we just have to do our job to prove to them that we can meet the tests. And that's the approach we took in Maryland previously and it's the approach we'll take across the five regulatory jurisdictions that we need to get approved.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

Going back to expected returns and your funding of the deal, if I recall correctly, you explained at the time that one of the reasons this was an opportunity for you was that you had unique access to very low cost capital at the

holding company today. The deal, obviously, doesn't close until second quarter, third quarter of next year and you are materially increasing holding company leverage. What have you done to lock in those costs in anticipation of closing?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

So, there's three elements to the financing mechanism. One, which was already underway, was some asset divestitures. As we looked at how assets were selling on the market in some of our non-core that are not necessarily supportive of our portfolio management, we had proceeded with divesting those. We've committed \$1 billion of that cash to the deal. There's \$1 billion in converts and \$1.7 billion in straight equity approximately that we're looking at. And the rest of the \$7 billion is on debt.

At this point, what we're using prior to the debt issuance is hedging interest rates. So we can protect the low interest rates and we have a bridge loan that's outstanding right now. We don't anticipate to – it was the surety that Pepco needed to approve the deal that we'd be able to have the money to close it on, as they're looking for their shareholders, an all-cash deal. So we would want to move sooner versus later to do away with that bridge loan, have the equity in place, the cash in place, the debt hedged and so, if there are other strategic opportunities that come up on the other side of the company, we're not constrained by any covenants of the bridge. So that's what we've been working on thus far.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

Let's maybe turn to the competitive side and focus first on the outcome of the latest PJM auction. So in that auction, the price and the rest of RTO region basically doubled from \$59 a megawatt day to \$120 a megawatt day. What were the drivers of that increase in your view and what did they imply for the direction of capacity prices in future auctions?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

So what we saw in this auction is, overall, a slightly lower demand from the last auction, but then we saw a reduction in imports, capacity being bid in from outside the system. We saw a reduction in demand response, bidding and clearing, but probably what – and there's more analysis to be done – is bidding behavior was adjusted.

In the last auction, over two-thirds, if not about three-quarter, of the participants in the auction took themselves in as a price taker, which means they bid zero and not their full avoided cost rate, their ACR; they just said whatever it is, we'll take it. And that caused quite a bit of pain with the clearing price of just right under \$60. We anticipate now, the way that the RTO cleared, there's much more discipline in bidding where people did bid their full ACR as we did on our plants.

We typically would bid zero on our nuclear plants and committed to that in the merger proceeding with Constellation and the settlement with the market monitor. As we had multiple units, five units in PJM, two units in other RTOs continuing to struggle around profitability – we've been very public on it – we had a provision with the market monitor that we could present a full and justified ACR that was independently validated, and which it was, we bid that in on those units and, unfortunately, it did not clear.

But it shows to the regulators, to the RTO, to the stakeholders in the area that these nuclear assets that are very valuable for reliability and even more value for environmental, we need some kind of market designs that need to

be adjusted. So we'll go to work on that. Now that we've got a clear view on what 111(d) will be next week and with the capacity market completing, getting into the stakeholder process to further evaluate that.

We think this is more of a sustainable level. We've all been surprised in this auction before. Every couple years there's something that happens that was unanticipated. Some of the market rule changes that were implemented and some more that we're trying to implement should take the volatility out of it and be able to adequately recover the required value that we should be receiving for the assets.

More work is going to be done on demand response after the D.C. Circuit Court ruling. We're not sure how that ends up, but it looks less like a supply and more like a demand element. We're not sure by how they ruled who's going to manage that. We see the speculation elements still to be addressed as we read the FERC ruling on that. It was unfortunate that we didn't get anything in this last auction, but I think that was a driver in some of the bidding behavior changes on DR in new units coming in. We'll continue to work on that. So we feel much better about our future where we're going than we have in the last couple of years fighting through some of these issues.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

Some of the factors that are likely to stay with us longest are the rule changes and possibly this court decision. Could you explain what the appellate court determined and what the possible implications are for demand response in PJM?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

So there's a couple elements about the way the court looked at it. They thought that, one, FERC did not have jurisdiction; that this was a retail component and not a wholesale component. And there's implications around that, that if it's not FERC that has jurisdiction, who does? And so that has to be cleaned up.

It also said that even if FERC did have jurisdiction, they were overreaching on the way that they would compensate or allow compensation to be granted in the marketplace as an asset. You get not only the DR, but you're also getting the LMP for the area. So, I can't tell you – I mean we're all working on it now – what's the path forward and we haven't even seen the suggestions on the path forward, but we know it's not going to look anything like it has in the past.

We've all voiced our issues about the way DR has been compensated. We've put a lot of money, hard capital in the ground to create a reliability. And they're getting compensated for flipping a switch. So I've heard some numbers that this could change, especially on the seasonal DR. Instead of \$50 being profitable, that prices would have to go, for that product, to \$300 to \$400, but we'll have to see how it works out over the next couple of months. We do see it as upside.

Hugh de Neufville Wynne

Analyst, Sanford C. Bernstein & Co. LLC

Q

Let's switch for a moment to the energy markets. Could you describe the upward and downward pressures that you see on the wholesale power price in ComEd, and the eastern MAAC zones? In particular, I'd be interested in your view on the outlook for gas transportation infrastructure, LNG exports from the eastern part of PJM, what that might do for gas and power prices, and what coal plant retirements and new wind capacity might do for energy prices in the west?

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

A

So, in the west, we're seeing – just over the last couple of months, we're seeing a much more consistent and higher price on the ATC, and as we watch the hourly LMPs and the five-minute LMPs, that the price suppression for some reason, if there's transmission constraints or whatever has something setting the market higher.

We do not see – there's not a log of gas infrastructure built in Chicago or NiHub right now. There's a potential of conversion, as we've seen from NRG's acquisition of EME, taking it out of bankruptcy that will have a potential upside just because of the dispatch on those units. That'd be more of a capacity play than an energy play.

So we do see a continued upside in the northern Illinois power prices, and that's why we've been using our hedging strategy. As more win gets developed that will have a dampening effect in – that's why we'd rather get into the RGGI or the clean energy standard approach versus what we currently have today with individuals being subsidized.

Other considerations that we continue to talk about is a much more liberal standard on developing transmission to take this constrained renewable power further east where the load pockets are in demand for it. So there's more there.

On the eastern MAAC side, with gas prices, I have not seen anything that shows a significant impact on gas prices from LNG exports. We've got the Maryland facility that's being developed by PJM. That's about the biggest one on the East Coast that we see. And with the supply that was in the Marcellus and the infrastructure that's being built around, we see that as being supportive to a long-term gas price, \$4.50 to \$6.00.

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

Good. And I think we've run out of time. So thank you very much. Appreciate it.

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

Good conversation. Thanks. Appreciate it, Hugh.

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