

STANFORD WASHINGTON RESEARCH GROUP

A Member of Stanford Financial Group

Long Term Contracting *The Lay of the Land*

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September 6, 2007

Who we are...

- Stanford WRG provides institutional investors with “top down” analysis on how Washington (D.C.) impacts publicly-traded equities through Regulation, Legislation, and Politics.
- Federal electricity outlook
- Federal pipeline outlook
- Federal environmental outlook



Our Clientele

- Traditional utility funds owning publicly traded entities.
- Dividend and income funds.
- Hedge funds who own publicly traded shares of market participants.
- We do not generally work with bondholders or private equity firms.



Looking at the “Lay of the Land”

- Democrats take House and Senate
- “Green” tops federal energy agenda
- Rate shocks follow rate freezes
- Persistent high cost of hydrocarbons
- Dissatisfaction with organized markets
- Success of “restructuring” questioned



Federal Activity

- Pending energy legislation problematic
- Veto promised
- Electricity prices not on federal agenda
- Negative views on coal
- Skeptical views on nuclear
- Buzz on renewables, alternatives



Electric Themes In Pending Bills

- Efficiency targets for federal government
- Senate bill makes PURPA changes to facilitate LSE recovery of “efficiency” programs
- DOE funding for state/local programs on efficiency and sustainable infrastructure
- “Smart grid” incentives
- PHEVs?



More Bureaucracy?

- Grid Modernization Commission?
- National Renewable Portfolio Standard?
- Regional efforts on greenhouse gases?



More Markets?

- Renewable credits trading?
- Carbon trading?



2008 Presidential Elections

- Everybody's green
- Everybody's got an "energy plan"
- Gasoline consumption continues to grow



Sellers are from Mars... ?

- Market fundamentals indicate tightening
 - Generation additions slow in coming
 - Coal very problematic now
 - Nuclear a long way off
 - Renewables good, but ...
 - ... Demand continues to grow faster



Sellers are from Mars ... ?

■ Risk ifs

- Carbon, when and what kind of “price”
- Hydrocarbon inflation
- Market tightening
- Reliability crunch – will it be 2009 or 2010?

■ Reward ifs

- Economic downturn dampens demand
- Conservation/efficiency programs make meaningful gains
- Alternatives/renewables exceed expectations



Buyers are from Venus... ?

- Spot prices above marginal cost of many known units
- “Good deals” are hard to come by
- “Value added” services hard to value
- Market structure perceived as unfavorable to customers
- Buyers not uniformly positioned



Buyers are from Venus... ?

■ Risk ifs

- Today's contracts wind up “above market” in the future
- Contracts can limit procurement flexibility in future

■ Reward ifs

- Stability in supply and in price as markets tighten



A Market with a Sellers' Bias?

- A market with a sellers' bias
 - Market entry fundamentals clouded by either mitigation (peaking capacity) or political problems (baseload)
 - Demand continues to grow
 - Hydrocarbons look to remain expensive
 - Will politicians put LSE's on LDC model?
 - Buyers still looking at marginal costs of existing units when sellers are looking at long-term average costs and escalating construction costs for new units



Reality...

- A tight, and tightening market is uncomfortable for buyers
- Enron-hangover persists, sellers also risk-averse in offers
- Volatile and tight-ish markets lead to shorter durations
- What is “competitive”?



Valuing Long Term Contracts

- Recognizing imperfection
- Partial solutions
- Differing expectations of future prices
- Poor visibility on risk
- Political overhang
- External risks



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